Non-confidential version

Stansted Market Power Assessment

M.A.G's response to the CAA's additional consultation of 17 October 2013

11 November 2013

Section 1: Introduction and Summary

1. This document is the response of Manchester Airports Group plc (**M.A.G**), the owner of Stansted airport (**Stansted**), to the CAA's consultation document published on 17 October 2013 (the **Consultation Document**) regarding market developments relevant to its market power assessment (**MPA**) of Stansted under the Civil Aviation Act 2012 (**CA Act**).

2. We welcome the CAA's acknowledgement that developments since the publication of its 'minded to' document in January 2013 have changed the factual situation at Stansted. In light of these developments, the CAA's decision to conduct a limited consultation on its MPA represents a sensible and appropriate step. We therefore welcome the opportunity to contribute to the CAA's assessment of the significant changes that have taken place at Stansted since M.A.G's acquisition in early 2013.

Developments have a profound impact on the CAA's 'minded to' assessment

3. The CAA's 'minded to' document noted that likely future developments, including the divestment of Stansted, would form a key part of the CAA's on-going MPA. Our response to the CAA's 'minded to' document in May 2013 (the **MPA Response**) highlighted the importance of such future developments and outlined M.A.G's strategy for enhancing Stansted's competitive position.

4. As the CAA suggested, there have been a series of significant developments since January 2013 that have a profound impact on the CAA's MPA for Stansted. While we maintain our position on the conclusions set out in the CAA's 'minded to' document, we note that it concluded that Stansted has the weakest market power of the three designated airports and that much of the evidence pointed to Stansted not having substantial market power. In particular:

    a. the CAA was not able to reach a provisional conclusion in its 'minded to' document that Stansted has substantial market power in the passenger sector, only that it *may* have substantial market power in the passenger sector, and (unless the basis changed) Stansted would be *likely* to have it by the end of the Q6 regulatory period; and

    b. as regards the cargo sector, although the 'minded to' document set out a provisional view that Stansted has market power, the approach taken to assessing the cargo sector was out of line with assessments carried out by other regulatory bodies and did not contain any detailed quantitative analysis to support the CAA's provisional view.

Recent developments show that Tests A, B and C are not met

5. For the reasons set out in the MPA Response, we disagreed, and continue to disagree, with the CAA's provisional conclusions set out in the 'minded to' document. Indeed, we believe that developments since the publication of the 'minded to' document show that the CAA's provisional conclusions were incorrect.

6. However, even if those provisional conclusions had been supportable on the basis of facts as they stood in January 2013, we agree with the CAA's assessment that developments since then show that none of three MPA tests is met in relation to passenger or cargo.

7. Stansted operates in well-functioning and competitive markets, and does not hold positions of market power within the meaning of section 6 of the CA Act. In short, there is no market failure at Stansted and therefore no need for the CAA to impose regulation.

8. Recent developments provide clear evidence to support M.A.G's view of the market in which Stansted operates, and therefore that none of Tests A, B and C is met in relation to the passenger or cargo sectors.

9. In relation to the passenger sector:

    a. Test A: We welcome the CAA's provisional view that recent developments show that airline buyer power is sufficient to mean that Test A is not met. In addition, we demonstrate at paragraphs 30 to 46 below that the new factual situation has wider ranging impacts for many (if not all) of the different facets of Test A.

    b. Test B: There is no real risk of excessive pricing given the long term discounted deals agreed with passenger airlines and the Airport Charges Regulations 2011, which prohibit discrimination against any existing or new airline customers who have not agreed such long term deals.

    c. Test C: It is clear that the benefits of regulation would be negligible because regulation would have little or no positive effect on M.A.G's pro-competitive approach to operating Stansted; yet the adverse effects of regulation remain high because it would risk crowding-out healthy commercial activity at Stansted, distorting competition and imposing costs on Stansted and its customers.

10. The analysis of M.A.G's commercial approach applies equally to passenger and cargo airlines and the new factual situation reinforces our view that Stansted does not have substantial market power in relation to cargo airlines. Our engagement with cargo airlines already demonstrates (and will continue to do so) a strong appetite for developing the cargo business at Stansted, based on strong commercial relationships.

11. The Consultation Document invites M.A.G and cargo airlines to consider the implications for the MPA of a public commitment by the airport to maintain the non-discrimination principles that have applied as part of the CAA's Q5 settlement. M.A.G would be prepared to offer such a commitment to cargo airlines at Stansted for a defined period of time if the CAA considers that this would be necessary for it to reach a conclusion that the market power test is not met for cargo.

Developments provide evidence of wider and lasting changes

12. The Consultation Document naturally focuses on the deals that M.A.G has reached with Ryanair and easyJet because they are Stansted's two largest airline customers. In addition to these agreements, there has been a wide range of other relevant changes.

13. In particular, the deals and negotiations with our other airline customers (both passenger and cargo) are also important, as are (for example) major new developments such as the Terminal Transformation Project. Such developments show that the positive approach and commercial

behaviours introduced by M.A.G apply across Stansted's entire business, not just in relation to its largest customers.

14. M.A.G is continuing to work hard to attract new airlines and incentivise existing airlines to grow at Stansted and we will keep the CAA up to date with these further developments as they happen. However, the CAA should not only look at the situation as of the date of its decision, but also the direction of travel that has been established across Stansted's business (including both passenger and cargo customers) and what that demonstrates about Stansted's conduct and the markets in which the airport operates.

The narrow scope of the CAA's consultation

15. We recognise that the Consultation Document focuses only on the impact of the key market developments that have taken place since January 2013, and does not provide an update on the CAA's thinking on all the issues raised in the 'minded to' document, or address the issues raised in the MPA Response. In light of the narrow scope of the issues considered in the Consultation Document, we would encourage the CAA to reach a final decision on these issues as quickly as reasonably possible.

16. The remainder of this response to the Consultation Document is structured as follows:

    a. In Section 2, we outline the new factual situation and provide an update on the latest developments.

    b. In Section 3, we explain the impact that the new factual situation has on the MPA.

    c. In Section 4, we set out a public commitment in relation to cargo airlines, which M.A.G is willing to make.

    d. Section 5 sets out our conclusions.

Section 2: Outline of the fundamental changes of circumstances

17. Since the beginning of 2013, there have been fundamental changes at Stansted and the markets in which the airport operates, relating to: (i) the acquisition of Stansted by M.A.G in February 2013; (ii) the fact that Heathrow, Gatwick and Stansted are no longer under common control; and (iii) the introduction of a new commercial approach by M.A.G.

18. Although M.A.G only acquired Stansted in February 2013, it has accomplished a huge amount in the short time that has elapsed since then:

    a. <u>Airline deals and offers</u>: Long term deals have been agreed with, and formal offers have been made to, a large number of airlines, including long haul airlines and cargo airlines. An airport seeking to exploit market power would not have been able to persuade airlines to engage willingly in negotiations and to sign up to new deals so quickly.

    b. <u>Terminal Transformation Project</u>: We are transforming Stansted's terminal by spending in the region of £40 million (and retailer partners are committing a similar amount) to improve passenger service, reduce operating costs and increase the airside retail area of the terminal building with the explicit aim of increasing commercial revenues. The project is currently ahead of schedule, and the first phase is expected to be operational during December 2013.

    c. <u>Investment in business development</u>: When we acquired Stansted, there was a single member of staff responsible for developing Stansted's relationships with all airlines. We now have [*redacted*] people responsible for developing Stansted's relationships with low cost airlines, a further [*redacted*] responsible for full service carriers, and a further [*redacted*] responsible for cargo airlines.

    d. <u>Improved consultation and engagement processes</u>: Stansted has shown a constructive approach to building relationships with airlines, particularly in relation to the Terminal Transformation Project. This project required a high degree of commercial and operational co-operation between airlines, handling agents and retailers.

    e. <u>Positive approach to engagement with the Airports Commission</u>: M.A.G has played an active role in the Airports Commission process to date. In particular, for the short to medium term we are promoting improvements to the quality of Stansted’s rail access to help make better use of Stansted’s spare capacity. For the long term, we have set out a range of options for new runways at Stansted which we believe should be included on the Commission’s shortlist of options for Phase 2 of its process.

19. These developments provide tangible evidence of how the commercial environment has changed at Stansted since M.A.G completed the acquisition of the airport in February 2013. This new approach represents a significant change from that taken while Heathrow, Gatwick and Stansted were under common ownership. As Michael O'Leary of Ryanair stated when the deal between Ryanair and Stansted was announced on 16 September 2013, it is "*indicative of the new regime at Stansted and*

M.A.G that within a period of six months of taking over they are signing an aggressive and dramatic growth deal".[1]

20. M.A.G's objective for Stansted is to grow the business by making the airport attractive to airlines, retailers and passengers. We will do this by building productive long term relationships with airline partners at Stansted, incentivising passenger and cargo growth, and improving the layout and use of the terminal. These aims are reflected in the commercial activity that has taken place at Stansted since February 2013, and we are on course to achieve them.

21. As the CAA is aware, the situation is still moving quickly as we continue to build strong relationships with airline customers. M.A.G will keep the CAA up to date with developments as they happen. Since March, we have entered into discussions with [*redacted*] passenger airlines and [*redacted*] cargo airlines. We have agreed deals with [*redacted*] passenger airlines and [*redacted*] cargo airlines and we have made offers to [*redacted*] other passenger airlines and [*redacted*] other cargo airlines.

22. The deals we have agreed with passenger airlines have a number of common features:

    a. The largest deals are all long term – covering at least the whole of the Q6 period.

    b. Prices per passenger are designed to encourage Stansted and its airline partners to work together to increase passenger numbers at Stansted (which is currently only 51% utilised).

    c. Prices per passenger are [*redacted*].

23. These deals have been negotiated, and are being negotiated, in the face of strong competition from other UK and European airports. Airlines choose where to allocate their aircraft by comparing offers from airports across Europe. See, for example, Michael O'Leary's comments in a Ryanair call with investors a couple of months before agreeing the new deal at Stansted:

    > "*Regardless of whether or not we do anything at Dublin or Stansted this winter, we have a myriad of other airports' offers on the table. The challenge for us in the next 12 months, with no capacity growth, is to be very selective and very disciplined where we allocate our capacity because it's got to come from somewhere else within the system.*"[2]

24. In short, 95 out of every 100 passengers at Stansted now benefit from long term deals. In fact, the majority of passengers using Stansted are likely to experience continued price *reductions* over the next decade.[*redacted*].

---

[1] Independent, 17 September 2013, *Ryanair and Stansted end stand-off with 10-year deal*.
[2] Ryanair investor call, 29 July 2013, at 12:50: http://www.ryanair.com/en/investor/investor-relations-news.

Section 3: Impact of the new factual situation on the MPA

25. We welcome the CAA's acknowledgment that "*conditions in the passenger market appear to have changed in a way that is potentially material*".[3] However, we note that the Consultation Document states that "*[i]n relation to the cargo market, the CAA is not aware of any significant market developments that impact on the 'minded to' MPA*".[4] For the reasons set out below, we disagree with this statement because it does not take into account the entirety of the new factual situation, which has a significant impact on both the passenger and cargo sides of Stansted's business.

26. M.A.G's view remains that Stansted does not have market power within the meaning of section 6 of the CA Act in relation to passenger or cargo customers. We disagree with the provisional conclusions set out in the CAA's 'minded to' document on the basis that they were not supported by the facts as they stood in January 2013. The developments since that date add further support to our view that none of the three MPA tests is met in relation to passenger or cargo customers. Indeed, the new factual situation in late 2013 impacts on almost every facet of the MPA and it is essential that the CAA considers the impact of these developments on its provisional conclusions.

27. In doing so, it is vital that the CAA takes into account the full range of developments that have occurred since January 2013. In particular:

    a. The Consultation Document focuses on Stansted's deals with its two largest airline customers, Ryanair and easyJet. These two deals are highly significant for Stansted, and provide strong evidence of M.A.G's new commercial approach and how it intends to operate the airport in the future.

    b. The CAA should also take into account the additional evidence of deals and negotiations with other existing and potential airline customers (both passenger and cargo). Such developments are especially instructive, as they demonstrate that M.A.G's consistent approach to developing Stansted applies across the whole business, not just in relation to Stansted's largest customers.

    c. In assessing the impact of these deals on the MPA and in making a final determination, the CAA should not limit its focus to those deals that have been finalised, but must also take account of those deals that are at various stages of negotiation and have yet to be finalised. These deals in progress still provide good evidence of Stansted's commercial approach to incentivising growth through discounts, and of the vigorously competitive environment in which Stansted operates. In particular, on-going negotiations provide tangible evidence of Stansted's incentives to grow its non-aeronautical revenues in a multi-sided market, and of all airline customers (not just Stansted's largest customers, with whom deals have already been reached) having bargaining strength as a result of Stansted's spare capacity and desire to grow.

---

[3] Consultation Document, paragraph 1.5.
[4] Consultation Document, paragraph 1.8.

28. The Consultation Document focuses on a small, albeit important, selection of those aspects of the MPA that are affected by the recent developments. In our view, the changes since January 2013 have a much broader impact on the MPA than set out in the Consultation Document.

29. This section is structured as follows:

   a. Key issues relevant to the CAA's assessment of whether Test A is met in relation to Stansted's passenger business, and in relation to which recent developments have an impact, are highlighted.

   b. Additional issues relevant to the CAA's assessment of whether Test A is met in relation to Stansted's cargo business, and in relation to which recent developments have an impact, are highlighted.

   c. The impact of recent developments on an assessment of whether Test B is met, in relation to passenger and cargo.

   d. The impact of recent developments, and provisional views set out in the Consultation Document, on an assessment of whether Test C is met, in relation to passenger and cargo.

Test A - Passenger

30. We agree with the CAA's provisional conclusion that Test A is not met in relation to its passenger business, and in particular we agree with the view that, as a result of recent developments, airlines have been shown to have countervailing buyer power at Stansted. The airport is in a weaker position, and the airlines are in a stronger position, than the analysis in the 'minded to' document acknowledged.

31. However, the impact of the developments since January 2013 on Test A is much wider than the issue of countervailing buyer power. The new factual situation demonstrates firmly the behaviour of a business operating in a competitive environment, and not one with substantial market power. Stansted is competing vigorously against the other London airports (and *vice versa*) in a way not seen under BAA's ownership, and also against airports throughout the UK and continental Europe.

32. Indeed, it is difficult to overstate the importance of Stansted's new ownership to the MPA. Given the interlocking nature of the issues relevant to Test A, the new factual situation affects most, if not all, of the issues relevant under Test A. However, we highlight below the following key issues relevant to Test A in relation to which recent developments have a significant impact: (i) the existence of multi-sided markets; (ii) the appropriate geographic market definition and related switching analysis; (iii) product market definition; and (iv) countervailing airline buyer power.

Multi-sided market

33. In Section 7 of the MPA Response, we explained that Stansted operates in a multi-sided market. At the time of the MPA Response, commercial (i.e. non-aeronautical) revenues were already 44% of Stansted's business, and they have always been central to Stansted's business model. The importance of these revenues provides a significant constraint on Stansted's incentives to increase passenger charges and its ability to do so without an adverse effect overall on its profits.

34. Developments since the 'minded to' document was published provide further compelling evidence of the importance of commercial revenues:

    a. <u>Low charges for new passengers</u>: Stansted is seeking to incentivise airlines to deliver passenger growth by using discounted airport charges. One of the reasons why M.A.G has offered these discounts is that additional passengers will also generate a contribution in terms of commercial revenues.

    b. <u>One bag rule</u>: [*redacted*] As the Consultation Document notes, this is designed to increase commercial revenues at Stansted.[5]

    c. <u>Increased time for passengers to shop</u>: [*redacted*]

    d. <u>Terminal Transformation Project</u>: As the CAA is aware, Stansted is investing approximately £40 million (and retailers are committing a similar amount) to improve passenger service, reduce operating costs and increase the airside retail area of the terminal building. By improving the retail experience for passengers, we expect to increase significantly the level of retail income per passenger. In the MPA Response[6], M.A.G highlighted that this project will strengthen Stansted's incentives to increase passenger numbers and reduce its incentives to increase aeronautical charges.

35. The multi-sided nature of Stansted's business reduces its incentive and ability to raise airline prices, and therefore has the effect of further weakening any market power Stansted might have. The developments highlighted above provide strong additional evidence of this fact.

Geographic market definition / airline switching

36. The issues of market definition and airline switching are of critical importance to the MPA. As these issues are not addressed in the Consultation Document, they are not addressed extensively in this response. However, the CAA's 'minded to' document set out a provisional view that Stansted operates in a very narrow geographic market, and that airlines have a limited ability to switch between airports for reasons that the CAA attributed to capacity constraints and 'strategic' constraints. These factors were material to the CAA's provisional view that Stansted met Test A of the MPA.

---

5 Consultation Document, paragraph 2.26.
6 MPA Response, paragraphs 7.11-7.12.

37. The evidence now available to the CAA since M.A.G's acquisition of Stansted in February 2013 (which marked the point at which all three major London airports came under separate control) demonstrates that the geographic market in which Stansted operates is far broader than previously envisaged by the CAA, and that the ability of airlines to switch between airports is much greater than the CAA took into account in developing its 'minded to' view.

38. It will be important for the CAA to consider again its market definition and analysis of switching constraints in the light of the additional evidence that is now available to it. In relation to passenger airlines, the 'minded to' document provisionally suggested that airlines are 'strategically constrained' from moving aircraft out of London, and that Stansted is the only London airport with material amounts of spare capacity. The CAA now appears to recognise that the market is far broader when it states that airlines operating at Stansted have the ability to "*allocate new capacity across their respective networks*".[7] The new factual position supports the CAA's current view because if the 'minded to' document had been correct, M.A.G would have had no incentive to agree long term, growth-related deals at discounted prices with airlines.

Product market definition

39. The 'minded to' document set out a provisional view that, in relation to its passenger business, Stansted operates in a product market that comprises only low cost carriers. As the CAA is aware, our view is that such a market definition is not supported by the available evidence[8], and recent developments demonstrate that a much wider product market definition is appropriate.

40. By way of example, the offer made to [*redacted*], the new services by [*redacted*] (a full service carrier), and our negotiations with [*redacted*], demonstrate the ability and desire of Stansted to attract long haul and full service airlines. This further demonstrates that Stansted is already willing and able to compete with (for example) Heathrow and Gatwick for these airlines, and it provides evidence that the product market definition in the 'minded to' document does not reflect the current factual position.

41. Although Stansted's offering in these sectors is still nascent, the evidence now exists to support the contention that Stansted is willing and able to compete vigorously in this area. In its final MPA assessment, the CAA will need to take account of this new evidence and consider Stansted's likely future conduct in its assessment of the markets in which the airport operates.

---

7 Consultation Document, paragraph 3.29.
8 MPA Response, Section 6.

Airline buyer power

42. The CAA's provisional view in January 2013 was that the inability of Stansted (under previous ownership) and Ryanair to conclude a long term deal provided evidence of Stansted's market power.[9] The change in circumstances since January 2013 has led the CAA to revisit this provisional view and, as paragraph 3.35 of the Consultation Document highlights, M.A.G's recent agreement with Ryanair shows that the airline has strong countervailing buyer power.

43. We agree with the CAA's revised view that the ability of airlines (large and small) to negotiate prices that are significantly lower than the current regulatory price cap, provides compelling evidence that airlines at Stansted have buyer power.[10] Similarly, the ability of Stansted's major customers to "*allocate new capacity across their respective networks*" means that they have "*the ability to impose substantial harm on STAL, which they may have been able to make use of in negotiations leading to the recent deals*".[11] This is particularly obvious in the cases of Ryanair and easyJet, and accords with Stansted's experience, but other deals and offers – in relation to passenger and cargo airlines – demonstrate clearly that it is not limited to Stansted's largest customers.

Other issues

44. As stated above, it is difficult to overstate the importance to the MPA of (i) Stansted's new ownership and (ii) the fact that Heathrow, Gatwick and Stansted are no longer under common ownership. It affects most, if not all, of the issues in the 'minded to' document.

45. Even if it is accepted (which it is not) that the provisional views set out in the 'minded to' document were correct in January 2013, the forward-looking nature of the MPA means that the CAA's previous analysis of many issues no longer applies. For example:

    a. Whether Stansted actively markets itself to passengers (see e.g. footnote 88 of the 'minded to' document).[12]

    b. The competitive price at Stansted (see e.g. paragraph 13 of the Summary in the 'minded to' document, and the Leigh Fisher and Europe Economics reports).

    c. Stansted's profitability (see e.g. paragraph 7.13 of the 'minded to' document).

    d. The price elasticity of demand of passengers (see e.g. paragraph 4.111 of 'minded to' document).

46. These issues are not the subject of the current Consultation Document, so are not addressed in detail here. However, we take this opportunity to reiterate that the CAA should take into account the new factual situation when assessing these issues in any final determination. We would be happy to engage with the CAA on these issues in greater detail should the CAA wish to do so.

---

9 'Minded to' document, paragraph 6.91.
10 Consultation Document, paragraph 3.40.
11 Consultation Document, paragraph 3.29.
12 We discussed this issue in more detail in our response to the airline submissions dated 24 July 2013.

Test A – Cargo

47. In the short time since M.A.G acquired Stansted, more deals have been agreed with passenger airlines, which is the larger part of Stansted's business, than with cargo airlines. However, as set out above, some cargo deals have already been agreed, and M.A.G's commercial strategy for Stansted is clear. It is not necessary for deals to be in place with all, or even a majority, of cargo airlines for the impact of the new deals on the MPA analysis to be significant. The MPA is concerned with forward-looking competitive conduct – an airport with substantial market power would have little incentive even to start negotiating such deals. We are determined to help cargo airlines thrive at Stansted and are already working hard to attract new cargo airlines to Stansted from airports such as Heathrow, Manston, Luton and Schiphol.

48. The new factual situation therefore applies to both the passenger and cargo sides of Stansted's business. In addition, further evidence is now available to the CAA that significantly affects the CAA's analysis of the cargo sector at Stansted. This should be read in conjunction with the analysis in Section 11 of our MPA Response, which explained that:

    a. Air cargo is a small part of the cargo sector and it faces direct competition from road, rail and sea.

    b. Most air cargo goods are carried in belly-hold, which competes directly with cargo-only flights.

    c. Even in the time-sensitive cargo-only segment, customers are sophisticated logistics companies who have plenty of choice.

    d. Stansted does not have substantial market power.

49. The provisional analysis in the 'minded to' document was not a sufficient basis on which to find that Stansted has substantial market power in the cargo sector. For example, there was no quantitative market definition analysis undertaken before concluding that Stansted operates independently of all other airports. This exercise would show that Stansted operates in a wide market which includes other airports in the UK, airports in Northern Europe, and road, rail and shipping.

50. The Consultation Document does not take the CAA's analysis any further forward, and it is not clear what further analysis has been carried out by the CAA during 2013. As a result, the CAA is not in a position to make a finding that Stansted has market power in relation to cargo within the meaning of section 6 of the CA Act.

51. The new factual situation serves to reinforce the position, as set out in our MPA Response, that Stansted does not have market power in relation to cargo. In particular:

    a. The fact that Stansted is now owned by M.A.G rather than BAA removes any suggestion that Stansted does not compete with Heathrow and Gatwick for cargo destined for London. In addition, each of these airports, plus Luton, Manston, Southend, Cambridge, Oxford and Birmingham, are all within a two hour drive to London and could be used as a gateway airport for cargo destined for London.

b. M.A.G is committed to forging strong long term partnerships with airline partners in order to encourage growth. Cargo airlines are an important part of this strategy. It would not be optimal for Stansted to adopt contradictory strategies for passenger and cargo airlines whereby growth is incentivised for passenger airlines but not for cargo airlines. The same incentive – to utilise a higher proportion of Stansted's capacity – applies to both the passenger and cargo sides of Stansted's business.

c. As a result of the Airport Charges Regulations 2011, Stansted "*must not discriminate between airport users*" unless it can show that "*the reason for the differentiation is relevant, objective and transparent*".[13] As a result, even if there were not strong competition in the cargo sector, strong competition in the passenger airline sector would protect all of Stansted's customers.

52. Since M.A.G acquired Stansted at the end of February 2013, it has become increasingly evident that Stansted faces strong competitive pressures in trying to attract and retain cargo customers. These factors, which are set out in more detail below, include:

    a. Competition from other providers, including:

        i. other UK airports;

        ii. other European airports; and

        iii. other modes of transport including trucks, trains and ships.

    b. The decline of the pure freight sector and the growth of belly-hold.

Competition from other providers

53. As noted above and in the MPA Response, there are a number of other UK airports that compete with Stansted to be the gateway airport for cargo destined for London. Each has cargo operations that would allow a customer of Stansted to move its business (or part of its business) to another provider if it was not satisfied with Stansted, for example if Stansted were to propose price increases or unwelcome changes in relation to the land, facilities, planning policies and consents, or night flying permissions.

54. The bulk of Stansted's cargo business customers have relationships with a number of airports within driving distance of London and other population centres in the UK. For example, [*redacted*].

55. The size and sophistication of these customers, coupled with their ability to switch away current capacity and/or future growth from Stansted, gives them buyer power. This point is correctly noted by the CAA in paragraph 3.26 of the Consultation Document in the context of passenger airlines' buyer power. The same logic applies equally to the cargo side of Stansted's business.

56. In the South-East, Stansted faces strong competition on two fronts: from Heathrow's and Gatwick's belly-hold services on the one hand, and [*redacted*].

13 The Airport Charges Regulations 2011 (SI 2491/2001), paragraph 14.

57. In addition, there are a number of airports across Northern Europe which compete with Stansted for cargo customers as these airports are within an eight-hour drive of London (the maximum number of hours a truck driver can drive in one day). For example, the major cargo hub of Amsterdam Schiphol is within the catchment area for London as it is between 5-6 hours' drive away, as shown by Table 1. This means that customers who are dissatisfied with Stansted could relocate some or all of their cargo volumes to another hub in Northern Europe without any significant impact on their operations or future capabilities. Indeed, as their responses to the debate regarding Air Passenger Duty on freight aircraft showed, they were willing to relocate the bulk of their operations to mainland European airports if their costs increased unacceptably, for whatever reason.

Table 1: Driving times from Amsterdam Schiphol to London

Destination	Miles	Google Maps	@56mph
Central London (Charing Cross Station)	331	05:46 hours	05:55 hours
Stansted airport	358	05:50 hours	06:24 hours

Source: Google Maps

58. The strong competition provided by European airports is further evidenced by the fact that around one-fifth of cargo from China bound for the UK is landed in continental European hubs and brought across the Channel to the UK by truck.[14] China is an important source of UK cargo. That such a high proportion of it is delivered to the UK in this way is a strong indication that there is real competition for Stansted from other hubs across Northern Europe.

59. This is also a strong indication that sufficient volumes of Chinese cargo could be switched away from Stansted to large competitors such as Schiphol, in response to a small but significant price rise by Stansted, so as to render such a price rise unprofitable. This type of quantitative analysis is missing from the 'minded to' document, which does not appear to have been considered by the CAA in the intervening period, and which must be undertaken by the CAA before it could make a final determination that Test A has been met in relation to cargo.

60. As raised in the MPA Response, M.A.G's position in this regard is consistent with that of the European Commission, which has consistently held that the air cargo market is geographically wide and competitively constrained by other modes of transport too, particularly road and rail.[15]

The decline of the pure freight market and the growth of belly-hold

61. As demonstrated by the figures in Table 2 below, there is a clear trend away from transporting cargo on cargo-only flights and towards using belly-hold. This trend pre-dates the recent adverse economic conditions and it is expected to continue, particularly given the large amount of belly-hold capacity in the new generation of long haul aircraft.

---

14 Source: M.A.G analysis of IATA data, for cargo shipped in December 2012.
15 See paragraph 11.22(b) of the MPA Response.

Table 2: UK air cargo volume proportions (%), split between cargo-only and belly-hold

	2006	2007	2008	2009	2010	2011	2012
Cargo-only	37.54	36.70	36.18	36.63	33.53	33.11	32.80
Passenger belly-hold	62.46	63.29	63.83	63.37	66.48	66.89	67.20

Source: M.A.G analysis of CAA data

Table 3: UK air cargo volume (tonnes), split between cargo-only and belly-hold

	2006	2007	2008	2009	2010	2011	2012
Cargo-only	944,324	933,892	915,077	831,138	852,472	837,586	832,637
Passenger belly-hold	1,571,331	1,610,406	1,614,639	1,437,818	1,690,464	1,692,382	1,705,808

Source: M.A.G analysis of CAA data

62. The ever increasing preference for belly-hold is a strong indication that Stansted does not have substantial market power. Stansted represents negligible of belly-hold cargo (less than 0.3% of UK belly-hold cargo passes through Stansted), so the trend towards belly-hold cargo has consistently eroded Stansted's competitive position.

63. Belly-hold cargo is only generally carried in larger wide-bodied aircraft such as Boeing 767 and larger, i.e. the planes that fly long haul routes, and not those used by Stansted's current customer base no matter how many additional narrow-bodied aircraft they operate. Heathrow, Gatwick, Schiphol and other airports therefore have a clear competitive advantage over Stansted. Stansted's share of the air cargo sector is currently limited to a share of the cargo-only sector, which has already declined to less than one-third of the air cargo sector (which is itself a minor part of the wider cargo sector) and is continuing to decline. It is therefore difficult to see how the CAA could conclude that Stansted has substantial market power in this sector.

Test B – Passenger and Cargo

64. We agree with the provisional view set out in the Consultation Document that Stansted no longer meets Test B for the passenger side of its business, as competition law provides "*sufficient protection*" against the risk that Stansted may engage in conduct that "*amounts to an abuse of market power*" (section 6(4) of the CA Act). However, we also make the following observations:

    a. The relevant assessment under Test B is whether competition law provides "*sufficient protection*" against abusive conduct, not whether competition law or regulation provides "*the best thing for Stansted's passengers*".[16] If the CAA's approach in this regard is indeed to consider whether competition or regulation is likely to produce the *better* outcome, this would be a misdirection as to the requirements and purpose of Test B for the reasons set out in Section 12 of the MPA Response.

b. The CAA's analysis in relation to the passenger business applies equally to the cargo business. By way of example:

   i. The deterrence effect of regulation noted at paragraph 3.41 of the Consultation Document logically applies to both the passenger and cargo sides of the business.

   ii. M.A.G has already built a track record that shows its commercial strategy is a long way removed from any risk of an abuse of market power.

   iii. The need for Stansted to incentivise new and existing airlines to use its spare capacity applies equally to passenger and cargo airlines.

   iv. In addition to the clear evidence of Stansted's commercial approach, all airlines (both passenger and cargo) are protected by the Airport Charges Regulations 2011, which prevent discriminatory pricing.[17] In short, this means that airlines that do not have a deal in place with Stansted by April 2014 will benefit from tariffs that are the equivalent to other airlines, unless there is a justification for a difference that is relevant, objective and transparent. The type of discriminatory pricing described at paragraphs 3.62-3.63 of the Consultation Document would therefore not be possible to the extent that the Airport Charges Regulations 2011 applied.

65. The reference to "*relevant operator*" in section 6(4) of the CA Act means that the CAA must assess the specific situation at Stansted when assessing whether Test B is met. The fact that nearly all of Stansted's passengers are now protected from any conceivable price rises by their long term deals, and by the application of the Airport Charges Regulations 2011, significantly alters any assessment of Test B in the specific case of Stansted.

66. We therefore strongly believe that Test B is not met for either the passenger or the cargo side of Stansted's business.

---

[16] See the CAA's news release of 17 October 2013, the fourth paragraph of which refers to "*whether regulation remains the best thing for Stansted's passengers*". However, paragraph 3.5 of the Consultation Document seems to contain the correct analysis.

[17] The Consultation Document notes (at paragraph 3.44) that airlines would be protected by competition laws against discriminatory pricing. As Stansted is not a dominant company for the purposes of competition law, we do not believe that competition law on its own prevents Stansted from discriminating between airlines – they are instead protected by many other factors, including (a) by the competitive nature of the market and their ability to switch sufficient aircraft away from Stansted to defeat any price rises, (b) their buyer power, (c) Stansted's commercial incentives and publicly announced objectives, (d) the Airport Charges Regulations 2011, and (e) the CAA's powers, including the power to re-impose regulation at Stansted.

Test C – Passenger and Cargo

67. The CAA is right to revisit its analysis of Test C in the light of the new factual position. The balance between the potential benefits and adverse effects of regulation has changed materially since the publication of the CAA's 'minded to' position in January 2013. The adverse effects of any regulation would significantly outweigh any residual potential benefits (even if they did not before). As a result, we agree with the provisional view set out in the Consultation Document that Test C is not met in relation to the passenger side of Stansted's business.

68. It is also clear that Test C is not met in relation to the cargo side of the business:

    a. The balancing exercise between the costs and benefits of regulation fundamentally changes in relation to cargo if there is no regulation of the passenger side of Stansted's business. Cargo represents only around [*redacted*] % (in 2012) of Stansted's total revenues (and [*redacted*] % of its aeronautical revenues). However, many of the direct costs of regulation would still be incurred to regulate cargo on its own. Therefore, as noted in the Consultation Document, the proportional cost of regulating the cargo sector only would increase significantly. Such an increase demonstrates that the cost of regulating only cargo would significantly outweigh any benefit that regulation of cargo only might bring.

    b. The CAA's duty under section 1(2) of the CA Act is to "*promote competition in the provision of airport operation services*". Regulation at Stansted would risk undermining the competitive environment that has recently been established. Indeed, the CAA has correctly recognised that an adverse effect of regulation is that it risks the "*crowding out of a more commercial approach*" at Stansted (paragraph 28 of the Summary in the 'minded to' document). Regulation at Stansted would inevitably inhibit the commercial approach adopted by M.A.G. There are still deals to be agreed with airlines, and the newly agreed deals need to be given the chance to flourish. Any regulatory intervention at this time would risk 'crowding out' precisely the positive competitive behaviour that the CAA should promote in accordance with its duty under section 1(2) of the CA Act, and would hamper the development of a freely-competitive airport business operating in the South-East.

69. At this stage, there would also be additional costs in regulating only the cargo side of Stansted's business. For example, as there have been no specific licence proposals published for cargo, the CAA would incur, and would cause stakeholders to incur, additional costs in relation to a further consultation on the licence proposals. It is not currently clear, for example, what would be contained in a cargo-only licence, and the costs of establishing this would be material.

Section 4: Commitments

70. M.A.G considers that Tests A, B and C are not met in relation to the cargo business at Stansted. As a result, we believe that no further steps to address the "*concerns of cargo customers around future pricing levels*" are necessary.

71. It is important to recall in this context that the Airport Charges Regulations 2011 provide significant and adequate protection in this regard, as would the application of competition law.[18]

72. By way of background, the CAA decision on Stansted price control in the Q5 regulatory period contains a specific control on the price that Stansted can currently charge cargo operators.[19] It is not, as far as M.A.G is aware, considered necessary to impose any controls or protections that go beyond the current controls on the price that Stansted can currently charge cargo operators.

73. More specifically, Condition 2 states:

> "*In each of the five consecutive years beginning on 1 April 2009 the operator of Stansted airport shall not levy airport charges in respect of air services that do not fall within the definition of relevant air services for the purposes of Condition 1 that are higher than are levied in respect of equivalent air services falling within that definition.*"

74. The CAA also imposed a public interest condition (the **Public Interest Condition**) on Stansted, the substantive part of which was as follows:

> *"This condition shall apply when and for so long as STAL fixes its airport charges for the landing of aircraft so that the charge levied for landing an aircraft in excess of 50 tonnes but below 250 metric tonnes during a peak period is higher than the charge levied for landing at other times. Where this condition does apply, the charges levied for landing aircraft in excess of 250 metric tonnes shall, at all times, bear the same relationship to the equivalent charges levied on aircraft in excess of 50 metric tonnes but below 250 metric tonnes."*

75. As stated above, the Airport Charges Regulations 2011 have come into force since the CC Q5 Report and the CAA Q5 Decision. The situations covered by Condition 2 and the Public Interest Condition are now clearly covered by paragraph 14 of the Airport Charges Regulations 2011 – the text of paragraph 14 is set out below for reference:

> "*14. Basis for setting airport charges*

---

[18] The Airport Charges Regulations 2011 (SI 2491/2001), which implemented into UK law Directive 2009/12/EC.

[19] Airport Regulation, Economic Regulation of Stansted Airport 2009-2014, CAA Decision, 13 March 2009, at: http://www.caa.co.uk/docs/5/ergdocs/20090313StanstedPriceControl.pdf. This decision followed the Competition Commission's report entitled "Stansted Airport Ltd, Q5 price control review", presented to the CAA on 23 October 2008, at: http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/539.pdf.

> (1) *Airport charges set by a regulated airport operator must not discriminate between airport users.*
>
> (2) *Paragraph (1) does not prevent a regulated airport operator from varying airport charges for reasons relating to the public and general interest, including for reasons relating to the environment, where the criteria used for varying the charges are relevant, objective and transparent.*
>
> (3) *Subject to paragraph (1), a regulated airport operator may set airport charges that differentiate between airport users provided that the reason for the differentiation is relevant, objective and transparent.*
>
> (4) *For the purposes of paragraph (3), a reason may (but need not) relate to the quality, scope or costs of services associated with the airport charge.*"

76. The Airport Charges Regulations 2011 provide cargo operators with adequate protection from any undue discrimination, and there is therefore no need for a successor to Condition 2 or the Public Interest Condition, irrespective of whether that is achieved by imposing licence conditions or through commitments given by M.A.G.

77. Nevertheless, if the CAA considers that such a commitment would be necessary for Stansted to fail the market power test for cargo, then M.A.G would be willing to offer a public commitment that would have the effect of mirroring the current conditions for a further two years. Such a commitment would apply to Stansted's current tariff structure, and any future tariff structure that may subsequently be adopted (following consultation with users) during the two-year period.

78. Any such commitment would need to be time-limited to avoid the existence of unnecessary and diverse regulation (whether via licence conditions or commitments). In this respect, we are proposing that the commitment would be limited to a period of two years to afford the CAA and airlines the ability to observe Stansted's commercial behaviour over that period. Following the two-year period, the Airport Charges Regulations 2011 and the CAA's ability to conduct a further MPA at Stansted (if required), would provide effective protection for cargo airlines.

79. Such a commitment would provide further clear assurance to cargo operators around M.A.G's approach to setting tariffs over the next two years, as we work to strengthen our commercial relationships with these airlines. The commitment would prevent Stansted from charging excessive prices (which is the only type of abusive conduct raised by the CAA or by airlines) because the airport could not charge cargo airlines more than its published tariffs.

Section 5: Conclusion

80. It has been M.A.G's consistent view that none of Tests A, B or C is met in relation to either the passenger or cargo sides of Stansted's business. Developments since the CAA's 'minded to' document was published in January 2013 reinforce that view.

81. When announcing the publication of the Consultation Document, the CAA Group Director of Regulatory Policy stated:

> "*Our aim is to protect passengers, so we will act if the market fails. But regulation must achieve more benefits for consumers than it costs. That is why, following the airport's recent deals with easyJet and Ryanair, it is sensible for us to consider whether regulation remains the best thing for Stansted's passengers*."

82. The evidence and analysis contained in the MPA Response, and in this response, demonstrates that:

    a. There is no market failure, and therefore no need for the CAA to act, in relation to Stansted's passenger or cargo businesses. Stansted operates in a highly competitive environment in both sectors, and is forging strong commercial relationships with its airline customers.

    b. The costs of regulation would far outweigh any potential benefits. In particular, the costs of any regulation that related only to cargo would be disproportionate to the potential benefits.

    c. M.A.G's commercial behaviour provides evidence that Stansted does not have a position of market power. Other developments, including the Terminal Transformation Project, similarly provide evidence of an absence of market power.

83. Developments since M.A.G's acquisition of Stansted – and the fact that Heathrow, Gatwick and Stansted are now under separate control – are sufficient to change the CAA's provisional views set out in the 'minded to' document.

84. We recognise that, at the time of the 'minded to' document, the CAA could not reasonably foresee how M.A.G would operate Stansted. However, that has now been demonstrated, and the available evidence shows that Stansted operates in a well-functioning market and does not have market power in relation to either passengers or cargo.

85. We therefore urge the CAA to conclude, at the earliest opportunity, that that market power test is not met, and to allow Stansted to continue on the healthy pro-competitive course that it has established. In these circumstances competition, rather than regulation, will be of greatest benefit to consumers.