

Summary of Responses to the Market Power Test Consultation

CAP 1432



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Chapter 1

Introduction

Draft guidance

- 1.1 In December 2015, we consulted on a draft of our 'Market Power Test 'Guidance – Draft'¹ (Draft Guidance).
- 1.2 The Draft Guidance explained our powers under the Civil Aviation Act 2012 (CAA12) to apply the Market Power Test (MPT) to make Market Power Determinations (MPDs).
- 1.3 The Market Power Test consists of three parts:
- Test A - consider whether an airport operator has substantial market power (SMP).
 - Test B - consider whether competition law does not provide sufficient protection against the risk of abuse of the SMP.
 - Test C - consider whether the benefits of regulating the airport operator by means of a licence outweigh the adverse effects.
- 1.4 If we make an MPD that determines an airport operator meets the Test, we are required to regulate that airport operator by means of a licence.

Consultation responses

- 1.5 The consultation on the Draft Guidance closed on 12 Feb 2016 and the following Stakeholders responded:
- Heathrow Airport Ltd (HAL);
 - Gatwick Airport Ltd (GAL);
 - IATA;
 - Ryanair;

¹ The consultation document is available at www.caa.co.uk/cap1355 and the Draft MPT Guidance is available at www.caa.co.uk/cap1354

- British Airways plc (BA);
- easyJet; and
- Virgin Atlantic Airways (VAA).²

1.6 We appreciate and thank stakeholders for the time that they have taken to consider and respond to the Draft Guidance. Stakeholders' comments on how we proposed to apply the Test in the future allowed us to ensure that the final Market Power Test Guidance (Guidance) is more practical in explaining how we will apply our powers. For instance, where the Draft Guidance was not as clear as we intended, we have revised the drafting to improve its clarity.

1.7 This 'Summary of Responses to the Market Power Test Guidance CAP 1432' (Responses document) sets out the comments received and explains our response to those comments and how we reflected them in the Guidance. The Guidance is published alongside this document at www.caa.co.uk/CAP1432.

1.8 Where we have not changed the wording from the Draft Guidance in response to stakeholders' comments, we have explained why in this document with our reasons.

Structure of this responses document

1.9 The following chapters of this Responses document discuss the comments Stakeholders' made and our responses to those comments, including how we have amended the Guidance.

- Chapter 2 reviews responses on the process to decide when to launch undertake MPDs, and how we will undertake MPDs;
- Chapter 3 discusses responses to our approach to Test A – Market definition and market power;

² A non-confidential version of these responses can be found at www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Airport-Market-Power-Assessment/

- Chapter 4 covers responses to our approach to Test B – Adequacy of competition law;
- Chapter 5 contains responses to our approach to Test C – Adverse Effects and Benefits of licence regulation; and
- Chapter 6 considers comments that were not directly focused on the detail of the Guidance.

Chapter 2

Process and approach to conducting MPDs

Introduction

- 2.1 This chapter considers the responses related to process and approach we proposed in the Draft Guidance for conducting an MPD.
- 2.2 It covers the key issues raised by respondents to the consultation:
- When we will deviate from the Guidance;
 - Standard of proof;
 - Initiating an MPD;
 - Material Change of Circumstances;
 - Timetable for considering a request to make an MPD;
 - Timetable and stages for completing an MPD; and
 - Confidentiality.

When we will deviate from the Guidance

What we proposed

- 2.3 Paragraph 1.3 of the Draft Guidance stated that from time to time, given the specific circumstances of a particular case, we may need to deviate from the Guidance and that we would explain the rationale for deviating from the Guidance in any report we published.

Stakeholder comments

- 2.4 HAL was concerned that the caveat “*we may need to deviate from this Guidance*” could significantly compromise the value of the Guidance. HAL considered that as the Draft Guidance is high level and largely principles-based, it did not consider we would ever be a need to depart from it. If such a need may arise, the circumstances should be specifically flagged in advance.

Our response and final policy

- 2.5 While it is our intention to publish robust Guidance that we do not need to depart from, we cannot always consider every possibility in Guidance. As such, it is appropriate to include a caveat to the Guidance because we must assess each case on its own facts. Where appropriate, we will explain why we have adopted a specific approach which may deviate from the Guidance. We have amended the Guidance to clarify this point.

Standard of proof

What we proposed

- 2.6 Paragraphs 2.33 to 2.35 of the Draft Guidance stated that we are required to make our assessment on the balance of probabilities. However, the weight of evidence required to satisfy this standard would depend on the particular circumstances of each MPD.
- 2.7 In referring to a CAT judgement³, we said that overall, the judgment reaffirmed 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.

Stakeholder comments

- 2.8 HAL suggested that the Draft Guidance could be more consistent in describing the appropriate standard of proof we will require when regulating. It suggested that the phrase “*presumption of innocence*” taken from the Competition Appeal Tribunal (CAT) judgment should be interpreted as a presumption that regulation should not be imposed unless there is specific, relevant and sufficient evidence that the tests for imposing regulation have been satisfied. It also suggested that it would be appropriate for us to expressly set out this position in the Draft Guidance, rather than referring to the CAT judgment.

³ Makers UK Limited v Office of Fair Trading [2007] CAT 11, paragraph 46

- 2.9 HAL stated that in other parts of the Draft Guidance we appeared to adopt positions that are difficult to reconcile with the presumption that specific evidence is required to meet the tests.
- 2.10 GAL questioned whether these paragraphs had any relevance to Guidance on the MPT. It stated that there is no potential finding of “*guilt*” under the MPT and citations referring to the “*presumption of innocence*” do not seem appropriate.

Our response and final policy

- 2.11 This section of the Draft Guidance was seeking to clarify that we will need to exercise our discretion in the light of relevant decisions of the CAT and the Courts.
- 2.12 In this context, we are required to exercise our functions in accordance with our duties under CAA12.
- 2.13 While the assessment that we make in preparing an MPD does not imply any finding of “*guilt*”, we consider that this standard of proof is appropriate given that imposing the obligation to hold an economic licence in order to be able to charge for services is clearly a serious matter that restricts the commercial freedom of the airport in question. As such, an MPD should only be made on the basis of sufficient evidence.
- 2.14 We consider that the balance of probabilities test allows for the use of regulatory judgement and that to require specific, relevant and sufficient evidence for every aspect of our determinations would go beyond the standard of proof required.
- 2.15 We have amended the wording in the ‘Standard of Proof’ section to refer to the requirements of CAA12 and to provide greater clarity.

Initiating an MPD

What we proposed

- 2.16 Paragraphs 3.2 to 3.4 of the Draft Guidance stated the circumstances when we would undertake an MPD.
- 2.17 Paragraphs 3.7 to 3.8 of the Draft Guidance explained that we expect the parties who request an MPD to be able to provide a well reasoned request containing information relevant to the analysis.

Stakeholder comments

- 2.18 HAL considered stated that the Draft Guidance provides almost no indication of when we may consider it appropriate to conduct an MPD.
- 2.19 IATA stated that increased transparency on price and quality of service is required, in order to make it easier to detect when an airport may be in position of market power such that an MPD is required or when an abuse of market power is taking place, as well as improving performance results.
- 2.20 IATA suggested that relying on third parties directly (who are impacted by an MPD) to request initiation of an MPD can lead to a low number of requests. An airline that is under the market power of an airport may not be aware that the airport is abusing its market power or may hesitate to initiate a request for an MPD if it is concerned about retaliatory action by the airport.
- 2.21 easyJet noted that while we are not required to make an MPD for an airport with less than 5 million passengers, it would be helpful if the Guidance stated that we would be willing to consider making an MPD at an airport with fewer than 5 million passengers if there was the potential for significant harm to passengers.

Our response and final policy

- 2.22 Where CAA12 gives us the discretion to undertake an MPD, it does not specify any criteria on that discretion. However, we must have regard to the regulatory principles in Section 1(4) of CAA12, namely that our

regulatory activities should be transparent, accountable, proportionate and consistent, and targeted only at cases where action is needed.

2.23 We consider it would be inappropriate to go beyond CAA12 to state that we would be willing consider making an MPD based on predetermined criteria.

2.24 However, on the specific point regarding airports with fewer than 5 million passengers we would consider a well reasoned request.

2.25 We will be available to discuss any aspect of an airport operator's or an interested party's market power concerns about an airport operator.

2.26 We have clarified in the Guidance that we will be available to discuss market power concerns.

Material Change of Circumstances

What we proposed

2.27 Paragraphs 3.5 to 3.6 of the Draft Guidance stated that "*material change of circumstances*" is not defined in the legislation, and that it is a matter of regulatory judgement as to whether there has been a material change of circumstances.

Stakeholder comments

2.28 HAL accepted that we may be unwilling to exhaustively explain in advance all circumstances in which an MPD will be undertaken, or when a material change in circumstances exists. However, it urged us to provide more detailed guidance, for example explaining the types of legal precedents we would be likely to consider relevant when determining whether a material change of circumstances has occurred.

2.29 GAL stated that:

- the Guidance should reflect (what it considered to be the clear steer from the Competition Commission (CC)) that the development of competition would be a material change of circumstances, and that

we should not set an unduly high bar in applying the “*material change of circumstances*” test.

- it suggested that instead of stating that “*We consider that a change of circumstances needs to be material in areas that are likely to be relevant to Tests A to C*”, that we change the words “*needs to be*” in this quote so that they read: “*would exist if the change is, or the changes together are*”. It indicated that this change would make clear that this is a sufficient, rather than a necessary, test.
- a material change of circumstances is one of fact; rather than of “*regulatory judgement*”.

2.30 While IATA noted the difficulties associated with describing what events constitute a material change in circumstances, it considered that it would be beneficial if we could describe what market outcomes would be observable when a material change of circumstances had occurred.

2.31 VAA stated in determining when to launch an MPD, it would welcome some greater clarity on how a material change of circumstances is defined.

2.32 Ryanair considered that when its long-term contract with Stansted Airport Limited (STAL) concludes, there is a real danger that STAL will raise prices, as regulation will not be in place to protect it. Such a circumstance, Ryanair contended, would result in a substantial change in market conditions such that we would need to undertake a new assessment of STAL’s market power in time for STAL to be regulated when its deal with Ryanair expires.

Our response and final policy

2.33 While we appreciate that it could be beneficial to stakeholders if we could provide greater detail on what constitutes a material change of circumstances, CAA12 does not define this and we maintain that for us to attempt to do so would be inappropriate. Indeed we consider that market participants are better able to identify circumstances that may constitute a

material change of circumstances and, having done so, can use them in making a case to us.

- 2.34 We suggest that any stakeholder who is considering whether or when to make a request, arranges a meeting to discuss this with us. This would enable us to consider a specific set of circumstances rather than attempt to set-out a wide range of possible parameters that could hinder rather than assist stakeholders, would be unlikely to be complete and which could rapidly be superseded.
- 2.35 We have, however, amended the wording of the Guidance to state that “We consider that a change of circumstances would be more likely to be found where the change is, or the changes in aggregate are material in areas that are likely to be relevant to Tests A to C.”
- 2.36 We recognise that assessing whether a material change of circumstances has occurred is based on a specific set of factual circumstances. We have clarified in the Guidance that determining whether there has been a material change of circumstances is a matter of “*regulatory judgement based on the specific circumstances under consideration*”.
- 2.37 We also refer stakeholders to Competition and Markets Authority (CMA) Guidance related to merger remedies and decisions that have been made where the question of whether there has been a material change of circumstances has been considered.
- 2.38 The CMA’s ‘Remedies: Guidance on the CMA’s approach to the variation and termination of merger, monopoly and market undertakings and orders’ CMA11⁴ covers the CMA’s approach to the variation and termination of merger, monopoly and market final undertakings and orders. The CMA’s approach includes considering whether there has been a change of circumstances.

4

CMA11 ‘Remedies: Guidance on the CMA’s approach to the variation and termination of merger, monopoly and market undertakings and orders’ August 2015, which is available from: www.gov.uk/government/publications/remedies-Guidance-on-the-cmas-approach-to-the-variation-and-termination-of-merger-monopoly-and-market-undertakings-and-orders

2.39 Listed below are a selection of CMA decisions that considered whether there had been a material change of circumstances. The examples noted are, with one exception, in industries other than aviation and all were considered under other legislation. However they may assist stakeholders to understand how such assessments have been made. The examples are:

- Competition Commission (CC) BAA Market Investigation - Consideration of possible material changes of circumstances - 19 July 2011.⁵ The CC considered that it had a duty to assess whether there had been an MCC since the preparation of its report;
- CMA - Review of FirstGroup undertakings - Final report - 20 April 2016.⁶ The CMA reviewed the undertakings in relation to the completed acquisition by FirstGroup plc of SB Holdings Ltd. The MCC was related to a change in competitive conditions in the relevant market;
- CMA - Rough gas storage undertakings review - Final report 22 April 2016.⁷ A review of the undertakings given in December 2003 by Centrica Storage Limited (CSL) and Centrica, in relation to the completed acquisition by Centrica of Dynegy Storage Limited and Dynegy Onshore Processing UK Limited ('the undertakings'). The MCC was related to reduced performance of a gas storage facility;
- CMA - Provisional decision on the CMA's review of the Performing Right Society Limited undertakings - 23 March 2016.⁸ The Performing Right Society Limited (PRS) gave undertakings in February 1997 following an investigation by the Monopolies and Mergers Commission (MMC). The CMA reviewed the undertakings

⁵ BAA Market Investigation - Consideration of possible material changes of circumstances - 19 July 2011, which is available from:

webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/baa-airportsf

⁶ CMA Review of FirstGroup undertakings - Final report - 20 April 2016, which is available from: www.gov.uk/cma-cases/firstgroup-undertakings-review

⁷ CMA Rough gas storage undertakings review - Final report 22 April 2016, which is available from: www.gov.uk/cma-cases/rough-gas-storage-undertakings-review

⁸ CMA - Provisional decision on the CMA's review of the Performing Right Society Limited undertakings - 23 March 2016, which is available from: www.gov.uk/cma-cases/performing-right-society-undertakings-review

to consider whether the undertakings remained appropriate, or needed to be varied or superseded, by reason of a change in circumstances. The MCC was related to the introduction of a new EU directive;

- CMA Review of old merger remedies: The CMA reviewed approximately 70 merger remedies.⁹ The MCC was in most cases a change in the market conditions or market structure.

Timetable for considering a request to make an MPD

What we proposed

- 2.40 Paragraphs 3.9 to 3.12 of the Draft Guidance explained the process for requesting an MPD.

Stakeholder comments

- 2.41 IATA stated that it was not clear how the prioritisation criteria would be applied in deciding whether to undertake an MPD.
- 2.42 easyJet noted that while it recognised that the decision on a request to make an MPD may not be simple, and as such that it could take up to six months, it considered that in other cases an assessment may be relatively simple. It would be helpful if we stated that we would aim to progress a decision in as quick a time frame as possible within the overall timeframe of six months.
- 2.43 BA considered that the timetable of six months was excessive. It added that the timetable only commenced after the requesting party had submitted its final submission. It was not clear whether the requesting party or the CAA or both determine whether and when a submission may be considered final. BA suggested that the Guidance should be more explicit as to when, and by whom, a request may be considered final.

⁹ CMA – Review of structural merger undertakings given before 1 January 2005, which is available from: www.gov.uk/cma-cases/review-of-structural-merger-undertakings-given-before-1-january-2005

Our response and final policy

- 2.44 We have clarified this section in the Guidance by separating out:
- the process for those requests where we have discretion on whether to undertake an MPD;
 - the process for those requests where we are required to undertake an MPD; and
 - the timing on when we will complete our assessment and issue our response to the request.
- 2.45 Where we are required to undertake an MPD, the prioritisation criteria apply to deciding **when** we would commence an MPD; they do not apply to deciding **whether** to undertake an MPD. So the decision for considering the request would be straightforward.
- 2.46 However, where we have discretion on whether to undertake an MPD, the prioritisation criteria would apply both to deciding **whether** to undertake an MPD and **when** we would commence an MPD (if we decide to undertake the MPD). We have clarified this in the Guidance.
- 2.47 Deciding when a submission is final is a matter for discussion between the parties requesting an MPD and ourselves. Starting the consideration process from the date of the final submission ensures we have a complete submission before we commence our process. It is designed to:
- allow the parties making the submission to have the opportunity to provide additional information or analysis, where appropriate, once they have discussed their proposed submission with us; and
 - make the overall process more efficient so that we complete only one consideration process, which is not later delayed by additional information from the requesting party that is submitted after we have commenced our process.
- 2.48 We envisage that the decision on when a submission is final will be made jointly by the parties making the submission and ourselves. We have not amended the Guidance on this point.

- 2.49 Considering whether to commence the process of making an MPD is a significant commitment of resources by the affected stakeholders, including ourselves and as such requires that we exercise appropriate diligence in making such a decision. The six month estimate allows for the time it will take to consider a request including; setting out the project plan and analytical framework, gathering necessary information, analysing and assessing information along with our internal review and decision making processes.
- 2.50 We have amended the wording in the Guidance to state that we will complete our assessment of a request as quickly as possible and where it is possible to complete in less than six months, we will do so.

Timetable and stages for completing an MPD

What we proposed

- 2.51 Paragraphs 3.14 to 3.27 of the Draft Guidance stated that:
- We aim to publish an MPD decision within 18 months of commencement of our MPT assessment. However, there may be instances where we need to depart from this.
 - 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 it, together with the reasons why we are doing so.

Stakeholder comments

- 2.52 HAL noted that our aim to complete the process and publish an MPD within 18 months is less than half the length of time it has taken us to complete the process to date. HAL suggested that a failure to meet this target (or to conduct a poor process in order to meet this target) would ultimately be less conducive to regulatory certainty than a longer but more

realistic target. HAL considered that it may be more appropriate for us to adopt an indicative timeframe:

- which industry players can have full confidence that we will be able to meet, except in exceptional circumstances; and
- which will not compromise the integrity and quality of the decision-making process.

2.53 GAL stated that:

- In paragraph 2.45 of the Draft Guidance, we said that, in some cases, we may decide to begin the process of developing a licence alongside the MPD. GAL considered that the two processes should be sequential to guard against the risk that the ongoing work on the licence conditions taints the MPD.
- 18 months should be the very outside limit to publish an MPD decision. It suggested we could informally apply an approach similar to that under the Enterprise Act 2002, where we would adopt a 12 month limit that could be extended if required by a maximum of six further months.

2.54 IATA considered that to minimise the timescales, we adopt a simplified MPT that could expedite the MPD process through leveraging airport benchmarking of quantitative data while not compromising on the robustness of the consultation process. It added that benchmarking could also be used to identify when MPDs may be needed.

2.55 VAA welcomed the clear distinction between when we will be gathering information and when we would consult on our assessment. It stated that this would be helpful in determining how to resource its response to particular stages of the assessment process.

2.56 VAA stated that in conjunction with our indicative timetable to complete future MPDs within 18 months, there is a need to ensure that the process remains robust, and that flexibility is allowed if a longer period is deemed necessary.

Our response and final policy

- 2.57 Respondents expressed concern about the timescales to complete an MPD – both whether 18 months was too long and not long enough. We developed the timescale based on the process and stages we set out in the Guidance, and taking into account our experience of completing the first MPDs. We acknowledged in the Draft Guidance that there are situations where we may need to depart from this; however our opinion remains that we could and will aim to complete an MPD within 18 months. This period is consistent with the CMA's current timetable for conducting Market Investigation References, which we would see as an analogous exercise.
- 2.58 The process explained in the Draft Guidance is designed to:
- allow key stakeholders to be aware of the process and timetable, including allowing for any specific circumstances that may affect it; and
 - maintain the integrity and quality of the decision-making process.
- 2.59 CAA12 does not allow us to adopt a simplified MPT assessment. That said we consider that the process and stages we have developed will allow us to expedite making future MPDs.
- 2.60 Section 50 of CAA12 allows us to require that information is provided to us where we reasonably require it to carry out our functions related to the regulation of dominant airports. As such we can gather benchmarking or comparative data where we consider that it is appropriate. However, where we have discretion about whether to undertake an MPD, we are more likely to consider gathering such data as part of undertaking an MPD, instead of to assist us to decide whether to undertake an MPD.
- 2.61 We agree with GAL's comment about paragraph 2.45 of the Draft Guidance and we have deleted it from the Guidance. We would normally expect a sequential process. Instead we refer the reader to Chapter 7 of the Guidance which sets out the process we will follow once an MPD has been made.