



M.A.G's comments on airline submissions to the CAA on Stansted market power

July 2013

M.A.G comments on airline submissions

Introduction

1. Since M.A.G submitted its Interim Response on 24 May 2013, some responses from other stakeholders to the CAA's 'minded to' document have been posted on the CAA's website, raising issues to which M.A.G would like to respond.
2. The Annex to this letter primarily responds to issues raised by Ryanair in its letter of 24 May 2013 (the "Ryanair Letter"). We note that easyJet also submitted a response on the same date. However, we do not propose to respond to any specific issues raised by easyJet as we understand that easyJet's views have since evolved, and that it is now of the view that Stansted does not have substantial market power (see for example the letter from the Stansted ACC to the CAA dated 25 June 2013 (the "Stansted ACC Letter"), which says easyJet believes that "STN does not have SMP over easyJet" and that "from easyJet's perspective, STN does not require economic regulation").

Looking to the future

3. In its Annual Report 2012, Ryanair stated that the change of ownership of Stansted would result in "much needed competition, lower costs and better passenger service at Stansted".¹ This has proven to be the case. The criticisms of Stansted contained in the Ryanair letter, and the basis for most of Ryanair's views on Stansted's market power, relate to conduct that took place prior to M.A.G's acquisition of Stansted, when the three largest London airports were under common ownership. Since that time, the divestments ordered by the Competition Commission following its BAA airports market investigation have fundamentally changed the competitive environment, as they were designed to do.
4. There are many examples in the Ryanair Letter (and indeed in the Stansted ACC Letter) of views that are based on the conduct of Stansted's previous owners at a time when the three largest London airports were under common ownership. That conduct does not inform an assessment of the new competitive environment in which Stansted operates, particularly now that Stansted is under new ownership. Key examples in the Ryanair Letter include:
 - Section 2, paragraph 1: This paragraph alleges that Stansted has made misleading statements about its operational efficiency, its offers of discounts to airlines and its failure to attract new airlines. It also refers to a change in price more than six years ago (also referred to at Section 2, paragraph 8), which was a consequence of the expiration of long term agreement reached over a decade ago. The change in price was an increase towards the competitive price following a long period of deep discounts aimed at making the

¹ Ryanair Annual Report 2012, page 5.

airport viable. In any case, these issues relate to the conduct of Stansted's previous owners, and are of no relevance to the competitive position now or in the near future, or our conduct going forward.

- Section 2, paragraph 2: As explained in Section 7 of our Interim Response, the commercial revenues brought by passengers are central to our strategy for success at Stansted. However, in this paragraph Ryanair alleges that Stansted's lack of advertising direct to passengers is evidence of a high degree of market power. Whether or not there was a lack of such advertising by Stansted's previous owners, that it is no longer the case. Evidence of M.A.G's approach can be seen in our recently concluded long term agreement with easyJet, as a result of which we will be providing significant marketing support for easyJet to promote Stansted's routes to passengers. [REDACTED]
[REDACTED]. The explicit rationale of the easyJet deal is to more than double the number of easyJet passengers at Stansted over the next five years.² Stansted has already directly marketed to passengers through adverts in the Cambridge Business and Cambridge Style magazines in its April and July editions, as well as installing an Airport Billboard road sign on the Stansted airport exit road in July and easyJet route advertising is been displayed at various locations in the terminal during July. Sample copies of Stansted's direct marketing are attached at Appendix 1.
- Section 2, paragraph 3: This paragraph refers to Ryanair's switching of flights away from Stansted since 2007, which Ryanair alleges had no effect on Stansted's pricing. As stated above, this relates to a period when Stansted was under different ownership owners, at a time when the competitive environment was fundamentally different, and at a time when there was considerable uncertainty as a result of the Competition Commission's BAA airports market investigation. It is therefore of no relevance to the competitive position going forward, other than that it provides unambiguous evidence of the fact that Ryanair can and does switch flights away from Stansted. In any case, as explained in detail in the paper by Professor George Yarrow submitted on 12 July 2013 in response to an information request from the CAA, the relevant economic theory is clear that a combination of falling demand and increasing prices does not necessarily indicate a lack of competition.
- Section 2, paragraph 7: This paragraph states that "neither the withdrawal nor the grounding of aircraft has constrained STAL". This again relates to the conduct of Stansted's previous owners in a very different competitive environment, and is of no relevance to our conduct going forward. At the very most, this could indicate that switching and grounding of aircraft did not lead Stansted to reduce its prices. The

² http://www.stanstedairport.com/about-us/media-centre/press-releases/easyjet-sign-long_term-deal-to-double-traffic-at-stansted.

relevance of this point depends in part on the level of Stansted's charges over this period, relative to the competitive level of charges.

- Section 2, paragraph 10: This paragraph refers to Stansted's previous owners' internal projections regarding employment costs with which M.A.G does not necessarily agree. They were calculated by Stansted's previous owners when the airport was being run under a different business model. This paragraph also refers to alleged tactics by Stansted's previous owners to "impose higher costs on airlines", which are of no relevance to the current and likely future conduct of M.A.G.
 - Section 2, paragraph 11: This paragraph refers to the well-documented difficulties that Stansted's previous owners and Ryanair encountered in reaching a mutually beneficial agreement. It is of no relevance to the competitive position now or in the near future. As the CAA is aware, we aim to build healthy and long lasting relationships with our airline partners and believe we have already made good progress in doing so in the short time since our acquisition of Stansted was completed.
5. While we do not agree with the presentation of the historical facts in the Ryanair Letter, or the inferences of market power that are drawn from them, we do not propose to engage with them in detail here. To the extent that they are relevant at all, we have already addressed these issues in our Interim Response.
6. The important point to note is that Stansted is now under new ownership and the CAA's market power assessment is forward looking. Now that Stansted has been separated from Heathrow and Gatwick, its commercial incentives are fundamentally different, as is the competitive environment in which it operates. Critical to Stansted's success is our new approach to engaging with our airline partners. We have to compete against all London airports (and airports across the UK and Europe) by offering value to airlines and by being attractive to passengers, and we have demonstrated over the past few months that this is what we are doing.

The competitive assessment

7. As we made clear in our Interim Response, we strongly disagree with many of the arguments made by Ryanair in its previous submissions to the CAA (which are also reflected in the Stansted ACC Letter). We would like to reinforce our disagreement with some of those arguments that are repeated in the Ryanair Letter and the Stansted ACC Letter, and would ask the CAA to note that the ACC's position does not represent the views of easyJet – Stansted's second largest airline customer.

The ability to switch away from Stansted

8. We submitted detailed evidence in our Interim Response showing that Ryanair reduced its weekly departures in summer months by between 15% and 24% between summer 2007 and

summer 2012 while vastly increasing its departures from other UK and continental European airports (see Figure 1 in Section 4 of the Interim Response, and para 9.5).³ This shows that Ryanair is both willing and able to switch away from Stansted to our competitors if we do not work hard to offer them value for money. It shows that London is not uniquely important because marginal flights can be switched away in response to price rises by Stansted. These issues are discussed in further detail in Sections 4 and 5 of our Interim Response.

9. For the purposes of assessing Stansted's ability to increase prices to airlines and therefore its market power, it is irrelevant whether these flights were switched to other London airports or to airports in the rest of the UK and Europe.⁴ If Ryanair (and other airlines) are making purchasing decisions that directly compare and choose between the offerings of airports throughout Europe, then these airports are, by definition, direct competitors of Stansted and Stansted's market power (and lack thereof) must be assessed in that context.⁵

Marginal switching

10. The Ryanair Letter assumes throughout that because its commercial strategy requires an irreducible core of flights to and from a major European city such as London, this means that its main London airport, Stansted, must have market power.⁶ This error is important because it is also adopted throughout the CAA's 'minded to' document (for example, paragraphs 4.119, 4.120, 5.54-5.59, and 5.87). In particular, as emphasized at paragraphs 4.30 to 4.37 (and Annex D) of our Interim Response, the central issue in the CAA's market power assessment is whether Stansted's airline customers could render an attempted 5-10% price rise unprofitable by switching away a sufficient number of marginally profitable flights to other London, UK or

³ The comparable figures for easyJet are between 33% and 37%.

⁴ We note in passing that Ryanair has in fact switched aircraft recently between Stansted and Gatwick (see paragraph 5.23 of the 'minded to' document). We also note that easyJet switched large amounts of traffic directly between Stansted and other London airports (including Gatwick) in the same period, thus showing that spare capacity is available in London and that Ryanair could have done the same if it had wished to do so. See Figure 2 in section 4 of our Interim Response.

⁵ We note that Gatwick also submitted in its response to the CAA's 'minded to' document for Stansted that the CAA should conduct "more comprehensive analysis" on airlines switching capacity away from London. It argued that the CAA "fails to recognise what happened when Ryanair reduced capacity at Gatwick equivalent to about 1 million passengers over the last couple of years, and what will happen this summer when Ryanair makes an even larger reduction than that at Stansted. The CAA should conduct more comprehensive analysis in this area" (page 2).

⁶ Gatwick's response to the CAA's 'minded to' document for Stansted also commented on the alleged strategic importance of London. It stated that the implication is that "the airlines cannot reduce their capacity serving London and have no other options as to where they use their capacity. However, this is clearly not the case for the larger LCC's and charter carriers who have many options as to where they deploy their fleets and for whom London capacity is by no means immutable" (page 2).

European airports (in aggregate).⁷ Our Interim Response shows clearly that they could. The issue of whether Ryanair could switch away its entire base is not a relevant consideration for these purposes.

The correct definition of 'constraint'

11. A related misconception reflected in both the Ryanair Letter (for example, Section 2, paragraphs 3 and 7) and the CAA's 'minded to' document (for example, Summary paragraph 10 and paragraphs 5.21 and 5.103) is that Ryanair failed to 'constrain' Stansted's pricing because, despite switching flights away from Stansted, Stansted's previous owners did not reduce their prices. In the relevant competition law terminology, a price rise is 'constrained' if the airport's airline customers have the ability to render the price rise unprofitable by switching away. The airport's subsequent pricing decisions are irrelevant to the analysis (particularly in this case, given that the decisions were taken by Stansted's previous owners operating in very different competitive conditions).

W-pattern routes:

12. The Ryanair Letter (Section 2, paragraph 4) refers to paragraph 4.128 of the CAA's 'minded to' document and the argued difficulty of flying W-routes. However, this paragraph should be read in conjunction with the further discussion in paragraphs 5.12 to 5.19 of the 'minded to' document. In those more detailed paragraphs, the airlines' ability to reduce the frequency of existing services or fly W-routes or triangle routes is said to be able to defeat a price rise in the short term. Evidence is adduced by the CAA to show that airlines can and do operate these routes voluntarily to utilise their aircraft as efficiently as possible rather than simply to constrain an airport's price rise. Therefore, there may be a debate about whether W-routes are the most efficient way to utilise aircraft (all else being equal), but there should be no question that W-routes are an example of the types of constraining behaviour that airlines have at their disposal.⁸ Airlines can and do use these methods effectively, either on their own or in combination.⁹

Comparison with Heathrow and Gatwick:

13. We note Ryanair's view that, contrary to the position adopted by the CAA, Stansted has more market power than Heathrow and Gatwick (Section 1, paragraph 6 of the Ryanair Letter). For the reasons given in our Interim Response, we do not believe this represents the reality of

⁷ For the need to consider the aggregate constraint of other UK airports, see paragraphs 5.24 to 5.28 of our Interim Response. For the need to consider the aggregate constraint of different methods of switching, see paragraphs 9.10 to 9.15 of our Interim Response.

⁸ See for example paragraph 5.8 et seq of the CAA's 'minded to' document for an indicative list for the types of methods that can be used to defeat any attempted price rises by Stansted in the short, medium and long term. These issues are discussed in more detail in paragraphs 9.10 to 9.15 of our Interim Response.

⁹ For an explanation and illustration of this see easyJet investor relations webcast: http://corporate.easyjet.com/investors/presentations-webcasts/2012.aspx?sc_lang=en

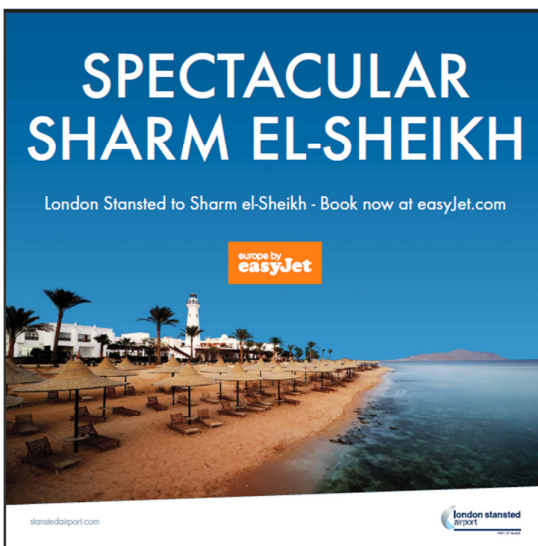
competition between London airports. If this is truly Ryanair's view, it would call into further question its understanding of the relevant economic tests and therefore its views on other aspects of the CAA's market power assessment.

Appendix 1 - Examples of easyJet direct marketing



Airport road sign - installed in July 2013

2. Route advertising installed in the terminal at various locations in July 2013



ELEGANT GLASGOW & EDINBURGH

London Stansted to Glasgow & Edinburgh
Book now at easyJet.com

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stanstedairport.com 

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London Stansted to Belfast - Book now at easyJet.com

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STUNNING SOFIA

London Stansted to Sofia - Book now at easyJet.com

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BE MARVELLED IN MARRAKECH

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