

## The Use of Selective Criteria in the Economic Regulation of Airports

### 1. Introduction

- 1.1 The goal of the Aviation Strategy<sup>1</sup> is to strengthen the competitiveness and sustainability of the entire EU air transport value network. Tackling limits to growth in the air and on the ground, in particular by boosting the efficiency of airport services, is one of the three key priorities that the Commission has identified.
- 1.2 The Thessaloniki Forum of Airport Charges Regulators is tasked with 1) working on and making recommendations for a better common implementation of the Directive 2009/12/EC on Airport Charges (the "ACD") and 2) promoting best practices in economic regulation of airports.<sup>2</sup> The ACD requires Member States to assign responsibility for supervising the setting of airport charges to Independent Supervisory Authorities ("ISAs").
- 1.3 In this paper, the Forum discusses the use of selective criteria in the context of the economic regulation of airports. We discuss the use of criteria in the following circumstances:
  - To distinguish airports likely to have Significant Market Power (SMP) from those which are not, to inform decisions on whether to conduct a Market Power Assessment (MPA).<sup>3</sup>
  - To decide on an appropriate form of economic regulation, or alternatively that further regulation, beyond the regulatory intervention set out in the ACD, is not required.
- 1.4 Finally, we discuss the criteria proposed by industry as part of this process.
- 1.5 This discussion report has been formulated by the Working Group of the Thessaloniki Forum on Airport Charges, taking into consideration the views of representatives of the airport and airline communities. Members of the working group are Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Switzerland and the United Kingdom.
- 1.6 Our definition of SMP corresponds with the principles of EU competition law and rulings of the ECJ. The concept of dominant position is not defined as such in the Treaty but it is established by case law as: "[A] position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent

<sup>1</sup> [https://ec.europa.eu/transport/modes/air/aviation-strategy\\_en](https://ec.europa.eu/transport/modes/air/aviation-strategy_en)

<sup>2</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0012&from=EN>

<sup>3</sup> Throughout this document: Airport refers to the Airport Managing Body or the Airport Authority. User or Airline refers to airlines operating or planning to operate at the airport during the period in which the charges being consulted on will be applicable (airlines planning to operate should formally notify the airport of this intention prior to the consultation). ISA refers to the Independent Supervisory Authority referred to in the Airport Charges Directive and designated by the individual Member State.

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independently of its competitors, customers and ultimately of its consumers".<sup>4 5</sup>

1.7 This report has been adopted by the Thessaloniki Forum on 23 November 2018.

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<sup>4</sup> Case 27/76, United Brands v Commission.

<sup>5</sup> Although there are parallels between assessing SMP for an MPA and assessing market power under competition law, there are also some important differences between them. For instance, when assessing market power at an airport as a whole, ISAs may consider either the overall bundle or different possible bundles of airport services and then determine the relevant market in which the airport offers those services. In comparison, when assessing market power under competition law, we need to start by determining a product market relevant to the complaint in question. This may be much narrower than the total range of services offered at an airport. Also, when carrying out an MPA at an airport, it is usually a forward-looking assessment whereas assessing market power under competition law may be either backward-looking assessment of past behaviour or forward-looking (i.e. in merger control).

## 2. Caveats

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- 2.1 The report does not represent the views of the European Commission and does not in any way change the requirements of the ACD.
- 2.2 The scope of this paper does not include arriving at a position on whether the ACD should be reviewed, nor whether any such future review should mandate the carrying out of MPAs.
- 2.3 This report should not be used as a limitation or constraint for Member States to apply their own methodologies when circumstances, regulation or other causes recommend it.
- 2.4 The ideas expressed in this report are currently being discussed in the context of potential future legislative initiatives. Criteria, as discussed in this paper, are not currently used by ISAs that implement the ACD.
- 2.5 These recommendations will be kept under review and changed as and when deemed necessary by the Thessaloniki Forum.

### 3. Background

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- 3.1 Market conditions may vary on a spectrum ranging from perfect competition, in which no individual airport has any market power, to a single airport with a very high degree of market power. Economic Regulation may be required to ensure that an airport with Significant Market Power (SMP) cannot set Airport Charges which are excessive, or deliver lower capacity or quality of service than desired by airlines and passengers.
- 3.2 The level of regulatory intervention should be tailored to the degree of market power, with flexibility to adapt the regulatory model if market circumstances change substantially. One way to achieve this is to conduct an MPA and tailor the regulatory remedy to the results.
- 3.3 The first report of the working group on MPAs, published in November 2017, states that MPAs *“can play a useful role in deciding which airports may require economic regulation and in which form.”*<sup>6</sup> However, the paper also states that several practical and institutional aspects should be carefully considered and addressed before embedding MPAs in a regulatory framework. The working group also produced a second report which set out recommended practice when conducting an MPA.<sup>7</sup> Where we refer to an MPA in this paper, we refer to a detailed assessment of market power in line with these recommendations.
- 3.4 Some of the practical aspects to consider are that MPAs:
- require specialised knowledge, judgement, access to information, and expertise.
  - are costly and can take considerable time.
- 3.5 Like any piece of work, if it is carried out in an improper manner, the MPA would lead to an imprecise or questionable result.
- 3.6 In short, MPAs are complex. For this reason, it may be desirable to use criteria that indicate market power, to either reduce or remove the need for carrying out MPAs.
- 3.7 As it currently stands, the majority of regulators who participate in this working group would need a change in national legislation to be able to use criteria, other than those set out for application of the ACD.<sup>8</sup> The ACD is applied to, at least:
- any airport in a Member State open to commercial traffic whose annual traffic is over five million passenger movements.
  - the airport with the highest number of annual passenger movements in each Member State.

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<sup>6</sup><http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=36343&no=1>

<sup>7</sup> <http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=36344&no=2>

<sup>8</sup> The final decision on whether to extend the ACD requirements to airports outside of these criteria rests with the Member State.

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#### 4. Use of Criteria

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- 4.1 In order to add value to the framework for the regulation of Airport Charges, the benefits of using criteria must be demonstrably higher than the associated costs and risks.
- 4.2 Criteria should be evidence based; there should be evidence that the chosen criteria will be effective, and consistent, in fulfilling the intended purpose. There may be a single criterion, or a set of criteria; in the latter case, the set should in all situations be considered holistically as opposed to individually.
- 4.3 Criteria might range from the very simple, such as the 5 million annual passenger threshold in the ACD, to a complex set of economic criteria which contains many elements of an MPA. Similar to market power itself, there is a spectrum of ways to assess market power; with regards to reliability, the spectrum ranges from a simple single criterion, at the low end, to an MPA, at the high end. In general, there is a trade-off between simplicity and reliability with regards to assessing market power. The reliability of the criteria should reflect the purpose for which they are used.
- 4.4 In defining and applying criteria, the presence and form of regulation should be taken into account, as it may affect the result.<sup>9</sup>
- 4.5 We consider two broad distinct categories of criteria, which can be applied alternatively:
- ‘Screening Criteria’ intended to distinguish between airports which are unlikely to have any significant degree of market power, and those which require more detailed assessment through an MPA or a more complex set of criteria.
  - ‘Regulatory Criteria’ to be used to inform a decision on whether to impose economic regulation, and/or the form of economic regulation to be imposed, as an alternative to an MPA.
- 4.6 As noted above, criteria should be related to the level of market power that airports are likely to have.<sup>10</sup> However in many cases, factors or behaviours which may be indicative of SMP can also be observed in more competitive markets, meaning that they may be inconclusive on the need for conducting an MPA or imposing regulation. No factor should be viewed in isolation. Below we give some examples of why factors should not be viewed in isolation but considered as part of the overall circumstances:
- Cross-subsidization and price differentiation can occur in competitive markets.
  - Caution is required with criteria related to the economic performance of an airport such as profits above competitive levels, because it can be difficult to show objectively that returns on invested capital are supernormal.

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<sup>9</sup> As noted previously by the Forum, it may be necessary to apply a “modified greenfield approach” such as assessing what could happen in the market on the assumption that the relevant market was not subject to sector-specific ex ante regulation (but including regulation which would otherwise exist). See paragraph 44 of the second report on MPAs referenced above.

<sup>10</sup> That being said, criteria should not be used to make findings of SMP, but only that an MPA and/or economic regulation may be required.

- A free choice of dual till can mean an airport considers itself to be able to recoup its costs in the aviation till. The ability to recoup costs is not proof of SMP; it would be important to also assess some relevant metrics, for instance, profitability.
- 4.7 Criteria should be focused on indicating whether or not the airport has SMP in the upstream (ie airport services) market, rather than indicating the extent of any market power held by airlines in the downstream market where passengers purchase air travel services from airlines.

### *Screening Criteria*

- 4.8 Criteria for this purpose would easily and quickly screen out airports which clearly and unambiguously do not have SMP. The criteria would be used to decide that an MPA is not needed for such an airport.<sup>11</sup>
- 4.9 Screening out these airports would allow a regulator to focus on airports more likely to have SMP. This should lead to better informed and thus improved decision making where it is most needed.
- 4.10 Such criteria should be objective and simple to apply. They should also be set conservatively, in that they must be determinative of a decision not to implement regulation only in clear and unambiguous cases. If there is any significant doubt over market power, it is better to carry out a detailed assessment rather than relying on simple criteria:
- If an airport with SMP is wrongly deemed not to have SMP by criteria which are insufficiently conservative, economic regulation would be deemed unnecessary. This could have a significant negative outcome for users of that airport.
  - On the other hand, if criteria indicate that an airport requires an MPA, this is unlikely to result in negative outcomes for the protection of passengers (other than the cost of the MPA), even if ultimately the MPA shows that economic regulation is unnecessary.
- 4.11 The following is a non-exhaustive list of potential subject matter which we think would merit further investigation, to establish if and how they could be used to develop a set of Screening Criteria which is indicative of SMP:
- Thresholds relating to passenger numbers and/or aircraft movements.
  - Traffic share of an airport or airport group in the Member State.
  - Congestion
  - The presence of network effects.
  - Countervailing buyer power held by airlines.

### *Regulatory Criteria*

- 4.12 Regulatory Criteria will exist somewhere between Screening Criteria and an MPA on the market power assessment spectrum; that is, more complex than Screening Criteria

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<sup>11</sup> A similar but inverse approach would be to assume that an MPA is not required unless the criteria are met. We are not recommending either of these approaches as superior to the other.

but less complex than an MPA.

- 4.13 Relying on Regulatory Criteria rather than an MPA would result in a less robust assessment of the degree of market power of an airport. Consequently, it could happen that the resulting remedy would be inappropriate to the actual degree of market power in some cases. This works both ways; it could result in excessive regulation when not required or a situation where the interests of passengers are not being protected from an airport with SMP.
- 4.14 On the other hand, the use of Regulatory Criteria as an alternative to an MPA may lead to a reduced burden on the regulator and on stakeholders. It is a policy decision as to whether this reduced burden is worth the increased risk of sub-optimal decision making. A decision would also need to be made regarding the appropriate point to choose on the reliability spectrum. Any such decisions should be informed by cost/benefit type analyses.
- 4.15 It would be possible to use Regulatory Criteria to decide on the regulatory model. This may come with the option to potentially carry out an MPA in the event of an appeal of this initial decision; see, for example, the proposal from the airline associations discussed in Section 5. In such a regime, the use of Regulatory Criteria may not lead to a significant reduction in the number of MPAs, while still requiring an initial assessment of potentially complex Regulatory Criteria.
- 4.16 At the present time, the Forum has not assessed whether the benefit of using Regulatory Criteria outweighs the potential risks. There is a risk that such criteria are likely to either:
- Be relatively complex to assess and therefore be quite similar in nature to an MPA, carrying similar appeal risks; or
  - Be relatively simple, and consequently insufficiently linked to the likelihood of SMP to be fit to fulfil their intended purpose.
- 4.17 Nevertheless, the Forum recommends, non-exhaustively, that the following could be explored further to establish if and how they could be used to develop a set of Regulatory Criteria which is indicative of SMP:
- The airport's share in a defined catchment area (such as the Member State)
  - Airline shares of traffic at the relevant airport.
  - Airlines' percentage of traffic at the relevant airport compared to its overall traffic.
  - Traffic mix at the airport and the potential for the same mix to be accommodated at potential competitor airports.
  - The level of congestion at the airport and at potential competitor airports.
  - Existence of supernormal profits and/or returns (eg above the WACC of the airport).<sup>12</sup>
  - Comparison of unit cost (or charges levels) across comparator airports.
  - Airline switching prevalence, particularly within the defined catchment area.

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<sup>12</sup> WACC is the Weighted Average Cost of Capital. For more details on the WACC see: <http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=29019&no=2>

- Comparability of services at potential competitor airports.
- Ownership arrangements.
- Proportion of transfer passengers relative to total passengers.
- Number and significance of complaints (or other data) related to service quality, differentiated services, discrimination.
- Cost to passengers from using alternative airports compared to fare differential between them.
- Countervailing buyer power held by airlines.

## 5. Criteria Proposed by Industry

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5.1 At meetings of the working group, presentations were given by Airports Council International (ACI), a group of airline associations<sup>13</sup>, and finally by CEG on behalf of IATA and A4E. These serve as examples of possible frameworks making use of both Screening and Regulatory Criteria.

### *ACI*

5.2 The proposal from ACI involved, effectively, two stages of Screening Criteria, followed by an MPA if the Screening Criteria indicate that this is required. It proposed to categorise airports as follows:

- Group 1 are airports which do not meet the ACD criteria, ie those with less than 5 million passengers per year and not the largest airport in the Member State. For these airports, no application of the ACD is required.
- Group 2 are airports which meet the ACD criteria, but are deemed not to have SMP either as a result of the application of the secondary screening criteria, or an MPA. These airports would be subject to a 'safeguard ACD' based on transparency, non-discrimination, and consultation requirements.
- Group 3 are airports deemed to have SMP by an MPA, following the application of both sets of criteria indicating that an MPA is necessary. These airports would be subject to more stringent economic regulation.

5.3 The secondary stage of Screening Criteria suggested by ACI could therefore exclude the possibility of more stringent economic regulation at large airports. This stage required that all three criteria be met in order to rule out an MPA. The proposed criteria are as follows:

- Competition for passengers:  
"Is there another airport within 120 minutes by car, bus or rail that has the equivalent infrastructure and facilities? OR  
Is the proportion of inbound leisure passengers higher than 60%? OR  
Is the proportion of transfer (including transit) passengers higher than 60%?"
- Countervailing buyer power:  
"Are there one or two airlines at the airport that represent more than 60% of the airport capacity or traffic? AND  
Does at least one of these airlines have less than 40% of their total capacity or traffic at the airport?"
- Spare capacity:  
"Is there spare capacity at the airport? OR  
If there is another airport(s) within 120 minutes by car, bus or rail that has equivalent infrastructure does the airport(s) have spare capacity?"

### *Airline Associations (Airline Associations Proposal 1)*

5.4 The airline associations proposed that Regulatory Criteria be used to allocate airports to one of three groupings, with the potential to carry out an MPA if requested by an

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<sup>13</sup> A4E, era, IACA, IATA

airport or airline, which could lead to reallocation.

- Those to be excluded from the ACD (Group 1).
- Those to be subject to 'improved application of the ACD' (Group 2).
- Those to be subject to more stringent economic regulation (Group 3).

5.5 It proposed a passenger number criterion to distinguish Group 1 from other groups, similar to the current ACD. The criteria proposed to allocate airports to Group 3 are any of the following:

- hybrid/dual till:  
"this type of practice would not be possible in a competitive market"
- airport networks/common ownership:  
"No competition under common ownership when in the same conurbation"  
"For national networks, cross subsidisation allows for charges that are not cost related... which would not be possible in a competitive market"
- airports operating at full capacity:  
"With excess demand and lack of alternatives for airlines, airports are able to exercise their market power"

#### *IATA and A4E (Airline Associations Proposal 2, carried out by CEG)*

5.6 The CEG report set out a set of Regulatory Criteria to identify airports 'likely to have SMP' which could then be subject to economic regulation.<sup>14</sup> The proposal would identify such airports as follows:

- 'Is there likely to be an effective constraint from a nearby airport or an airport at another destination offering a similar type of holiday?'
- 'Does the airport have spare capacity (now or in the near future)?'
- 'Does the airport display pricing behaviour consistent with effective competition (e.g. reporting under a single till)?'

5.7 Where the answer to any of these questions is "No", CEG believes that the airport is likely to have SMP. It states that national regulators should retain the option to conduct an MPA where they believe that the criteria are omitting an important local factor, where the application of the tests does not produce a clear answer or where stakeholders have made a justified request for an assessment.

#### *Views of the Forum*

5.8 The Forum welcomes the input from industry. While the subject matter identified is generally relevant to assessing market power, as discussed in Section 4, in advance of implementing any such framework there would have to be evidence that the chosen criteria will be effective and consistent in fulfilling the intended purpose. Such evidence should relate not only to the subject matter and the structure of a set of criteria, but also the threshold for each criterion. Below, the Forum considers each set of criteria

<sup>14</sup>

<http://www.ceg-global.com/uploads/PDFs/White%20Papers/CEG%20Airport%20Charges%20Report%201102018%20.pdf>

holistically. The Forum then discusses some issues which would need to be addressed or considered, regarding the specifics of how industry have proposed to embed the subject matter in a set of criteria. This could be used as a starting point for any future work as discussed above.

### *ACI Screening Criteria*

- 5.9 We noted that Screening Criteria should be conservative. Although ACI describe its proposed criteria as conservative, we do not agree with this characterisation; for example, Dublin Airport would appear to be excluded from the possibility of price cap economic regulation under the ACI criteria.<sup>15</sup> However, an MPA published in 2016 recommended that price cap based economic regulation of Dublin Airport continue, in recognition of a high level of market power.<sup>16</sup>
- 5.10 A set of criteria should be viewed holistically; the key output is the overall result. However, it is not clear why ACI require an airport to meet all three criteria in all circumstances. In theory, competition for passengers could place sufficient competitive constraints on an airport to render regulation unnecessary without any element of countervailing buyer power, or vice versa. For example, in a market with many similar suppliers and many purchasers of a given service, there may be a high level of competition with little or no countervailing buyer power being held by the purchasers.

### *Airline Associations Regulatory Criteria (Airline Proposal 1)*

- 5.11 We noted that the complexity of criteria should reflect the purpose for which they are used. The set of criteria proposed by the airline associations would be used to implement a stringent regime of economic regulation, in the event that any one of the criteria is met. Given the simplicity of the criteria, the risk of misallocating airports would be very high.
- 5.12 This risk would be somewhat mitigated by the potential for appeals. However, it is likely that a majority of airports placed in Group 3 would immediately seek an MPA, particularly given the simplicity of the criteria. It would then be necessary to further distinguish between them. This could only be done either with other more complex Regulatory Criteria or through an MPA. Thus, with regards to assessing market power, we would be back where we started in advance of implementing the criteria based approach.

### *CEG Regulatory Criteria (Airline Proposal 2)*

- 5.13 Similar to the airline associations, the CEG report proposes that criteria would be used to implement economic regulation, in the event that any one of the criteria is not met.

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<sup>15</sup> Belfast International Airport is within 120 minutes by car, Ryanair and Aer Lingus represent more than 60% of traffic, and Belfast Airport is not Level 3 Coordinated.

<sup>16</sup> Indecon found that, despite some degree of countervailing buyer power, the key indicators of market power were consistent with Dublin Airport holding SMP, and recommended that economic regulation continue accordingly. See: <http://www.dttas.ie/sites/default/files/publications/aviation/english/review-regulatory-regime-airport-charges-ireland/review-regulatory-regime-airport-charges-indecon-economic-consultants.pdf>

CEG set out details on how these Criteria would be assessed. Again, we would expect that airports subject to economic regulation as a result of the application of these Criteria would immediately point to a range of 'local factors' and request that an MPA is carried out.

- 5.14 Applying the set of criteria proposed by CEG would be relatively complex. Embedding Criteria such as these into a regulatory model may therefore not lead to a significant reduction in the number of MPAs required to ensure with the desired level of certainty that economic regulation is appropriately targeted, while still requiring an initial assessment of complex Regulatory Criteria. However, in the case of the first two tests, in our view CEG do set out relevant questions.
- 5.15 It is clear that the result of applying these Criteria would not accord with the result of at least one MPA which has recently been carried out. The London airports Heathrow, Gatwick, Stanstead, Luton, and London City are all Level 3 Coordinated and thus we expect they would be deemed 'likely to have SMP' due to the second criterion, before considering the first and third. However, an MPA published by the UK CAA in 2014 indicated that Stanstead did not have SMP.<sup>17</sup>

#### *Competition for Passengers*

- 5.16 The ACI criteria require one of the following three elements to be fulfilled in order to determine that the airport in question faces competition for passengers:
- An equivalent airport within 2 hours travel time
  - At least 60% of passengers are transfer/transit
  - At least 60% of inbound passengers are leisure passengers
- 5.17 The report by CEG suggests that competition for passengers is generated if:
- There is a 'nearby' airport which is within a similar travelling time and cost from the main urban area served. This airport must have 'comparable' infrastructure, be under separate ownership, and not Coordinated. It must be economic and practical for airlines to shift significant traffic to that airport.
  - At least 70% of inbound passengers are leisure passengers, and there is evidence showing that a significant share of passengers are highly price sensitive; thus they would travel to other destinations in response to a relatively small change in airfares.
- 5.18 The upstream market for airport services depends on the downstream market. However, caution should be exercised when considering using this interdependency to map characteristics of the downstream market to the upstream market. For example, passenger responses to the presence of multiple airports within a given distance or travel time is complex, and it may be difficult to untangle this into a criterion to assess the competitive constraints in the upstream market. The mere presence of an airport in the vicinity, or within a given travel time, gives virtually no information about whether passengers will actually switch sufficiently in response to a small but

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<sup>17</sup> <https://www.caa.co.uk/Commercial-industry/Airports/Economic-regulation/Licensing-and-price-control/Airport-market-power-assessments/>

significant increase in airport charges.<sup>18</sup> The question of whether passengers switch sufficiently to another airport in response to a limited but not insignificant price increase is partly dependent on the familiarity of passengers with the other airport(s) and the degree of overlap in flight destinations between airports. In addition, the smaller the share of airport charges in the ticket price, the lower the likelihood that passengers will actually switch sufficiently in response to an increase in airport charges.

- 5.19 Equivalent infrastructure and facilities could be interpreted to mean another airport with scheduled passenger traffic, or another airport which could serve the same fleet mix as effectively as the airport in question, or an airport which could serve the same traffic volume as the airport in question, or a range of other possibilities. Thus, there is an element of subjectivity in the criteria as currently set out.
- 5.20 Furthermore, criteria relating to the proportion of transfer passengers or the proportion of inbound leisure passengers must be considered carefully. For instance, even where the airport faces real competitive constraints in the setting of aeronautical charges for transfer/transit passengers, it may still be possible, overall, to charge above cost price levels when origination/destination passengers are factored in. The extent to which the proportion of inbound leisure travellers is indicative of elastic passenger demand, and thus corresponding competitive constraints, is not clear. In the case of a destination airport for a city or area with unique offerings, demand from leisure travellers may be less elastic than airports serving areas with more substitutable offerings, such as a beach holiday. How these compare to the elasticity of demand of non-leisure passengers, and the implications for basing a criterion on this, has not been demonstrated.

### *Spare Capacity*

- 5.21 ACI suggest that spare capacity be defined with reference to the Coordination status of the airport under the Slot Regulation;<sup>19</sup> Coordinated airports where at least 80% of the declared capacity of the most constrained element of airport infrastructure is utilised would be deemed not to have spare capacity. The procedure for setting the declared capacity, as well the authority competent to do so, varies across Member States. In many cases, however, the capacity is not set on an absolute basis, but rather is demand driven and can vary across the day. Thus it is a question of whether the expected profile of demand for the upcoming scheduling season can be accommodated, and declaring capacity accordingly. One would therefore be assessing the extent to which demand exceeds supply with reference to a level of supply which

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<sup>18</sup> The economic-theoretical starting point of the market definition is the hypothetical monopolist test. In principle, this starting point may also be applied to investigate the dominance of a single company. This test will examine how many customers, as a result of a hypothetical, low but not negligible (between 5% and 10%) sustainable increase in the price of the products under investigation in the areas concerned would switch to easily available replacement products, or to suppliers that are elsewhere established. If the price increase can be implemented profitably because there are not too many customers switching to another product and another geographic area, there is a separate product or separate geographic market. Competitive constraints are taken into account to evaluate the ability of the airport to increase its charges above the competitive level. See for instance: European Commission (1997), Commission Notice on the definition of relevant market for the purposes of Community competition law, OJEC, 97/C 372/03.

<sup>19</sup><https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1993R0095:20050730:EN:PDF>

is itself partly driven by demand. Furthermore, in some cases, the airport managing body itself is the competent authority for setting the declared capacity and would be incentivised to increase the declared capacity to reduce the percentage utilisation and thus be deemed to have 'spare capacity'.

- 5.22 There is typically significant variation in the extent of spare capacity. Many airports are relatively constrained at certain times of day and/or certain times of year, but relatively unconstrained at others. Most airports have little utilisation of the available capacity from roughly 11 pm-5 am; this is not an indicator that the airport is not congested. Airports have at least some spare capacity in some hours or on certain days which is unlikely to be usable due to fragmentation in the flight schedule.<sup>20</sup> At other airports, factors such as planning limits, night time limits, and noise restrictions would further complicate this assessment. These factors would pose clear difficulties for the ACI proposal in terms of independence, representativeness, and circularity.
- 5.23 The airline bodies and CEG suggest that an airport does not have spare capacity if it is Coordinated. CEG further suggest that whether it is expected to have spare capacity in the future should also be considered, ie if planned capacity expansion exceeds forecast demand growth. Assessing congestion with reference to Coordination status alone would provide guidance, but will not provide a full picture of the extent to which the airport is congested, as outlined above. Some airports are Coordinated only on certain days or times of year, or due to congestion for a very short or specific time of day. It is very rare for an airport designated as Level 3 to revert to Level 2. If an airport were to invest in capacity to an extent greater than the forecast demand growth and thus generate spare capacity, particularly on an ongoing basis, it will have exceeded the requirements of its airline users. The ability to 'over-invest' in this way, which could be expected to lead to Airport Charges above competitive levels to cover the costs related to the investment, would demonstrate that the airport is behaving to an appreciable extent independently of user requirements. Thus, depending on how it is viewed, the behaviour which CEG suggests could indicate that an airport does not require regulation could in fact be an indicator of SMP.
- 5.24 Whether a consistent approach is taken in different Member States with regard to the Coordination Level should also be considered, as should the potential for creating unintended incentives through making a decision to Coordinate an airport potentially consequential for the regulatory model. Unintended incentives could be created for an airport to demonstrate spare capacity and thus avoid economic regulation by either opposing Coordination or increasing the declared capacity, or for airlines, who could be incentivised to support Coordination or oppose an increase in the declared capacity in order that economic regulation would be imposed.

### *Countervailing Buyer Power*

- 5.25 The extent of countervailing buyer power held by airlines is dependent on the ability of an airline to credibly threaten the airport, typically in terms of switching traffic to another airport. It also requires that the optimal response from the airport is to allow

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<sup>20</sup> Fragmentation occurs where airlines holding historic entitlements operate short series of slots, meaning that unless another airline wishes to operate a corresponding short series in a different part of the scheduling season, corresponding slots in other parts of the season will not be used.

itself to be disciplined in this way rather than simply allowing the airline to carry out its threat. While we expect that the traffic share element would be relevant in considering this, there are many other relevant factors, such as:

- The feasibility and cost to the airline of switching away traffic.
- The preferences of passengers.
- The ability of the airport to replace the potential lost traffic.

5.26 The existence of spare capacity at a potential competitor airport could indicate that there are opportunities for airlines to switch to that airport; it could also indicate that airlines have shown no desire or willingness to do so. The degree to which these airports are susceptible to countervailing buyer power will vary significantly due to the factors outlined. Also, as outlined above, it is not the case that a potential competitor airport will be unable to accommodate switching traffic simply due to being Coordinated.

#### *Airport Networks*

5.27 An airport network is not likely to compete with itself in the same way as individually owned airports. However, it is not clear why a network of airports would necessarily be expected to have more market power, relative to a single equivalent airport. Network cross-subsidisation, which is permissible under the ACD, does not bear any obvious relation to market power, particularly given that such networks are often established in national legislation.

#### *Charging Behaviour*

5.28 The use of a dual or hybrid till may be indicative of market power, given the ability to freely profit from commercial activities. As stated in paragraph 4.6, it can also mean that an airport considers itself to be able to recoup its costs in the aviation till, which is not proof of SMP in itself. However, if deemed relevant, it would be better to evaluate metrics such as profitability directly. Furthermore, in many cases the structure of the till is set out in national legislation, or decided by a regulator.

5.29 As noted in Section 4, however, caution is also required with criteria related to the economic performance of an airport, such as profits above competitive levels. It can be difficult to show objectively that returns on invested capital are supernormal.

#### *Hub Airports*

5.30 A hub airport has been cited as a potential criterion by both ACI and the airline bodies, however with directly opposing views as to what it indicates. On the one hand, the ability of an airline to credibly threaten to reduce the scale of a hub based flight schedule may be less than that of an airline with a point-to-point based flight schedule, due to the loss of network efficiencies. In order to maintain network efficiencies, it would be necessary to move the entire operation to a different hub, which may be impossible or very costly. Thus, the countervailing buyer power of the airlines may be reduced at a hub airport. On the other hand, there may be more effective competition between airports with higher levels of transfer traffic, as from the airlines' perspective, the facilities themselves take primacy over the exact location of the airport. Airports

may compete more effectively if the main reason for airlines' choice of airport is simply the suitability and value for money provided by the actual airport facilities, and thus the geographical factor is less relevant than, for example, an airport serving a holiday destination with unique offerings. Further evidence is required to determine which, if either, of these arguments is more valid.