A. RESPONDENT DETAILS

Name: Stuart Voller  
Organisation represented: Department for Transport  
Location (Country): UK  
E-mail address: stuart.voller@dft.gsi.gov.uk

This UK response constitutes a combined response from the Department for Transport and the Civil Aviation Authority (CAA).

We are content for the views contained in this response to be made public and for these views to be attributed accordingly to the UK Department for Transport and the CAA.

B: GENERAL

B.1. Assessment of the market developments and the necessity to modify the 1994 and 2005 Aviation Guidelines

Developments regarding economic and social matters


Regulatory changes in the European Union since 2005

2. The European Commission’s (EC) Single Internal Market objective has led to the ongoing liberalisation of the airport and airline markets and the commercialisation of Member States’ airports. To the extent that there is a functioning pan-European aviation market, this market has now grown with the enlargement of the European Union in both 2004 and 2007.

3. The Commission has pursued a strategy of negotiating open aviation areas with third countries. The Air Transport Agreement between the United States of America (USA) and the European Union (EU), which came into force in March 2008, has opened routes between Member States and the USA to greater airline competition and had particular effects on the UK market, given Heathrow’s importance for transatlantic traffic. It has led to a degree of redistribution of airline operations between Heathrow and other London/UK airports. A notable example is the transfer by airlines operating routes to the
USA of flights from London Gatwick to London Heathrow between March 2008 and 2009, as can be seen from Figure 1 below.¹

Figure 1

Change in passenger numbers by Airline (YE March 2009- YE March 2008)

Source: CAA Airport Stats

4. Several EC regulations and directives impacting competition in the aviation sector have been introduced since 2005. The DBC regulation (Regulation 261/2004) has established common rules on compensation and assistance in light of denied boarding and cancellations. The effects of the PRM regulation (Reg 1107/2006) have been considered in a separate EC consultation, to which the CAA submitted a response. Aviation activities have been included in the emissions allowance scheme since the entry into force in 2008 of Directive 2008/101/EC. The Air Services Regulation (Reg 1008/2008) updated legislation governing the single EU aviation market and established rules on airline pricing transparency, which require airlines to make their pricing information sufficiently clear on their websites. Additionally, Regulation 80/2009 has stipulated a code of conduct for computerised reservation systems.

Airline competition issues since 2005

5. Overall, the move towards consolidation in the airline market appears to have accelerated in recent years and has manifested itself in different ways. There has been increasing use of codeshare agreements and a growth in airline alliances. There have also been a number of mergers or joint ventures between airlines in recent years. The relevant cases involving UK airlines have been investigated by the European Commission, and so will not be discussed further in this response.

6. An important State Aid case has been the Ryanair/Charleroi decision by the Commission in 2004, which raised issues that were addressed in the

¹ Since then further changes have been taking place, with some routes having been changed or even withdrawn (for example Air France operated a flight from Heathrow to Los Angeles for six months).
2005 State Aid guidelines for the aviation sector, and the subsequent annulment of the decision by the Court of First Instance on 17 December 2008 on the grounds of issues surrounding the Commission’s application of the Market Economy Investor Principle.

7. There have been a number of airline merger cases in the UK investigated by the Office of Fair Trading (OFT) since 2005. On 20 June 2007, the OFT accepted undertakings from Flybe Group Limited, in lieu of a reference to the Competition Commission, to address the competition concerns which arose from the anticipated acquisition by Flybe Group Limited of the BA Connect business of British Airways plc (ME/2795/06). On 18 January 2008, the OFT cleared the anticipated acquisition of GB Airways Limited by easyJet plc (ME/3399/07). The merger between VLM Airlines N.V. and the Air France KLM group (ME/3535/08) was approved with an “up-front entrant” remedy on 24 October 2008.

8. There have been fewer cases of anti-competitive behaviour or abuse of dominance under the Competition Act 1998. On the 5 November 2010, the OFT concluded that it had no grounds to take action against Flybe over alleged predatory entry by the airline against Air Southwest (MPINF-PSWA001). The OFT is currently investigating an alleged infringement of Chapter I and Article 101 of the Competition Act 1998 involving Cathay Pacific Airways and Virgin Atlantic (CE/8882-07).

9. Full details of all the above UK cases are available on the OFT website.2

Regulatory changes in the UK

10. In the UK airport market, a significant regulatory change has been the de-designation of Manchester airport from price controls, which came into effect in 2009. This reflects the increasing degree of airport competition in the UK and reduces the degree of regulatory intervention in the market.

11. A major development regarding the UK airport market has been the finding by the Competition Commission of an Appreciable Effect on Competition from the BAA common ownership of airports in the south east of England and in lowland Scotland in its BAA Airports Market Investigation published in March 20093. Since then, London Gatwick airport has been divested by BAA to Global Infrastructure Partners, and BAA is required also to divest Stansted airport and one of Edinburgh and Glasgow airports. These divestitures are expected to change the landscape of the UK airport market, with separate ownership of these airports predicted to increase competition in the South East airport market.

Evolution of airline business models since 2005

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2 www.oft.gov.uk
12. Historically it has been common to distinguish between three main airline business models: “full service” or “legacy” carriers; “no frills” or “low cost” carriers, both of which offer scheduled services; and charter carriers, traditionally used by tour operators for package holidays. However, the boundaries between the various airline business models are becoming increasingly blurred, with “full service” carriers adopting pricing structures introduced by “low cost” carriers, and some “low cost” carriers offering additional “frills” such as loyalty programmes, assigned seats or fast track boarding. Charter carriers, on the other hand, also sell seat-only flights, whilst some no-frills carriers also sell accommodation through their websites. A further distinction exists between point-to-point services and network services, in that the latter involves airlines actively facilitating connections between two individual flights - whether wholly on their own services, or in conjunction with the services of other airlines - to provide for a large number of possible origin/destination combinations, often with short haul flights “feeding” the airline’s long haul flights.

13. The UK considers that, whilst distinctions between different airline business models can be useful in certain contexts, some of the distinctions between various business models have eroded over time.

**Evolution of airport business models since 2005**

14. Although there have been no major changes in the business models of UK airports since 2005, some smaller airports have diversified their methods of revenue collection by charging passengers directly, instead of exclusively through airport charges to airlines. An example of an unavoidable direct charge to passengers is the Airport Development Fee, which is levied as a charge on departing passengers. Other airports charge discretionary fees for additional services such as fast-track security queues.

15. The CAA’s *UK Regional Air Services* study, published in 2005 and updated in 2007, found that airports have begun to change the way they view their operations, sometimes spurred by a move from public to private sector. Some airports are willing to use lower charges to encourage an airline to set up new services, while others will not negotiate on charges *per se* but will provide support for marketing a new service, thus reducing the airline’s start-up costs. In this way, a “virtuous circle” can develop whereby airports’ more commercial approach, competitive pricing and improved facilities stimulate traffic growth, which in turn generates revenue from non-aeronautical activities and underpins further expansion.

16. Over the last 20 years, many airports in the UK have moved from being predominantly in public ownership to being, either wholly or partially, in private ownership. Details on the ownership of UK airport are available from the Office of Fair Trading’s main page for its *Infrastructure ownership and control stock-take* study.5

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4 [http://www.caa.co.uk/docs/33/CAP754.PDF](http://www.caa.co.uk/docs/33/CAP754.PDF) and [http://www.caa.co.uk/docs/33/CAP775.pdf](http://www.caa.co.uk/docs/33/CAP775.pdf)

17. In general, competition between UK airports – both with neighbouring airports in serving local catchments, and more widely with any airport where airlines might choose to deploy capacity – now seems to be regarded by the industry as a “given” (although regulation continues at three London airports, reflecting limited competition). Airports have further intensified their commercial outlook, actively seeking airlines to plug gaps in their route portfolio to give a good mix of destinations, frequency and links to a hub for onward connections. Within this, airports seem to aim for a good spread of scheduled/charter and short/long-haul services, and leisure/business or outbound/inbound passengers. However, some airports focus on particular passenger groups, such as London City Airport customising its operations to business passengers. Other airports such as Biggin Hill, Farnborough and Oxford are specialists in business aviation.

18. Contact between airports and airlines is reported as closer, more frequent, intense and challenging. Contracts setting out commercial agreements between both sides are widespread. Continuing downward pressure on airport charges is also widely reported, suggesting that the rapid expansion of no-frills airlines at regional airports has increased the competitive pressure at regional airports. The CAA report No-frills Carriers: Revolution or Evolution?6, published in 2006, analyses the impact of no-frills carriers on the aviation sector, infrastructure and the public.

Current competitive situation of the various stakeholders in the aviation sector

19. There have been several studies that have analysed the competitive situation in the UK aviation sector since 2005. The development of competition for regional air services was investigated in the CAA’s UK Regional Air Services document in 2005, and its update in 2007.7 In the context of regulation, the CAA has published documents assessing the competitive situation at Manchester and Stansted airports.8 The UK Competition Commission’s BAA Airports Market Investigation analysed the competitive constraints faced by airports owned and operated by BAA, as well as the constraints faced by other UK airports.9

20. An indication of traffic shares of UK airports can be obtained from their respective shares of the UK total number of passengers, cargo tonnage and air traffic movements. For each year from 1990 to 2010, Table 1 of the CAA’s Airport Statistics reports the size of UK airports in terms of passengers, with the more recent tables offering comparisons with the airports’ size five years before.10 Table 6 provides statistics on each UK airport’s annual air traffic

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7 See footnote 3.

Stansted (2006): [http://www.caa.co.uk/docs/5/ergdocs/airportsdec06/sp2.pdf](http://www.caa.co.uk/docs/5/ergdocs/airportsdec06/sp2.pdf)


10 [http://www.caa.co.uk/default.aspx?catid=80&pagetype=88&sglid=3#Data](http://www.caa.co.uk/default.aspx?catid=80&pagetype=88&sglid=3#Data)
movements, split into passenger and cargo aircraft, with a comparison with the previous year.

21. Regarding airlines, the CAA collects data on UK airlines only. Table 1.6 for each year from 1990 to 2010 provides data on all services provided by UK airlines, which are given in terms of seat-kilometres and the number of passengers carried. Table 1.1 provides the size of each UK airline by available capacity in terms of tonne-kilometres.11

22. The CAA also collects extensive survey data on passengers’ itineraries, surface origin/destinations, travel purposes and socio-demographic information. Survey reports using that information are available on the CAA website.12

**Future challenges**

24. The UK aviation sector faces the prospect of greater competition between airports in the South East of England in light of the sale by BAA of Gatwick airport to Global Infrastructure Partners and the prospective sale of Stansted. In Scotland, airport competition is also expected to increase further once either Edinburgh or Glasgow airport is divested by BAA. These actual and prospective changes of ownership follow the conclusions and remedies proposed by the Competition Commission in its BAA airport market investigation published in 2009, as discussed in the section on regulatory changes in the UK.

Additionally, the profitability of smaller airports tends to be particularly sensitive to changes in the underlying economic conditions. A future challenge for these airports would be then to establish a degree of stability in terms of passenger and airline traffic across a fluctuating economic climate.

**The 1994 and 2005 Aviation Guidelines**

25. Overall, the 1994 and 2005 Aviation Guidelines continue to provide a satisfactory basis for the application of State aid policy and the UK would not wish to see any fundamental changes.

26. It is important that application of the guidance on State aid protects against the distortion of competition. In the first instance, it is for airport operators and airlines to determine and fund airport operations and air services respectively, based on market conditions. However, it is recognised that aviation plays an important role in connecting peripheral and development regions and the UK accepts that State aid may be necessary where local economic conditions cannot support basic airport and airline services. In such circumstances, State aid provides a legitimate tool to subsidise vital air connections and economic and social development in peripheral regions or islands.

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11 [http://www.caa.co.uk/default.aspx?catid=80&pagetype=88&pageid=1&sglid=1#Data](http://www.caa.co.uk/default.aspx?catid=80&pagetype=88&pageid=1&sglid=1#Data)
27. We consider it important that the 1994 and 2005 Aviation Guidelines are applied in a consistent way across Europe. The excessive or inappropriate use of State aid has significant potential to distort competition. In particular, State aid should not be used for services where the volume of passengers clearly points to services being commercially viable in their own right.

28. However, an area where the current guidelines may not be meeting their intended objectives to protect and support peripheral and development regions is in relation to start-up aid. This is particularly relevant in respect of the regions of Scotland, Northern Ireland and Wales within the UK. Further details are provided in response to section E.

29. Sector-specific rules for the aviation sector, as well as those the EC provides for many other sectors, can provide greater legal certainty than general rules to recipients of public funding, and may also serve to some extent as a deterrent to excessive public financing as they leave less room for interpretation of the more general rules for State aid.

30. Sector-specific guidelines might also be particularly valuable in sectors, such as aviation, where there is growing commercialisation and liberalisation, as the acceptable parameters for State aid might change over time. Further, guidance can be a way for the Commission to support its general policy objectives for the aviation sector.

31. Due to the wide scope for potential distortions and the additional legal certainty they provide, the UK considers that sector-specific rules for State aid in the aviation sector are still necessary.

B.2. Information on business models by airport operators and airlines

1. Since 2000, the following aid has been granted by the UK and approved by the EU under the aviation sector-specific guidelines (details are available on the DGCOMP state aid cases database):

- Airline Insurance (NN90/2001 and NN43/2002)
- Aid to airlines for closure of airspace (N854/2001)
- Aid of a Social Character for Air Services in the Highlands and Islands of Scotland (N169/2006)
- City of Derry Airport (NN21/2006)
- Newquay Cornwall Airport Development (N303/2007)
- Aid of a Social Character for Air Services in the Highlands and Islands of Scotland (N27/2008)
- Newquay Cornwall Airport Development (N269/2009)
- Derry City, owner and operator of City of Derry Airport, that has no separate legal personality (NN65/2009)
- Aid of a Social Character for Air Services in the Highlands and Islands of Scotland (SA.32497)
2. Separately, in the UK, there are a total of 20 PSO air services under Regulation EC 1008/2008, most of which (19) comprise lifeline air services in Scotland. The Scottish Government operates three PSOs to Barra, Campbeltown and Tiree from Glasgow. Argyll and Bute, Orkney, Shetland and the Western Isles Councils also support PSOs operating within their own boundaries. The remaining PSO relates to the provision of an air service between Cardiff and Anglesey, linking north and south Wales. Table 1, below, sets out the PSOs currently in operation in the UK.

Table 1: UK PSO routes

<table>
<thead>
<tr>
<th>UK PSO routes</th>
<th>Route between</th>
<th>Current operator</th>
<th>Contract expires</th>
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<tr>
<td></td>
<td>ICAO Name</td>
<td>ICAO Name</td>
<td>CRCO Name</td>
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<tr>
<td><strong>To/from mainland Scotland</strong></td>
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<td>EGPF Glasgow</td>
<td>EGEC Campbeltown</td>
<td>1755 Loganair Ltd</td>
<td>31/03/2013</td>
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<tr>
<td>EGPF Glasgow</td>
<td>EGPU Tiree</td>
<td>1755 Loganair Ltd</td>
<td>31/03/2013</td>
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<td>EGPF Glasgow</td>
<td>EGPR Barra</td>
<td>1755 Loganair Ltd</td>
<td>31/03/2013</td>
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<td><strong>Western Isles (Outer Hebrides)</strong></td>
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<td>EGPL Benbecula</td>
<td>1755 Loganair Ltd</td>
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<tr>
<td>EGP Benbecula</td>
<td>EGPR Barra</td>
<td>1755 Loganair Ltd</td>
<td>31/03/2013</td>
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<tr>
<td><strong>Orkney</strong></td>
<td></td>
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<tr>
<td>EGPA Kirkwall</td>
<td>EGBP Papa Westray</td>
<td>1755 Loganair Ltd</td>
<td>31/03/2013</td>
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<td>EGPA Kirkwall</td>
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<td>n/a Foul</td>
<td>9605 Directflight</td>
<td>31/03/2013</td>
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<td>23396 Hebridean Air Services</td>
<td>31/03/2014</td>
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<tr>
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<td>EGOV Valley (Anglesey)</td>
<td>6705 FLM Aviation (operating service on behalf of Manx2.com)</td>
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</tr>
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</table>

Notes

1.) Hebridean Air Services operated the Argyll and Bute routes under “emergency procedures” until mid-May following the failure of Highland Airways. On 15 May it was awarded the tender until 2014.

2.) A number of these routes are probably served on a VFR basis, for example those involving aerodromes without ICAO designators.
3. State aid in the aviation sector can, in certain circumstances, be justified, particularly if access to a region is of particular concern for the economic development of that region and private investment is not forthcoming - for example, if start-up costs are very high or the passenger base is very small at the outset (but the service is expect to become commercially sustainable after a short time). Through this aid, regional development and growth could be encouraged, which might also meet the Commission’s objectives of contributing to easing congestion at other airports and increasing the mobility of EU citizens.

4. However, public financing that constitutes State aid can also have a range of undesirable effects and therefore must be assessed on a case-by-case basis according to a range of strict criteria to ensure that it is suitable and appropriate in each particular situation, and does not have unduly detrimental effects on private investment or on competition at any level of the aviation sector.

5. The stated objective of the 2005 Aviation Guidelines, in paragraph 21, is to take “a positive approach to developing regional airports while at the same time ensuring strict compliance with the principles of transparency, non-discrimination and proportionality so as to prevent any distortion of competition which would not be in the common interest in terms of public funding to regional airports and State aid to airlines.” In order to accomplish this aim, it is necessary to assess prior notifications of potential State aid on a case-by-case basis according to the clear and strict criteria set out in the 2005 Aviation Guidelines.

6. On this basis, the UK considers that the level of regulation imposed by the 2005 Aviation Guidelines is appropriate in meeting the purpose for which they have been established.

B.3. Definition of relevant markets for airports and airlines

1. Airport categorisation according to passenger numbers can provide a useful initial indication of airport size, and remains appropriate in light of the evolution of the sector. However, a more complete picture of the size of an airport’s operations could be obtained by also accounting for the annual level of cargo tonnage. The number of annual aircraft movements is an alternative measure that may also add to the analysis. In addition, the location of an airport could be a material consideration, especially where airports are located in peripheral and development areas with no alternative high speed surface connections.

2. In principle, the UK considers airport size is a useful initial filter to rule out, at an early stage, the biggest airports at which State aid would not fulfil the State aid criteria. It should be followed, where relevant, by a thorough analysis of potential and actual substitutes for an airport’s air transport services. Competitive constraints faced by an airport may arise from neighbouring and non-neighbouring airports, as well as from inter-modal substitutes such as rail and road. Analysing these constraints would give a
more complete picture of the relevant market in which the airport is located and of the effects of any potential State aid on that market.

3. There might be merit in introducing a Block Exemption for small airports as State aid given to smaller airports is less likely to cause significant wider distortions of competition and private investment. Ideally, a well defined Block Exemption would remove investigations of State aid cases that would be expected to meet the State aid criteria, therefore lessening the regulatory burdens on both the Commission and the Member States and facilitating timely investment. However, in practice it might be difficult to define an appropriate threshold that would be high enough to be applicable to a critical number of cases but low enough to ensure that it does not capture cases in which State aid could have distorting effects that would require further investigation. The diversity of the structures and sizes of airport markets across the EU further complicates finding a threshold that would be appropriate for all countries. The inclusion of geographical criteria limiting the application of a Block Exemption to airports in peripheral and development areas could help mitigate distorting effects. Further criteria could be included to address situations where traffic at category C and D regional airports is declining.

4. The CAA has recently considered the issue of market definition for airports markets, while developing its Market Power Assessment Guidance. In general, the UK considers that all relevant competitive constraints should be analysed, whether falling within or outside the defined relevant market, which might include the constraints from airports across the European Union and potentially other modes of transport. For example, the CAA’s Aviation Trends for the 4th quarter of 2008 includes evidence that air transport routes from London to Brussels and from London to Paris have been constrained by Eurostar high-speed train services.\(^\text{13}\) Chapter 3 of the CAA’s Market Power Assessment Guidance provides an in-depth discussion of relevant factors in market definition for airport markets.\(^\text{14}\)

5. In the UK, the Office of Fair Trading and the Competition Commission deal with competition issues regarding the airline market, and have experience in competition cases involving airlines. Additionally, the European Commission has set precedents in its case law on the subject of market definition for airline markets. Relevant cases include Air France/KLM (M.3280), Ryanair/Aer Lingus (M.4439) and Delta Airlines/Northwest Airlines (M.5181). The CAA regulates airlines with regard to issues such as safety, compliance with EC regulations, and allocation of scarce capacity.

\(^{13}\) http://www.caa.co.uk/docs/80/ERG_AviationTrends_Q2_2008.pdf

\(^{14}\) http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf
C. FACTUAL INFORMATION ON THE REGULATORY AND ECONOMIC ENVIRONMENT

C.1. Airport’s economic activity and activities falling within the public policy remit

1. The UK is generally content with the current 2005 Aviation Guidelines in respect of the division between economic activities and activities falling within the public policy remit. The current guidelines provide sufficient clarity on the split between economic and public policy activities, while allowing scope for unlisted specific activities to be considered on their individual merits.

2. In the UK, activities involved in airport management and operation performed by the airport operator, with regard to services provided to airlines, are classified as economic activities within the meaning of EU State aid law. This would also include compliance activities by airlines and airport operators with safety rules and regulations unless a party carries out a safety function clearly defined and funded by the UK Government. Financing of the activities and equipment required for safety compliance is funded by the undertaking carrying out these activities. The same applies also to the financing and carrying out of firefighting services in compliance with the relevant legislation and regulations.

3. Police and customs activities are considered to be non-economic activities at an airport as they are provided and funded directly by the State. The CAA performs the role of aviation safety regulator in the UK.

4. Services that fall within the scope of air traffic services are currently provided by a number of suppliers:

   - En route air traffic services are supplied exclusively by NATS (En route) plc (NERL) from one of its area control centres. It does so under a licence issued under section 6 of the Transport Act and which is monitored and enforced by the CAA. NERL is obliged to provide a number of Core Services and Specified Services, details of which can be found in the Licence[^15].

   - Local air traffic services are supplied at individual aerodromes either directly by the aerodromes themselves or under contract to air traffic suppliers. The largest of these suppliers is NATS (Services) Ltd (NSL) which currently has contracts at 14 airports including each of BAA’s UK airports. Measured by aircraft movements handled at UK airports that report movements to the CAA NSL has a market share of above 60% as of 2010.

5. Air traffic services at aerodromes are not provided in accordance with a licence issued under the Transport Act as they have been exempted from licensing until 2019 by the Air Traffic Services (Exemption) Order 2011 (SI 2011 No.425).

[^15]: [http://www.caa.co.uk/docs/5/ergdocs/20110101NERLLicence.pdf](http://www.caa.co.uk/docs/5/ergdocs/20110101NERLLicence.pdf)
6. The UK believes that the question of whether NERL and NSL are undertakings for the purposes of competition law is a legal issue on which ultimately only the courts can provide a definitive answer. As doubts had been expressed on the status of providers of air traffic services in competition law, the CAA obtained legal advice that came to the conclusion that NERL was not an undertaking and that NSL was probably not an undertaking\(^\text{16}\). The CAA’s 2006 statement on whether NERL and NSL are undertakings can be found on the CAA website\(^\text{17}\). In due course, the CAA will wish to review the 2006 statement.

C.2. Services of general economic interest

1. The UK is content with the current framework established in the 2005 Aviation Guidelines and the 2005 Commission Decision on services of general economic interest for assessing compensation given to airports.

2. In relation to the provision of PSOs for airport services, the UK considers it is important that the guidelines protect against the distortion of competition. It is for airport operators to determine and fund airport services based on market conditions. However, the UK recognises that aviation plays an important role in connecting peripheral and development regions and accepts that PSOs may be necessary for airports located in peripheral areas, where local economic conditions cannot support the funding of airport services.

3. In these circumstances, PSOs provide a legitimate tool to subsidise air connections in order to ensure territorial cohesion and economic and social development in remote regions or islands.

C.3. Factual elements to be taken into account for the application of the market economy investor principle

C.3.1. With regard to the public funding of airport operators (e. g. financing of infrastructure investments, capital injections, etc.)

1. The UK is content with factual elements considered in the 2005 Aviation Guidelines with regard to the application of the Market Economy Investor Principle (MEIP) to public funding of airports.

2. MEIP provides an effective way of evaluating public investment plans to assess whether they may constitute State aid by offering favourable terms to the recipient, while maintaining the European Commission’s principle of neutrality with regards to ownership. The CAA considers that while the application of the MEIP may encounter difficulties, as evidenced in the case of\(^\text{16}\) This conclusion has been further supported in the more recent judgment of the CJEU in Case C-113/07P SELEX Sistemi Integrati SpA v Commission and Eurocontrol [2009] ECR I-0000.

\(^\text{17}\) http://www.caa.co.uk/docs/5/ATSCompetitionLaw040406.pdf
the establishment of Ryanair at Charleroi\textsuperscript{18}, the factual elements set out in the 2005 Aviation Guidelines provide a clear, transparent framework within which to assess State aid to either airports or airlines.

C.3.2. With regard to support by airport operators and/or public authorities to air carriers (e. g. marketing support, rebates schemes and start-up support etc.)

The UK is content with factual elements considered in the 2005 Aviation Guidelines with regard to the application of the MEIP to public funding of air carriers.

D. FINANCING OF AIRPORTS

D.1. Financing of airport infrastructure

1. In relation to the provision of State aid for the development of airport infrastructure, the UK considers it is important that the guidelines protect against the distortion of competition. It is for airport operators to determine and fund airport developments required, based on market conditions. However, the UK recognises that aviation plays an important role in connecting peripheral and development regions and accepts that State aid may be necessary for airports located in peripheral areas, where local economic conditions cannot support the funding of basic airport infrastructure.

2. The compatibility criteria set out in paragraph 61 of the 2005 Aviation Guidelines provide acceptable levels of legal certainty and contribute to the predictability of the Commission's decisions in individual cases. These criteria for evaluating public financing when State aid cannot be ruled out ensure that any aid that meets them is clearly-defined, necessary and would not affect the development of trade to an extent contrary to the Community interest. Although it is important for these criteria to be phrased generally for them to remain applicable on a case-by-case basis, they nevertheless provide an appropriate test to ensure that approved State aid should not be detrimental to competition in the aviation sector.

3. Further guidance could usefully provide additional clarity on the maximum aid intensity for types of infrastructure investment and airports, along with further indications on eligible costs, airport catchment areas and degrees of competition with other airports and high speed rail.

4. An airport’s size and the number of proximate airports can be useful indicators of the effects of potential State aid, although they would not be

\footnotesize{\textsuperscript{18} Commission Decision 2004/393/EC of 12 February 2004 concerning advantages granted by the Walloon Region and Brussels South Charleroi Airport to the airline Ryanair in connection with its establishment at Charleroi (OJ L 137, 30.4.2004, p1) and subsequent annulment decision by the Court of First Instance Case T-196/04 of 17 December 2008.}
sufficient to provide a complete analysis of possible distortions to competition. In order to accurately analyse the possible distortions of competition arising in a particular case, all the relevant competitive constraints that are faced by the airport receiving the public financing need to be considered. Chapter 3 of the CAA’s Market Power Assessment Guidance provides an in-depth discussion of relevant factors in market definition for airport markets.19

5. Public funding that passes the MEIP test would not necessarily create any distortions as it would take the place of private investment which may not be forthcoming. It should not then crowd out private investment. However, public investment which constitutes State aid, offering the recipient terms more favourable than those on the market, has the potential to distort competition as it would give its recipient advantageous terms compared to those on offer to its competitors, and to crowd out investment that might otherwise have been forthcoming from private investors.

6. As with all regional development aid, public financing of regional airports can provide both positive and negative externalities, depending on its nature. As with private investment, funding for the development of a regional airport’s infrastructure can stimulate the regional economy by offering an improved transport platform from which air transport links can operate and improve accessibility the region. This could, for example, have the positive externality of stimulating economic growth in the area surrounding the airport and lead to the creation of employment, possibly through development of industry or increased tourism. These effects would be reinforced by the synergies that may occur at the airport due to the public financing raising its profile and attracting further traffic. However, a potential negative externality would be that State aid simply redistributes economic activity from one region to another rather than generating additional economic activity. Another potential cost of this growth in air traffic could be higher levels of air and noise pollution. The decision to develop regional airports through public funding should therefore be made with consideration of all the possible positive and negative externalities associated with greater air traffic.

7. Any public funding that may constitute State aid towards an airport must be assessed against the criteria set out in the 2005 Aviation Guidelines to ensure that any investment found to constitute State aid is only approved under strict criteria to minimise distortion to the market. Public financing that passes the MEIP test and has been assessed not to constitute State aid should in principle have the same effects on the market as private investment, as an investor reacting to market signals should face the same risk and offer the same terms to the recipient airport regardless of whether they operate in the public or private sector. Generally, investors responding to market risk and returns would only invest efficiently in order to maximise their return, and consequently should not require the introduction of prescriptive conditions for an investment project that does not constitute State aid.

19 http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf
8. The CAA has previously made use of catchment areas in market definition for airport competition. The CAA’s paper “Empirical methods for assessing geographic markets, in particular competitive constraints between neighbouring airports – update” provides details on previous definition of catchment areas by the CAA and the UK Competition Commission.

D.2. Aid for operation of airport infrastructure

1. The UK is generally content with the current 2005 Aviation Guidelines in respect of public funding for airport operating and maintenance costs.

2. In relation to the funding of airport operating costs, it is important that the guidelines continue to protect against the distortion of competition. The majority of the major UK airports are now either wholly or partly under private ownership and none receives any form of aid for the operation of airport infrastructure. Consequently, the UK strongly agrees with the European Commission’s consideration that “an airport operator, like any other business, should meet the normal costs of operating and maintaining the airport infrastructure from its own resources.” However, the UK also acknowledges that there are exceptions where operating aid may be justified, under certain conditions in disadvantaged regions and if it is necessary for the operation of a service of general economic interest.

3. As the European Commission sets out in the guidelines, the Altmark decision provides conditions under which aid to an undertaking performing a service of general economic interest does not constitute State aid, while paragraph 66 sets outs the minimum content requirements for documenting the award of public service missions. The UK considers these to be clear and not in need of revision.

4. The UK considers the Commission’s current approach to the compatibility of public financing for airport services to be adequate and that the guidance is sufficient clear.

D.3. Aid for airport services

1. The UK is content with the current 2005 Aviation Guidelines and the Commission’s approach in respect of public funding for airport services, such as ground-handling services.

2. In relation to the funding of airport services, it is important that the guidelines continue to protect against the distortion of competition. It is for airport operators to determine and fund airport services based on market conditions. However, the UK recognises that aviation plays an important role in connecting peripheral and development regions and accepts that State aid

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20 http://www.caa.co.uk/default.aspx?catid=5&pagetype=90&pageid=12274

21 2005 Aviation Guidelines para62
may be necessary for airports located in peripheral areas, where local economic conditions cannot support the funding of basic airport services.

**E. START-UP AID**

1. In relation to start-up aid, it is important that the guidelines protect against the distortion of competition. Airlines operate in a competitive, commercial environment and it is for individual airlines to determine the routes that they operate. However, the UK recognises that aviation plays an important role in connecting disadvantaged regions and accepts that start-up aid may be necessary to establish air services to airports located in peripheral and development areas, where local economic conditions prove unattractive to airlines.

2. The UK supports the Commission’s use of strict and extensive compatibility criteria set out in paragraph 79 of the 2005 Aviation Guidelines, as they are conducive to limiting start-up State aid to appropriate circumstances and routes, which would minimise the risk of distortions to competition. However, following the use of airport size categories in paragraph 79(b) as initial indicators, it remains important that a full analysis of competitive constraints is performed in each case, as this would more fully take into account the potential for distortions to competition.

3. The 2005 Aviation Guidelines had a serious impact on start-up aid granted through local Route Development Funds in the UK between 2002 and 2007. The current limitation of start-up aid to services operating from category C and D airports (and B in extraordinary circumstances) is an appropriate initial selection criterion in assessing potential State aid, allowing the in-depth assessments to be undertaken only in cases where approval for State aid may be likely to be given. However, in such cases, it is important to analyse all the relevant competitive constraints faced by an airport in determining the potential impacts on competition of the start-up aid in each case.

4. The limits to start-up aid in terms of duration and intensity reinforce its intended purpose of providing aid to starting up a service that would be commercially sustainable after the start-up period. They create incentives for the airline operator of the recipient route to increase passenger traffic on the route. The digressive nature of the aid provides an incentive for the recipient route to be operated in a cost efficient way and provides for a decreasing potential impact on competition over the three years for which the aid could be granted.

5. Route-specific aid can have the positive externality of raising the profile of the airport from which the route is operated, and may attract other airlines to begin operating from the airport as well as more economic activity in the region generally. Although there is the risk that start-up aid would create distortions in competition between regions, since it would not be issued to all regions, the conditions attached to any aid approved by the 2005 Aviation
Guidelines would serve to mitigate such distortions. The UK RDFs were required to adhere to a stringent UK protocol and local scheme rules developed on the basis of the 2005 Aviation Guidelines. Additionally, it is worth noting that there are also alternatives to route-specific start-up aid, such as regional joint marketing initiatives.

6. However, the current 2005 Aviation Guidelines on start-up aid may not be providing sufficient scope to support the establishment of routes to peripheral regions of the EU. Although the current guidelines may be appropriate to cater for the characteristics of continental Europe, they are proving disadvantageous to the more peripheral regions of Europe like Northern Ireland, Scotland and Wales.

7. In the peripheral regions of the EU, where there is no high speed rail alternative, there is a greater reliance on air travel to access existing and developing markets. Airport passenger bases are potentially smaller and the risk inherent in starting up new air services is therefore correspondingly greater. The provision of start-up aid allows the risk inherent in the start up of new routes to be shared by airlines and local public authorities - a risk which is greater for peripheral regions of the EU. There is little in the current guidelines that adequately addresses these issues.

8. Separately, the current EU guidelines are silent on connectivity with airports outside the EU. For peripheral regions of the UK, the development of such links may assist the development and support of business connections with existing and emerging markets and direct economic benefits these can deliver. The current guidelines do not offer sufficient flexibility for peripheral regions to be supported by start-up aid which is based on the specific economic needs of those regions. Greater scope within the guidelines would offer an opportunity for the aviation sector to contribute to economic regeneration of those regions, increasing inward investment and higher value added employment whilst increasing tourism opportunities.

9. In addition, the current guidelines restrict support to EU carriers only. Allowing the provision of start-up aid to non EU carriers could increase the scope and competition for new services to be established to peripheral regions, by providing a large pool of eligible airlines. Should start-up aid be permitted for services from small or large regional airports in the EU to airports outside the EU, as suggested above, such services may prove more attractive to non-EU carriers, which may provide links to their hub airports. It may then possible to widen the scope for start-up aid while not necessarily increasing the risk of potential distortions to competition.

10. Finally, in a scenario where there is no displacement of services or distortion of competition, nor any strong sustainable economic growth and

increased connectivity across Europe and beyond, the annual volume of an airport’s passengers may be immaterial to the assessment of potential State aid. The current categorisation system, with its emphasis on annual passenger volume, effectively rules out the possibility of start-up aid from certain airports prior to the assessment of any potentially distortive effect. As a result, the guidelines could be ruling out support for services that would not distort competition. Nevertheless, as set out in our response to section B.3, we consider it is important to analyse all the relevant competitive constraints on the airport and route in question for each case of potential State aid.

11. Regardless of scope, it is important that any start-up aid support mechanisms are transparent, non-discriminatory and time limited. Such start-up aid schemes should only support routes where there is an identifiable economic benefit in terms of improving business connectivity, encouraging inward investment and making the region more accessible for inbound tourism.

F. 1994 Aviation Guidelines

1. The UK believes that the 1994 Aviation Guidelines remain appropriate in light of development in the market and that they complement, by addressing potential State aid issued to airlines, the 2005 Aviation Guidelines. The introduction and enforcement by the European Commission of the 1994 Aviation Guidelines have contributed over time to a significant reduction of State aid to EU airlines and have contributed to the development of competition between airlines.

2. The 1994 Aviation Guidelines include relevant guidance on public service obligations and aid of a social character, which remain relevant today. The elements covering restructuring aid appear to serve their purpose and may no longer be relevant.

3. Separately, we have noted the following typographical error in paragraph 74 of 2995 Aviation Guidelines. We suggest that the last sentence should read: “The Commission will ensure that such aid does not give any advantage to large airport already largely open to international traffic and competition.”

G. Further Information

Nil return