Thessaloniki Forum – Working group meeting on Market Power Assessments September 2017
Topics

1. Approach to regulating airports
2. Approach to conducting MPAs
3. Conclusion
Approach to regulating airports

- Certain airports should be automatically subject to effective economic regulation
  - airports where airlines have significant operations (e.g. hubs)
  - airports with the highest passenger movements in a Member State
  - airports operating as a network (under same ownership/management)
  - airports operating at full capacity
  - dual till airports

- Airports serving major cities and/or very specific niche markets are also likely to have market power
- Independent authorities should identify airports that meet the market power criteria and ensure that effective economic regulation is applied
Legislation in some countries already assumes market power

- **France**
  - French commercial code (Code du Commerce) provides for price regulation for monopolies after “consultation” with competition authority
  - Aéroports de Paris is subject to economic regulation which is applied through 5-year regulatory agreements (Contrat de Regulation Economique)
  - These are applied without MPAs – Competition Authority commented on framework in 2005

- **Netherlands**
  - Operating Decree for Schiphol airport (2006) recognises that there are no substitutes available for facilities or services covered by economic regulation
  - The new Aviation Act/Operating Decree came into force in 2017 without an MPA

- **Switzerland**
  - 2016 Aviation policy recognises monopoly position of airports
  - Aviation Law imposes cost based charges although Federal Council can determine costs and revenues to be included in charges calculation
  - Swiss Price Watchdog (Surveillant des Prix) has recommended application of Single Till to reflect charges setting in a competitive environment and prevent excessive charges
Approach to conduct MPAs when necessary

1. Identify sources
   • Competitive constraints
   Commission notice (97/C 372/03):
   - Demand substitutability
   - Supply substitutability
   - Potential competition

2. Define market
   • Define the product market
   • Define the geographic market

3. Assess market dynamic
   • Assess if market dynamics counteract market power

4. Conclusion
   • Conclude on degree of market power for the airport in that market

- Passenger and airline choices
- Airlines are in competition
**Demand substitutability: locational preference of passengers**

### Metrics and Sources

<table>
<thead>
<tr>
<th>Fixed origin and destination or highly flexible</th>
<th>Factors influencing preference to travel from or to a local airport</th>
<th>Availability of comparable airline services at alternative airports</th>
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</table>
| Assess composition of travel market (Source: Passenger surveys). | - Time cost (Source: ECTRL CBA guidelines)  
- Surface mode travel cost estimation (Source: Service providers)  
- Population concentration (Source: National statistical agencies)  
- Airline fare differential between alternative airports (Source: IATA DDS) | Unique routes & schedules at an airport within the considered market (Source: IATA SRS Analyzer) |
### Demand substitutability: evidence on locational preference of passengers

<table>
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<tr>
<th>Most trip choices of passengers are fixed</th>
<th>Most passengers have a strong preference to travel from or to a local airport</th>
<th>Availability of comparable airline services at alternative airports</th>
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- IATA 2015 airs@t survey:
  - 60% were business or VFR
  - 36% holiday
  - 4% religious and other

- In Europe, travelers purchasing discount economy tickets on the day of departure has remained stable since 2011 at 1.4% - 1.6% (Source: IATA analysis)

- Frontier survey:
  - 1% increase in surface distance reduces likelihood of passenger flying from that airport on average by 4%
  - For every 1% increase in distance a 1% change in relative prices is needed to persuade passengers to use more distant airport

- MPA by GAP of AMS found that the number of unique routes available is a key factor for passenger choice of AMS compared to alternative airports

- Frontier Economics analysis showed that LHR served 66 unique destinations among London airports in 2013 (based on OAG data).
Supply substitutability: airline switching costs

**Metrics and sources**

**Operational requirements**
- Availability of capacity (Source: Slot coordinators)
- Availability of appropriate infrastructure - runway, gates, etc. (Source: Airport specifications)

**Direct switching costs**
- Rebasing costs (Source: Airline surveys)
- Yield loss
- Sunk cost
- Marketing
- Renegotiation of contracts (Source: Airline surveys, IATA DDS)

**Indirect switching costs**
- Loss of economies of scale
- Managerial complexity
- Higher transaction costs (Source: Airline surveys)

**Loss of network economies**
- Revenues and share of operations from interconnected services (Source: IATA DDS)
Supply substitutability: other considerations

- **Capacity expansion**
  - Only relevant consideration if capacity becomes available over the short term (period under review)

- **New airport**
  - Construction/availability of capacity has to be imminent
  - Quality, accessibility, facilities etc have to be similar to be considered a viable alternative

- In both cases, switching costs also relevant
Define product and geographical markets

- **Define the product market**
  - Commission notice on the definition of the relevant market: 'A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use'.
  - Evidence: views of customers and competitors, consumer preferences, barriers and cost associated with switching to product substitutes, different categories of customers and price discrimination

- **Define the geographic market**
  - Based on the respective product market
  - Evidence: demand characteristics, views of customers and competitors, consumer preferences, current pattern of purchases, barriers and switching costs.
  - Lisbon airport and Orly do not serve the same demand/geographic market
The potential “threat” of airline switching cannot be automatically considered a competitive constraint

- Airlines serve underlying travel market
- Must not confuse network optimization with switching
- Withdrawing from an airport is also not the same as switching: if an airline chooses to stop operating at an airport, it does not mean that there is a substitute but rather than it simply will not serve demand at that airport
- And even if one or more airlines chose to remove aircraft or switch, it may not necessarily be sufficient to constrain an airport’s behaviour
Concept of countervailing buyer power

- UK CAA market power determinations – for an airline to have buyer power it would typically need to:
  - Have at least one substitute airport to which it could credibly threaten to switch in response to that particular airport operator’s behavior
  - Represent a significant proportion of a particular airport operator’s business
    - if constrained capacity/excess demand, airports face little or no downside traffic risk from an airline moving its services to another airport
  - Have the ability to switch sufficient volumes to discipline the proposed price increase
    - Rebasing of marginal aircraft will not discipline overall airport behavior
Conclusions

- Important to regulate appropriately where airports have market power

- Abuse of market power results in inefficient operations and investments, excessive charging/profit taking and inadequate service delivery

- Certain airport characteristics already indicate that airports have market power

- MPA can conclude on whether an airport has market power where there is any doubt, taking into consideration demand and supply side substitutability and any competitive constraints