OFFICE OF FAIR TRADING

Anticipated acquisition by easyJet Airline Company Limited of GB Airways Limited

No. ME/3399/07

The OFT's decision on reference under section 33(1) given on 18 January 2008. Full text of decision published 24 January 2008.

Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **easyJet Airline Company Limited** (easyJet Ltd) is a wholly owned subsidiary of **easyJet plc** (easyJet). easyJet provides short haul scheduled passenger airline services on 339[1] routes between airports in Europe (and to some destinations in North Africa).

2. **GB Airways Limited** (GB Airways) is a subsidiary of **Bland Group Limited.** It owns 16 passenger aircraft and operates scheduled flights to 32 destinations from London Gatwick (LGW) and London Heathrow (LHR) airports, and six scheduled destinations from Manchester. These destinations are within Europe and North Africa, mostly around the Mediterranean Sea.

3. Since 1995 GB Airways' services have been provided as a franchisee of British Airways plc (BA), pursuant to a licence agreement with BA. GB Airways' flights are marketed by BA under the BA brand as BA scheduled flights. The service provided (travel classes, onboard service, aircraft livery, flight attendants' uniforms, etc.) is the same as for any other BA flight.

[1] As at 9 November 2007.

Seats on these flights are also sold primarily using BA's distribution channels.

TRANSACTION

4. The transaction consists of the acquisition of the entire issued share capital of GB Airways by easyJet for a consideration of £103.5 million by means of a share purchase agreement signed on 25 October 2007. The transaction will result in GB Airways and easyJet ceasing to be distinct enterprises. For its last complete financial year (the year ended 31 March 2007) GB Airways achieved a turnover in the United Kingdom of £207,520,639.

5. The parties notified the transaction to the OFT on 9 November 2007, and the (extended) administrative deadline was 10 January 2008.

JURISDICTION

6. As a result of this transaction easyJet and GB Airways will cease to be distinct. The UK turnover of GB Airways exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

7. The parties overlap in the provision of scheduled passenger airline services on the following 'fun and sun' leisure routes from LGW:

- LGW – Alicante
- LGW – Malaga
- LGW – Faro
- LGW – Ibiza
- LGW – Mahon
- LGW – Palma
- LGW – Marrakech
- LGW – Innsbruck

8. On some routes easyJet also operates to the destination from Luton or Stansted airports. In the case of LGW – Alicante, easyJet also operates flights from LGW to a nearby airport in Murcia.

9. In addition, both parties operate flights from London to Funchal (GB Airways flies from LGW, and easyJet from Stansted airport) and from Manchester and Liverpool to Innsbruck (GB Airways operates from Manchester airport and easyJet from Liverpool airport).

Origin and destination markets

10. Customers normally wish to fly from a specific origin to a specific destination. Past decisional practice[2] has therefore considered the relevant starting point for market definition of scheduled passenger air transport services to be 'origin and destination' (O&D) pairs.[3] The OFT has taken a similar starting point in this case, and consistent with these same cases, has then considered whether it may be appropriate to narrow or widen the market from the starting point of a particular O&D pair.

'No-frills' v full service carriers

11. In *Ryanair/Aer Lingus* the European Commission observed that, although airlines may seek to differentiate themselves, they no longer fall clearly into no-frills or full service categories.[4] It concluded that, for the purpose of the overlap routes in that case, it was not appropriate to define separate markets for full service and no-frills carriers, although the distinction may impact on the closeness of competition. In this case, easyJet identifies itself as one of the first 'no-frills' airlines in Europe, while GB Airways operates under the BA brand, traditionally regarded as a full service carrier. However, consistent with the European Commission's approach in *Ryanair/Aer Lingus* and the nature of the overlap routes in this case (that

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[2] See, for example, the OFT's decision *Anticipated acquisition by Flybe Group Limited of the BA Connect business of British Airways plc* (7 February 2007) (*Flybe/BA Connect*) and the European Commission decision *Case No COMP/M.4439 – Ryananir/Aer Lingus* (27 June 2007) (*Ryanair/Aer Lingus*).

[3] GB Airways also sells a number of seats to tour operators, who may then integrate these seats into a package holiday. In relation to the overlap routes, this is particularly the case with Manchester – Innsbruck, [ ]. While a 'wholesale' market has been considered in previous decisions, easyJet does not supply other tour operators, although it does use its own flights in its new easyJetHoliday business. The wholesale market, and the Manchester / Liverpool – Innsbruck overlap, is therefore not considered further.

[4] *Ryanair/Aer Lingus* at paragraph 19.

is, the fact that they are 'fun and sun' routes used predominantly by leisure passengers for whom no-frills and full service flight services are considered to be credible alternatives), the OFT has not adopted separate markets for full service and no-frills carriers in this case.

Charter airlines v scheduled airlines

12. Charter airlines traditionally do not sell flights directly to passengers, but to holiday companies as part of a package deal, including accommodation and other services. However, increasingly, charter airlines have started selling 'seat-only' tickets direct to passengers. The OFT considered two possible ways in which charter flights may constrain scheduled flights through demand-side substitution:

    a) charter airlines sell some 'seat-only' tickets, which could act as a constraint on scheduled airlines. However, as the European Commission observed in *Ryanair/Aer Lingus*,[5] although these are broadly similar to seats on scheduled flights, there can still be distinguishing features, including the limited frequency offered and minimum stay requirements, and

    b) if passengers on scheduled flights separately book other elements included in a package holiday (e.g. accommodation), they may compare the price of the 'un-bundled' package, including scheduled flights, with that of the bundled package offered by the charter airline.

13. The parties submitted that it is becoming less and less relevant to distinguish between charter and scheduled services for leisure passengers. They referred to a number of traditional charter airlines who are actively promoting 'seat-only' sales. They also noted that scheduled airlines now allow passengers to create their own 'packaged' holiday by offering accommodation and car hire offers on their websites. Third parties' views on the constraint provided by charter airlines were mixed.

14. In *Ryanair/Aer Lingus* the supply of package holidays is considered separate from seat-only sales, but the European Commission noted that there may be substitutability for seat-only passengers, and the OFT considered the role of charter airlines in *Flybe/BA Connect* on the Birmingham – Geneva

[5] *Ryanair/Aer Lingus* at paragraph 300.

route. In the current case, given the nature of the destinations under discussion, in particular the fact that they are 'fun and sun' routes used predominantly by leisure passengers, the distinguishing features between seat-only sales by charter airlines and scheduled flights are less likely to be important on the basis that passengers on these routes will be sufficiently price sensitive to consider seat-only sales by charter airlines and scheduled flights as viable alternatives.

15. However, the OFT found it difficult to obtain precise figures on the number of seat-only passengers on each route. The OFT could not obtain exact figures from charter airlines and the parties' estimates of seat-only passengers on some routes differed from those suggested by third parties and survey data obtained from the CAA. As a result, the OFT has taken a cautious approach and considered that seat-only sales by charter airlines provide only a limited constraint on scheduled operators on each of the overlap routes. In any event, the degree of the constraint provided by seat-only sales by charter airlines does not affect the OFT's conclusion on the competitive assessment.

16. Since there is a high proportion of package holidays being sold on the overlap routes, and there is a lower proportion of independent travellers on those routes, the OFT considered whether package holidays provided by charter airlines act as a significant constraint on the overlap routes. However, independent travellers on the overlap routes will not necessarily consider a package holiday as substitutable for flight tickets only, and it may be possible to price discriminate against such passengers, suggesting that these passengers will not be protected from price increases by the constraint from those buying package holidays. The OFT (consistent with *Ryanair/Aer Lingus*) does not therefore consider that the potential for customers to switch between package holidays and 'unbundled' package offerings is sufficient to include package holidays in the same relevant market.

17. The parties also submitted that, even if charter and scheduled flights could not be considered as part of the same product market on the basis of demand-side substitution, charter airlines selling package holidays could switch between selling seat-only and package holidays to some extent. There have also been recent examples of traditional charter airlines switching their services from charter to scheduled flights. The OFT did receive some evidence that deals between charter airlines and other holiday

service providers (e.g. hotels) do not last longer than a season, suggesting contractual commitments would not prevent charter airlines switching between seat-only and package holiday sales. However, on considering all of the available evidence, the OFT does not consider that a 5 – 10 per cent price rise to independent travellers would be sufficient for charter airlines to switch away from package holidays to seat-only sales. Third parties suggested such substitution was particularly unlikely where charter airlines also have vertically integrated package holiday businesses.

18. Based on the supply-side considerations summarised above, the OFT has taken a cautious approach, and has not included sales of seats by charter airlines where those seats are sold as part of package holidays in the relevant O&D markets.

Indirect and direct flights

19. The parties submitted that, on some of the overlap routes, indirect services could be relevant to the competitive assessment.[6] Previous decisional practice of the OFT and European Commission[7] has been to consider that indirect flights are less likely to constrain direct flights on short-haul routes, such as those considered here. Given the lack of compelling evidence to the contrary in this case, indirect flights were excluded from the OFT's analysis.

Flights from nearby airports

20. In *Ryanair/Aer Lingus* the European Commission found that all London airports were substitutable in relation to the overlap routes considered in that case. The parties submitted that it is not necessary to come to a view on this issue, but note that in their experience demand-side substitutability between services to LGW on one hand, and Stansted and Luton airports on the other, is not particularly high, but that LGW and LHR are strong substitutes. Third party views received by the OFT in this case were mixed, although the vast majority of third parties felt that there was at least some degree of substitutability between the London airports.

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[6] For example, Royal Air Maroc services on London – Marrakech (via Casablanca) and TAP Portugal services on London – Faro and London Funchal (via Lisbon).

[7] See, for example, *Notification by British Midland and United Airlines of their Alliance Expansion Agreement* (OFT decision of 1 November 2002) (*BMI/United*) and *Ryanair/Aer Lingus*.

21. In relation to the particular overlap routes in this case, the OFT considers that there is significant substitutability between London airports.[8] This is because of the nature of the overlap routes in this case, which are all 'fun and sun' destinations, carrying predominantly leisure passengers, who tend to be less time sensitive and find London airports more substitutable than business passengers. Yield data provided by the parties showed that yields decreased on certain of the overlap routes operating out of LGW when competitors entered from another London airport. However, notwithstanding the conclusion that London airports can be considered in the same market for the purposes of the O&D pairs in this case, for the purpose of the competitive assessment the OFT considers that, all else equal, airlines operating to/from the same London airport are closer competitors than those operating to/from different London airports.

22. With regard to the non-London overlap airports, both the European Commission[9] and the Spanish Competition Authority (Servicio de Defensa de las Competencia)[10] have recently found Alicante and Murcia airports to be substitutable. The parties, and a number of third parties, also submitted that they were substitutable for flights from London airports. The OFT therefore considers these airports together, although again the OFT considers that, all else equal, for the purposes of the competitive assessment airlines operating to/from the same airports are likely to be closer competitors than those operating to/from different airports.

Flights to other holiday destinations

23. The parties submitted that flights to other holiday destinations may constrain the parties' services on the overlap routes, because passengers on leisure or holiday routes are simply looking for 'a week in the sun'. There may be some customers who consider different destinations substitutable to some degree. However, based on the available evidence in this case, the OFT does not expect that this constraint is sufficient to prevent a 5 - 10 per cent price increase on the overlap routes. Evidence obtained from the parties showing that entry onto a specific route reduces yields on that route suggests that this route is not already constrained to

[8] In the context of this case, the OFT considers London airports to include LHR, LGW, Stansted and Luton airports. The OFT has not considered London City airport for the purpose of its analysis in this case, as neither the parties nor their competitors fly from this airport to any of the overlap destinations.
[9] *Ryanair/Aer Lingus* at paragraphs 234 – 241.

the same extent by operations on other (close) routes. The OFT has therefore assumed that different holiday destinations are not substitutable.

Business passengers versus leisure passengers

24. Previous merger cases[11] have distinguished between business and leisure passengers. The information obtained from both the parties and third parties in this investigation suggests that the overlapping routes are dominated by leisure passengers. Therefore, for the purposes of this assessment, the OFT does not distinguish between business and leisure passengers.

Conclusion – market definition

25. Given the factors set out above, the OFT considered the following O&D pairs relevant to the competitive analysis:

- London – Alicante/Murcia
- London – Malaga
- London – Faro
- London – Ibiza
- London – Mahon
- London – Palma
- London – Marrakech
- London – Innsbruck
- London – Funchal

26. On the evidence available in this case, the OFT considers the relevant market to be for the provision of direct scheduled passenger airline services on each O&D pair.

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[10] SDC Decision N-07044 *Air Berlin/LTU*.

[11] For example, see the European Commission's decision in *Air France/KLM* (Case No COMP/M.3280) and the Competition Commission's decision in *Air Canada/Canadian Airlines* Cm 4838 (August 2000).

HORIZONTAL ISSUES

Market shares

27. The OFT had a number of difficulties in determining accurate market shares on each of the relevant O&D pairs. The parties suggested that the charter/scheduled designation given to a flight was not always indicative of its true nature. Flights labelled charter may provide scheduled services, and vice versa. In addition, airline schedules, on the overlap routes in particular, vary throughout the year depending on the high season for leisure travellers. Finally, because a number of competitors had not confirmed their flight schedules for the 2008 summer season, it was difficult to obtain an accurate snapshot of post-merger market shares. While historical market share figures for scheduled flights (by both capacity and passenger numbers) were available, on some routes there had been significant entry and exit since the last IATA season (summer 2007).

28. Notwithstanding the difficulties with obtaining accurate market share figures, it is possible to make some general observations regarding the competitive situation on the relevant O&D pairs at the date of the announcement of the merger:

- market shares varied on a route-by-route basis, and between summer and winter seasons. However, on each of the overlap routes, the merging parties had significant combined market share, based on 2007 capacities. These ranged from just over 40 per cent on some routes (London – Alicante) to over 80 per cent (London – Innsbruck)

- with some exceptions, the parties generally had higher market shares on a LGW basis than an all-London basis

- on some of the overlap routes market shares varied significantly between the summer and winter seasons. While some routes experienced both an increased number of competitors and/or a capacity expansion by existing competitors in summer (e.g. London – Alicante, London – Malaga, London – Faro, London – Ibiza, London - Mahon and London - Palma), ski destinations (London – Innsbruck) and 'winter sun' destinations (London – Funchal, London - Marrakech) experienced increased capacity in winter. Charter airlines tended to have a greater presence during peak seasons, and hence there is likely to be a greater constraint on the parties from seat-only sales during these periods

- on some of the heavily seasonal overlap routes, GB Airways did not offer any off-peak services (London – Ibiza and London – Palma)

- GB Airways sells a significant proportion of tickets to travel agents or for resale as part of a package holiday, particularly on those routes with a significant charter airline presence, and

- with the exception of London – Innsbruck, the parties face competition from a significant competitor (at least during the peak period) on each of the overlap routes (flying from either LGW or another London airport).

29. Overall, the OFT considered that the market position of the parties on each of the overlap routes post-merger suggested that significant pre-merger competition existed between easyJet and GB Airways, and that the remaining competition on the overlap routes (at the date of announcement of the merger) did not provide a sufficient constraint to dismiss competition concerns on a significant majority of the routes in question at this stage of the analysis. The OFT therefore considered prospects for entry and expansion on the overlap routes.

Entry and expansion

30. The parties submitted that there were no significant barriers preventing rival airlines from entering on the overlap routes or expanding their services on that route. They suggested that entry/expansion could occur either through the 'flexing' of existing capacity by incumbent airlines at key airports (especially the London airports), or through expanding capacity at the relevant airports, including 'slot coordinated' airports such as LGW (i.e. a slot co-ordinator, Airport Coordination Limited (ACL), allocates slots to airlines for take-off and landing). Each of these is discussed below.

Flexing of existing capacity

31. The parties submitted that all of their key competitors already have significant capacity across more than one London airport, allowing slot flexing, that is increasing services or starting new services on a particular route by reducing or removing services, and therefore freeing up slots for

use on another route. BA has the largest slot portfolio at LGW and LHR, Ryanair has the largest slot portfolio at Stansted airport and the second largest at Luton airport, and a number of other airlines, such as Monarch, also have significant slot holdings at the various London airports. easyJet submitted that it constantly reviews its route mix to determine whether there are profitable opportunities available, and its competitors do the same. As such, the parties submitted that any attempt to increase fares or decrease services on an overlap route post-merger would prompt entry on that route by way of slot flexing.

32. Third party views on the ability of airlines to flex their current slot holdings (and accompanying assets) were mixed. While most third parties acknowledged that this did occur, some parties suggested that there were costs involved with such a strategy. These costs included:

- obtaining a sufficient number of slots at the destination airport (i.e. the non-London airport) in order to provide a competitive service, and matching the slots with those obtained in London (see discussion below regarding capacity at non-London airports) and the airline's overall timetable

- sunk costs associated with serving a particular route. Marketing costs were cited as an example, but there could also be labour costs and the costs of severing supplier contracts as a result of significantly reducing or terminating services on a particular route, and

- revenue foregone while the new entrant establishes itself on the route.

33. In addition to the costs set out above, third party evidence suggested that operators were less willing to withdraw routes which are important in terms of their overall network, or which already have high yields. Overall, it appears that a number of factors influence the ability to flex across routes, in particular the size of the airline, its current route mix and where the airline is based.

Operating additional services

34. The principal barrier to operating additional services from new slots (as opposed to slot flexing) in relation to all of the overlap routes is obtaining slots at London airports, through either existing spare capacity or obtaining slots from other airlines. The parties maintained that, although London airports face some congestion (LHR, LGW and Stansted are slot-coordinated airports) it is still possible to obtain some slots from the slot co-ordinator, particularly at off-peak times. The parties provided ACL data that shows that at certain times of the day there are spare slots, and argued that as the transaction concerns leisure routes, it is not necessary to offer a number of frequencies throughout the day. GB Airways itself operates several flights at off peak hours. ACL data also showed that slot congestion eased in the winter season, facilitating entry during this period.

35. The parties also claimed that it is possible to obtain slots when airlines reduce existing services from, or exit, London airports, and that there is a steady 'churn' of slots at LHR, LGW and Stansted that enables airlines to build up slot holdings. ACL provided some support for the parties' submissions, stating that despite airport congestion in London, a determined competitor could exploit entry opportunities at LGW, and that it was generally possible to obtain access to Stansted and Luton to operate competing services.

36. easyJet holds itself out as an example of an airline that has been able to build up a slot portfolio at LGW. Since entering in 1999, easyJet has been able to build up a significant slot portfolio. More specifically, easyJet more than trebled its capacity at LGW between June 2002 and June 2007. The parties gave a number of other examples of airlines that had been able to build slot portfolios at London airports.

37. The overwhelming majority of third parties who responded to the OFT's inquiries in this case commented that obtaining suitable capacity in London was extremely difficult, especially during the summer season. Third parties suggested that the situation at LHR is particularly severe, although obtaining slots at LGW is also difficult. There are also problems in getting suitable slots at Stansted, as it is currently constrained in the key peak period for early morning, which is likely to be crucial to low cost airlines aiming for high aircraft utilisation. At Luton airport, slots may be available but aircraft parking is a constraint. These observations are confirmed by a

Frontier Economics report undertaken on behalf of easyJet, [ ]. The *Ryanair/Aer Lingus* decision and OFT decisions[12] have also reached the same conclusion.

Congestion at non-London airports

38. In addition to congestion at London airports, a number of third parties suggested that it was difficult to obtain favourable slot times at some of the non-London overlap airports. The OFT found that some of these airports were congested at certain times of the day (for example, Faro, Ibiza and Funchal) or certain days (for example, Saturday is the busiest day at Innsbruck because it is 'change over' day for the chartered operators), during the peak season.

39. The parties argued that there was general slot availability at all of the non-London overlap airports. Where there was congestion at certain times or on certain days, this was largely due to the presence of charter airlines, with holiday packages typically starting and ending on the same day of the week. Given the leisure nature of the overlap routes, such limited congestion would not be a barrier to entry or expansion by scheduled operators at these airports.

40. The OFT received some evidence from third parties to suggest that there were technical barriers with flying to and from Innsbruck airport, which meant that special training and appropriate aircraft were required to operate Innsbruck services. However, the parties told the OFT that the training costs for landing at Innsbruck airport were relatively insignificant, and noted that a number of major airlines currently serve Innsbruck airport. The OFT does not consider that this barrier is sufficient to deter entry onto the London - Innsbruck route.

[12] See for example, *BMI/United* and *Ryanair/Aer Lingus*.

Evidence of actual entry/expansion

41. As set out above, in this case the OFT received mixed views on whether entry/expansion on the overlap routes would be sufficient in time, likelihood and scope to remedy any competition concerns that may arise from the merger. Despite this, the OFT found that there had been actual recent and, in many cases, significant entry and/or expansion on each of the overlap routes, and in relation to a majority of routes entry and/or expansion had occurred since the announcement by the parties of the merger.

42. Shortly after the merger announcement (and termination of GB Airways' BA Franchise Agreement), BA announced that it would enter five of the overlap routes (London – Alicante/Murcia, London – Malaga, London – Faro, London – Ibiza and London Palma). BA told the OFT that it was able to provide these services through flexing their current slot holdings at LGW (either reducing or removing existing services), and that they were continually looking to optimise their route mix.

43. In addition to this entry, since the merger Ryanair has announced that it will commence services on one of the overlap routes (London – Faro), and has within the last year launched services on two other overlap routes (London – Alicante and London – Palma within the last year), all from Stansted). Ryanair also launched services on London – Marrakech in October 2006. Monarch has also announced that it will commence services on a further overlap route (London – Mahon) from LGW to complement its existing London – Mahon services, and launched services on the London – Ibiza overlap route in the summer of 2007. Third parties also suggested to the OFT that they will continue to review opportunities for entry and/or expansion on the overlap routes.

44. The remaining two overlap routes have also seen recent entry and expansion by easyJet itself. easyJet entered both London - Funchal and London - Innsbruck in the last six months. easyJet also provided a number of examples of entry by competitors onto existing easyJet routes, and in particular onto routes serving the overlap destinations.[13] They also provided examples of its own entry onto routes serving airports at one end of the

[13] That is, entry by competitors where the origin or destination was either London or one of the non-London overlap airports e.g. Newcastle - Malaga, London - Rome.

overlap O&D pair (e.g. Bristol – Funchal and Liverpool – Innsbruck) to illustrate the lack of entry barriers at these airports.

Entry and expansion – conclusion

45. As discussed above, third party views on entry in this case were mixed. A number of third parties suggested that all London airports had limited slot availability, or were otherwise congested, such that entry was difficult. This is consistent with previous OFT and European Commission decisions and investigations. Some third party competitors in this case also suggested that their ability to flex existing capacity was limited, such that they would be unable to quickly adapt their route mix to any change in the competitive conditions on the overlap routes.

46. Notwithstanding the congestion concerns at London airports (and the limited congestion at some of the non-London airports), the OFT has evidence of a number of instances of recent, <u>actual</u> entry onto the overlap routes, many of which have occurred in the short time since the announcement of merger. Evidence indicates that this entry has arisen from a combination of existing capacity (through slot flexing) and through obtaining incremental slot holdings at various London airports. The extent of entry on these routes, despite the difficulties expressed by third parties, is significant when compared to the small number of overlaps in this case and taking into consideration the low frequency on some these (hence the need to obtain/flex only a small number of slots to compete on these routes). The extent of entry also reflects the leisure nature of the overlapping routes, where off-peak entry is sustainable (notwithstanding that it may not constitute the perfect substitute for a peak service) on the basis of leisure passengers being more willing to fly at off-peak times.

47. The OFT's *Mergers: Substantive Assessment Guidelines*[14] provides that a two year time horizon will generally be considered when assessing the potential for entry. Given the actual entry on the overlap routes in the short period since the announcement of the merger, and the evidence of entry and expansion prior to the announcement of the merger, the OFT considers that this, together with the likelihood of further entry and/or expansion on the overlap routes is sufficient to constrain the parties post-merger.

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[14] OFT's Mergers Substantive Assessment Guidance, paragraph 4.23.

Potential competition

48. In *Ryanair/Aer Lingus* the European Commission considered whether the merger would eliminate potential competition between the merging parties. In that case, the European Commission found that, given the pattern of competition between the merging parties, the parties exerted a competitive constraint on each other on a number of non-overlap routes. The OFT therefore considered whether the merger would eliminate potential competition on other routes where the parties did not overlap.

49. GB Airways told the OFT that it had not made any decision to enter new scheduled routes in the last year. In order to enter any new routes, GB Airways would have required BA's consent, [ ]. GB Airways could not therefore be considered a strong potential competitor in relation to non-overlap routes. In terms of competition to enter new routes, since BA approved all the routes that GB Airways entered, the merger could be viewed as moving capacity to enter new routes from LGW away from BA and to easyJet. In this respect, the merger will be 'deconcentrative'. As BA still has a substantial proportion of slots at LGW, easyJet has not eliminated or significantly weakened its main rival, and there remain a number of other potential competitors (at both LGW and London airports generally). [ ]. Therefore, the OFT does not consider that there will be a weakening of potential competition as a result of the merger.

Coordinated effects

50. Coordination may arise when a market has certain characteristics.[15] The relevant question in a merger control context is not whether a market is susceptible to coordination in general, but whether the merger may be expected to increase the probability that post-merger, firms in the same market will tacitly or explicitly coordinate their behaviour to raise prices, reduce quality, limit innovation or curtail output.

51. The OFT has considered whether the merger increases the probability that firms will collude (tacitly or explicitly) by reducing competition in the supply of scheduled passenger services. In particular, the OFT has had regard to

[15] See for example the OFT's Mergers Substantive Assessment Guidance, paragraphs 4.11 to 4.16, and the OFT decisions *Anticipated merger between First Milk Limited and Milk Link Limited (*12 December 2007), and *Anticipated acquisition by Wienerberger Finance Service BV of Baggeridge Brick plc* (11 December 2006).

the explicitly coordinated behaviour involving certain airlines (but not easyJet or GB Airways) that are the subject of recent and ongoing OFT and European Commission investigations.[16]

52. The OFT, however, has not obtained any evidence during the course of its review of the merger that the supply of scheduled passenger airline services is currently the subject of tacit or explicit coordination. The merger reduces symmetry on the overlap routes, on some routes there are a number of competitors, and the threat of entry (or actual entry) will significantly affect incentives (or ability) to coordinate. The OFT considered whether the merger may reduce potential competition by co-ordinated entry onto new routes. Specifically, it increases symmetry between the two large operators out of LGW – easyJet and BA. However, documents provided by the parties suggest that [ ]. In addition, on a London wide basis, there are many other operators that compete (Ryanair, Monarch, BMI, Thomsonfly). Collusion without these players would not be successful. The merger does not affect the competitive structure to such an extent as to make coordination more likely.

53. Accordingly, the OFT does not consider that there is a realistic prospect of the merger enhancing the incentive or ability for market operators to engage in tacit or explicit coordination in the supply of scheduled passenger airlines services.

THIRD PARTY VIEWS

54. The OFT received a number of third party views on the merger, from competitors, customers, suppliers and industry bodies. As set out above, views on a number of issues, including the substitutability of London airports, the constraint provided by charter airlines and airport congestion, were mixed. Overall opinions varied from a lack of concern, due largely to the small number of overlaps and the continuing constraint provided by BA and other airlines, to concerns regarding the ability to compete with the merged entity on the overlap routes and easyJet's overall position at LGW. These concerns have been addressed in the competitive assessment.

[16] See European Commission press release: *Commission confirms sending Statement of Objections to alleged participants in a air freight cartel* (21 December 2007) and OFT press release: *British Airways to pay record £121.5m penalty in price fixing investigation* (1 August 2007).

55. The OFT also received assistance from the Civil Aviation Authority in this case, and the competition authorities of Germany, Spain and the European Commission.

ASSESSMENT

56. The proposed merger involves the acquisition by easyJet of GB Airways, a franchisee of BA. Both airlines have a significant presence at LGW, and the parties overlap on a number of routes between the UK and 'fun and sun' destinations in Europe and North Africa.

57. The starting point for the OFT's analysis of the effect of the merger between the parties was the supply of scheduled passenger air transport services on overlapping O&D pairs. The OFT then considered whether the O&D pair should be widened or narrowed, based on a number of factors:

- 'no-frills' v full cost carriers: consistent with *Ryanair/Aer Lingus*, and due to the nature of the overlap routes in this case (that is, 'fun and sun' leisure routes), the OFT did not consider it relevant to adopt separate markets for full service and no-frills carriers

- charter v scheduled: the OFT did not consider that package holidays were sufficiently substitutable with scheduled services, on either a demand-side or supply-side basis. On considering all of the available evidence, the OFT did not expect that a 5 – 10 per cent price rise to independent travellers would be sufficient for charter airlines to switch away from package holidays to seat-only sales. The OFT did find that, consistent with past OFT and European Commission decisions, there were strong arguments for including seat-only sales by charter airlines in the relevant product market. However, the OFT had difficulties in determining the actual number of seat-only sales on the overlap routes, and hence the strength of any constraint provided by seat-only sales was unclear. As the OFT's conclusion on the competitive assessment did not turn on the constraint provided by seat-only sales, the OFT has taken a cautious approach and considered that seat-only sales provide only a limited constraint on scheduled services

- flights from nearby airports: the OFT considered, in relation to the particular overlap routes in this case, that there was significant substitutability between the various London airports. The overlap routes in this case involve predominantly leisure passengers, who tend to be less time sensitive and find London airports substitutable. This view was supported by yield data provided by the parties, and was consistent with the European Commission's view in *Ryanair/Aer Lingus*. The OFT also considered Alicante and Murcia together for the purposes of the competition analysis

- other factors: given the nature of the overlapping routes, the OFT did not consider indirect flights constrained direct flights, nor that a distinction needed to be made between business and leisure passengers. The OFT also considered whether flights to other holiday destinations may constrain the parties' services on the overlap routes, on the basis that passengers were simply looking for 'a week in the sun'. However, evidence obtained by the OFT suggested that any such constraint was insufficient to merit a wider market definition.

58. The OFT therefore considered direct scheduled passenger airline services on the following O&D pairs as relevant to the competitive assessment: London to Alicante/Murcia, Malaga, Faro, Ibiza, Mahon, Palma, Marrakech, Innsbruck and Funchal.

59. On the overlap routes, market shares varied depending on the unit of measurement (capacity or passenger numbers) and seasonal factors. However, the combined market shares of the parties, based on 2007 capacities, was significant, ranging from just over 40 per cent to up to 80 per cent. Although the parties faced competition from at least one other significant competitor on each of these overlap routes, the OFT felt that this competition alone would not provide a sufficient constraint to dismiss any competition concerns that might arise as a result of the merger on a significant majority of the routes in question. The OFT therefore considered prospects for entry and expansion on the overlap routes.

60. In considering evidence on entry and expansion, the OFT was required to balance, on the one hand, the apparent congestion problems at the overlap airports (in particular the London airports) and difficulties in 'flexing' capacity against the relatively small number of overlaps in this case, and on the other hand, the presence of a number of airlines at the relevant airports, and instances of actual entry and expansion. The evidence obtained by the OFT suggested that, despite the congestion problems at

the overlap airports, there had been a number of instances of recent entry and expansion at the overlap airports and onto the overlap routes themselves. In particular, substantial entry had been announced on the overlap routes since the merger was announced in October 2007, and third parties have indicated to the OFT that they will continue to review opportunities for entry and/or expansion on the overlap routes. Given the actual entry on the overlap routes in the short period since the announcement of the merger, and the evidence of entry and expansion prior to the announcement of the merger, the OFT considers that this, together with the likelihood of further entry and/or expansion on the overlap routes, is sufficient to constrain the parties post-merger.

61. The OFT also considered the implications of the merger for potential competition, and whether the merger would enhance the incentive or ability for coordinated behaviour. The OFT found that a number of potential competitors remained at both LGW and London airports generally, and that GB Airways was limited in its ability to compete with easyJet pre-merger by the terms of its franchise agreement with BA. The OFT found that the merger could even result in enhanced competition between easyJet and BA, and hence there would not be a weakening of potential competition as a result of the merger. In relation to coordinated behaviour, the OFT found that despite instances of coordinated behaviour in the airline sector (not involving the parties to this merger), the merger itself would not enhance the incentive or the ability for market operators to engage in tacit or explicit collusion in the supply of scheduled passenger airline services.

62. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

63. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.