OFFICE OF FAIR TRADING

Anticipated acquisition by Macquarie Airports Ltd and Ferrovial Aeropuertos SA of Exeter and Devon Airport Ltd

The OFT's decision on reference under section 33(1) given on 11 October 2005. Full text of decision published 20 October 2005.

Please note that square brackets indicate figures or text excised at parties' request on the grounds of confidential business secret.

PARTIES

1. **Macquarie Airports Limited (MAG)** is a global private equity fund with investments in airports and associated infrastructure. MAG is advised by Macquarie Investment Management (UK) Limited (MIMUK), a wholly-owned subsidiary of Macquarie Bank Limited. Macquarie Bank Limited and its subsidiaries are referred to as the **Macquarie Group**. In the EU, Macquarie Group companies jointly control the Rome Airports (Ciampino and Fiumicino) and Brussels Airport. They also hold indirect shares of 24.1 per cent and 11.3 per cent in Birmingham International Airport and Copenhagen Airport, respectively. MAG and Ferrovial Aeropuertos SA, through South West Airports Ltd, control Bristol International Airport (BIA) jointly on a 50/50 basis. [ ][1]

2. **Ferrovial Aeropuertos SA (FASA)** is a company incorporated in Spain which is active in the management of airport infrastructure concessions. Apart from its joint control of BIA, FASA has investments in three other airports: Sydney Airport, Belfast City Airport (100 per cent), and Antofagasta Airport in Chile. FASA's worldwide turnover is €7,268 million (approximately £4,904.02 million), and its Community-wide turnover is £6,828.6 million (approximately £4,608.54 million) of which €1,440.7 million (approximately £972.278 million) was attributable to the UK.

3. **South West Airports Limited (SWAL)** is a limited liability company incorporated in England and Wales. SWAL is the acquisition vehicle jointly owned by MAG and FASA. It is the parent companies' intention that SWAL will own EDAL as a sister company to Bristol, with separate management.

[1] Turnover data.

4. **Devon County Council (DCC)** is a public body with responsibility for local government in Devon. **Exeter and Devon Airport Ltd (EDAL)** is a wholly-owned subsidiary of DCC responsible for the management and operation of Exeter International Airport (EIA). EDAL's UK turnover is €16.60 million (approximately £11.2013 million).

TRANSACTION

5. The proposed transaction concerns the anticipated acquisition by MAG and FASA, via SWAL, of a controlling interest in EDAL from DCC, which will retain a [ ] per cent stake.

6. The case was referred to the OFT under Article 9 of the EC Merger Regulation (ECMR). A satisfactory submission was received by the OFT on 15 August 2005. The OFT's administrative deadline for dealing with this case is 11 October 2005. In accordance with Article 9(6) ECMR, the relevant statutory deadline expires on 17 October 2005.

JURISDICTION

7. The transaction met the threshold for investigation under the ECMR and was notified to the EC Commission (Commission) on 28 June 2005. The OFT subsequently requested referral of the case in accordance with Article 9(2)(a) of the ECMR, as on the basis of a preliminary assessment, the OFT could not rule out potential competition concerns in relation to the provision of airport infrastructure services in the South West of England. The Commission granted referral of the case on 8 August 2005.

8. As a result of this transaction, SWAL and EDAL will cease to be distinct. EDAL and BIA supply over 25 per cent of airport infrastructure services in the South West of England, thus meeting the share of supply test in section 23(1) of the Enterprise Act 2002 (the Act). Therefore, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

BACKGROUND

9. BIA is located eight miles outside of Bristol. It has one runway, 24 aircraft stands and capacity to service eight million passengers per annum (mppa). In 2004, it handled 4.6 million passengers, accounting for (on 2003 figures) 37.2 per cent of South West originating international charter traffic and 24 per cent of international scheduled traffic.[2] Seven million people live within two hours drive of the airport.

[2] Based on CAA OD Survey at UK airports, 2003. South West originating meant originating from one of the counties (as defined in 2003) of Avon, Cornwall, Devon, Dorset, Gloucestershire, Somerset or Wiltshire.

10. EIA is located five miles to the east of Exeter. It is a smaller airport with one terminal and stands for eight aircraft. In 2004, Exeter handled 614,000 passengers, and in 2003, it accounted for 9.9 per cent of South West originating charter traffic.

11. BIA and EIA are regulated by the Civil Aviation Authority (CAA) in respect of safety and economic issues, although *ex ante* price regulation by the CAA does not extend to either BIA or EIA, being limited to those airports that are 'designated' by the Department for Transport, i.e., three BAA-controlled London airports, and Manchester airport.

12. The UK air travel sector has exhibited strong growth, particularly at regional UK airports over the last 10-20 years, and particularly on the part of low-cost airlines. UK air passenger growth is expected to continue.[3] In the very long term, the Government's White Paper 'The Future of Air Transport'[4] forecasts that by 2030, BIA could attract between 10mppa and 12mppa and Exeter, 2.25mppa. The issue of growth at BIA and EIA in the short to medium term is addressed further under horizontal issues, below.

RELEVANT MARKET

Product market

13. The parties overlap in the provision of airport infrastructure services to airlines (operating primarily in leisure, as opposed to business services); provision of ground handling services and of associated services. The OFT has found it unnecessary for the purposes of this decision to break down the provision of these services to airlines into separate activities as it does not affect the analysis of the merger. We have taken the relevant product scope to be the provision of airport services.

14. We considered whether the product scope should be segmented by customer type. Airports typically provide services to a mix of customer types - full service scheduled airlines (FSSAs); low-cost airlines (LCAs); and charter operators (charter):

- FSSAs run a timetable-based service and tend to be more expensive than charter or LCA services due to higher service quality and frequency and lower load factors. FSSAs usually operate on a hub-and-spoke model whereby regional airports act as spokes channelling passengers through the hub airport

- LCAs, while running regularly scheduled passenger air services, do so at the lowest possible cost thereby offering low fares but a 'no frills' service. They operate a 'point to point' rather than a 'hub and spoke' model, tend to be the most price-sensitive, have higher aircraft utilisation and require faster turnaround times

[3] See e.g., Keynote Market Report 2005 – Airports (predicting average growth of around 3.5 per cent to 2009; Mintel : No-frills/low-cost airlines – UK – February 2005 (predicting total UK passenger growth to exceed 30 per cent annually to end 2006).
[4] Department for Transport, December 2003.

- charter airlines operate non-scheduled services to holiday destinations. Their services tend to be seasonal with more dense services in the summer, creating peak demand at airports. Due to their peak demands, they tend to be charged higher rates at airports.[5] Charter services have been commonly perceived to be in decline, in contrast to and to an extent because of the growth of LCAs.

15. Our third party inquiries suggest that the distinction between the different airline types has been blurred in recent years as a result of competition exerted on charters and FSSAs by LCAs. As a result, some FSSAs and charters have adopted the low cost model, setting up low fare subsidiaries or - for charters in particular – selling seat-only tickets to help fill flights. Conversely, although LCAs have traditionally been aimed at price-sensitive customers, yield management techniques mean that, at certain times and for certain destinations, their fares can be as high as those of FSSAs.

16. The European Commission has in past cases left open the issue of whether segmentation by customer type is appropriate.[6] That approach is also followed here. In so far as EIA does not currently have any FSSA services, the assessment centres on the merger's potential impact on charter and LCAs airlines and, in turn, consumers. The horizontal assessment addresses the related issue of buyer power – the degree to which different (classes of) airlines are able to leverage alternative supply options in their negotiations with airport infrastructure providers to counteract market power.

Geographic market

17. There are two issues that the OFT has considered in the context of geographic market: whether the supply of airport infrastructure services is national or regional in scope, and what the appropriate catchment area around airports might be.

A national or regional market?

18. SWAL take the view that the supply of airport infrastructure services in which EIA and BIA operate extends beyond the South West of England (SW) to cover the whole of the UK. Their principal arguments can be summarised as follows. When airlines are deciding whether and where to allocate new aircraft capacity, location of the airport is not the determining factor, but where they can maximise profitability; key factors include:

    - the nature of the catchment area and, specifically, the underlying demand there
    - (ii) capacity at the airport (i.e. availability of slots and ease of operation), and
    - (iii) the charging and price arrangements offered to the airline by the airport operator. Accordingly, airports around the UK (and in some instances, around

[5] According to the parties, in contrast, major charters move capacity from EIA during July and August in view of the high levels of employment in tourism and farming.

Europe) will compete for the same aircraft capacity from LCAs. Charters have similar considerations but the key factor for this customer class is overall aircraft profitability based on maximising load factors at attractive charge levels, rather than the region. Adding a new route is based on a ‘cascade’ principle, starting from the airports which attract the broadest range of passengers down to regional airports when the charter routes out of larger airports are matured. Aircraft are moved between airports to optimise usage based on local demand. Finally, in relation to this specific transaction, differences in the scale, maturity and market of BIA and EIA mean that the two airports are not each others’ close competitors.

19. Third party enquiries suggest that an airline’s choices may differ between its initial decision to bring a service to a particular airport and subsequent decisions once it has already started operating services from there, although some airlines claim that their choice is regional even for those services not established - because their business model is based on regional coverage. In making its initial decision, many airlines may well be looking for the most profitable combinations of origin and destination pairs taking into account volume, yields and costs, of which the charge imposed by the airport is only one element. (In the case of LCAs, the risk of entering a new market is shared by the airlines and the airport, and airports often offer discounts on charges, marketing and other support for new routes). At this point, third party evidence suggests that, for LCAs at least, there may be a choice of airports across the UK that may be available.

20. However, a number of airlines have told us that once a service is established from a particular airport, they no longer have the same ability to switch services to different airports across the UK. In particular, sunk costs of marketing to develop a demand in a particular region, and staff relocation costs, may make it difficult to move, except to near-by airports. Ability to switch is even more difficult for airlines with a base at an airport. At this stage, therefore – once an airline is ‘installed’ at one or more airports in a region – its demand for and price-sensitivity towards airport infrastructure supply in that region may in substantial part derive from the demand patterns of its airline passenger base (derived demand). For example, one customer told us that its business model is to service the SW market, and that it is not feasible to move elsewhere. In a similar vein, a number of other respondents expressed a strongly-held view that BIA and EIA are the only viable choices for serving the SW.

21. We note SWAL’s points, some of which appear to have intuitive merit, and which tend to suggest taking a UK-wide scope as the relevant frame of reference. However, we are unable safely to adopt this position as it implies a view on demand-side substitutability at odds with submissions from the source of such demand, i.e. airlines themselves. On the basis of third party evidence, the possibility of a regional frame of reference cannot be excluded, in particular for airlines already established in a region.

[6] Case IV/M.786, Birmingham International Airport; Case M.1035, Hochtief/Aer Rianta/Düsseldorf Airport; Case IV/M.2262, Flughafen Berlin II.

Catchment area analysis

22. As to passenger's geographic demand preferences, the distance that consumers are prepared to travel to an airport tends to vary by type of flight (long haul versus short haul) and by passenger type (leisure or business). It can also be influenced by airline fares from different airports. In general, third parties suggest that a drive time of between one and two hours around an airport represents its catchment area.

23. EIA and BIA's one-hour catchment areas overlap in Somerset and east Devon (estimated at around 625,000 people). The actual overlapping catchment for these airports is likely to be larger still, to include Devon and Cornwall. In 2003, BIA drew 17 per cent of its passengers from those counties. Such passengers are closer to EIA than BIA. For these customers, in the absence of empirical evidence to the contrary, it is reasonable to assume that services from EIA are likely to be substitutable, and, all else being equal, even preferable, to services from BIA.

24. We considered whether other airports that are geographically close to EIA and BIA should also be considered in the analysis. Newquay and Plymouth airports serve the far SW, but Newquay is in the main an airport of destination rather than origin. In addition, we were told that Plymouth's runway size severely restricts the size of planes that can be supported by the runway, such that most airlines are unable to operate from Plymouth. Third parties said that Newquay has inadequate surface transport links to be a viable competitor to Exeter, and it is not within EIA or BIA's two-hour catchment areas. As regards Bournemouth and Southampton, they are also not within BIA or EIA's two-hour catchment areas, nor are they within a two hour drive time of the population centre of Taunton (mid way between BIA and EIA). Cardiff may act as a constraint on BIA, but the extent of that, and its ability to constrain EIA, is unclear.

25. SWAL argue that London airports are a considerable constraint on SW airports, in that many passengers from the region still fly from London. In this regard, they cite the CAA 2003 survey which shows Gatwick taking 37 per cent of charter traffic, and Heathrow 40 per cent of scheduled traffic, originating in the SW. However, taking account of only those routes served by BIA *and* EIA for chartered and BIA *or* EIA for scheduled (there was only one scheduled route served by both BIA and EIA in 2003), Gatwick's share of chartered SW passengers falls to 25 per cent, and Heathrow's for scheduled from 40 per cent to 18 per cent. This is still likely to overestimate the shares for the London airports, as third parties told us that quality and range of services offered – particularly at EIA - have increased substantially in the past few years. Also, the CAA statistics pre-date easyJet's expansion at BIA and the flybe services started at EIA in the spring of 2004.

26. While some customers said that they would be in a position to withdraw services or supply the SW demand from London, others said that capacity constraints at London airports, and hence the difficulty of obtaining landing and take-off slots at these

airports, do not make them viable alternatives. Moreover, certain of the parties' internal documents imply that this constraint may be lessened further in future [ ].

27. Neither the parties nor any third parties provided any consumer surveys in relation to travelling times to airports of airline passengers from the SW region. BIA and EIA are geographically close to each other. In the absence of evidence to the contrary, it seems reasonable to assume that BIA and EIA are also close competitors, particularly for those airlines that are already operating services from these airports.

Conclusion on geographic market

28. In light of the difficulties of reaching robust conclusions on geographic scope at this stage, this question is left open. Instead, the OFT has in the following assessment focused directly on the question of greater relevance, that of the closeness of actual and potential competition between BIA and EIA and the extent to which other constraints might eliminate a realistic prospect of non-coordinated (unilateral) effects arising from the merger.

HORIZONTAL ISSUES

29. The following section considers (i) the closeness of competition between the parties; (ii) the theories of harm tested by the OFT in its investigation and the degree to which (iii) buyer power or (iv) entry or expansion will constrain the merged entity.

Closeness of competition between BIA and EIA

30. SWAL argued that regardless of the geographic proximity of the two airports, EIA and BIA were not close competitors due to the differences in the level of development at the two airports. This view tends to be undermined by Devon County Council's (DCC) own Invitation to Submit an Outline Proposal for the purchase of EIA, which states that 'Bristol is likely to remain the major competitor for scheduled and chartered services'.

31. There is further support for DCC's view in other evidence that suggests that EIA has been a growing competitor to BIA in the last few years. flybe, the only scheduled airline at EIA has told us that 15 of its routes at EIA are in direct competition with routes currently operating out of BIA (excluding its own flights). BIA's own internal documents state that [ ].

32. To assist the OFT in estimating the degree of airline passenger diversion between the two airports, both flybe and BIA provided evidence on demand impact for a sample of routes at BIA following the introduction of services to the same destinations by flybe at EIA. Demand at BIA still grew, notwithstanding the introduction of parallel routes at EIA. However, two factors suggest actual demand substitution (passenger switching) between the two airports:

- growth on those routes was substantially lower than the growth cited by CAA across all routes at BIA for the same year, and

- BIA growth on those routes was substantially less than demand increase achieved by those routes at BIA in the previous year.

33. In the absence of better evidence to the contrary, and consumer survey evidence in particular, we find it reasonable to conclude that there is at least a substantial number of passengers in the SW region for whom BIA and EIA are first and second choices for leisure travel with LCAs or charter airlines. As noted above, this passenger demand may drive the degree to which airlines currently operating at one or both airports would switch to other airports in response to the imposition of small but significant changes in price and non-price terms the airport, relative to their levels absent the merger (see further, theories of harm, below).

Theories of harm

34. In the light of the conclusion on closeness of competition outlined above, the OFT has considered three related theories of harm that might arise as a result of the merger, namely the capacity for the merged entity to: (i) increase airport charges; (ii) streamline services; or (iii) eliminate competition through reduction in investment.

Increasing airport charges

35. The elimination of competition between BIA and EIA post merger may increase the incentive for the merged entity to increase airport charges at one or other of these airports.

36. SWAL argues that there are some strong competitive constraints on BIA putting up its prices post-merger, including constraints from neighbouring airports such as Birmingham, arguments which the OFT considers merit further investigation. The arguments are, however considerably less credible in respect of EIA, given its size and geographic location. EIA and / or BIA thus may be in a position to execute at least a small but significant price increase. Some key customers have suggested that they would have no choice other than to accept such a price increase, as it may not have a sufficient impact on their profits to justify exiting from profitable routes in which they have made sunk cost investments.

37. If instead, airlines were to respond to any attempted increase in charges by either passing the price increases onto passengers, or reducing services provided from EIA (or BIA), this in itself may have a negative impact on air passengers in SW, through higher prices and / or a reduction in choice and service quality.

38. SWAL argues that its business plans for EIA and BIA are predicated on growth and expansion at both airports which would not be achievable were it to pursue a policy of

supra-competitive pricing at either airport. SWAL also refers to reputational damage were they to raise prices above competitive levels at EIA.

39. The issue here, however, is not whether growth would be entirely foregone by prospective price increases resulting from the merger but whether it may be reduced below what it would otherwise be. The evidence before us, in particular key customer evidence, suggests that this may be the case.

Streamlining of services to avoid duplication of destinations

40. SWAL may have the incentive to reduce duplication of destinations served from the two airports, to minimise any reduction in the growth of traffic at BIA as a result of the same destination services being introduced from EIA. If so, competition between the airports, and between airlines operating at these airports, may be reduced.

41. Third parties have raised credible concerns about the potential for a streamlining of services post merger. The possibility of this concern materialising is also suggested by BIA's [ ].[7]

42. SWAL has argued that the choice of destination is primarily the decision of an airline rather than the airport. While we note SWAL's argument, it also seems to be a feature of the industry that airports offer financial support to airlines launching attractive new routes which may bring additional business to the airport. An airport may therefore be able to exert an influence on the destinations served. A recent example of this at EIA has been the support offered to flybe for offering a Paris route. The choice of destinations is therefore something that both airports and airlines may be expected to influence. SWAL's incentives post-merger may be not to develop, or to divert, new services from EIA to BIA.

43. SWAL provided an indicative calculation of the impact on SWAL's profits across BIA and EIA if flybe were to withdraw one aircraft from EIA following a 30p increase in airport charges per passenger at EIA, and argued that at least 70 per cent diversion of passengers to BIA would be needed to avoid losses. However, this analysis does not take account of:

- potential charge increases at BIA to take account of lower competition on the route in question
- the potential for EIA to attract a replacement aircraft (from a different airline) to EIA
- the fact that non-aeronautical revenues per passenger may be higher at BIA,[8] nor

[7] The parties dispute the OFT's interpretation of this internal document.
[8] The parties consider the OFT's interpretation is incorrect

- the fact that the merged entity could provide differing incentives on new services being attracted to EIA, to ensure that replication of services provided from BIA is limited.

44. SWAL has said that the only way to grow EIA to recoup the initial investment (£[ ] purchase price) and additional investment of £[ ] earmarked for its development is by replicating fat routes[9] already served by BIA; no specific evidence has however been provided to substantiate this. In addition, SWAL put forward the argument that such a reduction in service replication may actually increase consumer welfare by increasing choice. However, in so far as SWAL's own argument is that much of EIA passenger growth is newly-generated, on the whole, it is not possible to assume that this may be a beneficial outcome of the merger, particularly if it leads to increases in airport charges at BIA.

45. In summary, credible third party concerns that the merger will lead to a harmful reduction in competing destinations cannot be dismissed, notwithstanding the arguments of SWAL on this issue.

Elimination of potential as well as actual competition via reduced airport investment and expansion

46. Although EIA may not at present be comparable with BIA and may in view of its geographic location not have the potential to grow to such a size, there are nonetheless strong indications of its potential to develop considerably, a belief held by its vendor, DCC and also of SWAL in its internal documents. EIA is already seen as a viable alternative to BIA for servicing air passenger demand in the SW by a number of airlines; further development of EIA may well increase the constraint placed by EIA on BIA. This potential has begun to be demonstrated by flybe since its move to EIA. Moreover, the vast majority of EIA's growth has been achieved by replicating routes served from BIA and there is evidence (outlined in paragraph 32 above) that the introduction of these routes has diverted traffic away from BIA.[10] There is therefore reason to believe that post-merger, the incentives on the merged entity to promote EIA as a strong competitor to BIA may be lower than they otherwise would have been. The level of investment made by SWAL at EIA may be lower than would be optimal for an independently-owned EIA (and vice versa).

47. Even though the OFT does not doubt that the parties plan growth for EIA, the issue is whether investment and growth at EIA will be significantly less with the merger, whereby the investor also owns BIA, than without.

48. One third party said that there has been less airport development in some areas of the UK where there are neighbouring airports under common ownership, and another third

[9] 'Fat routes' are the routes with the highest volume and value of traffic.
[10] There is only one route – Toronto – that is served from EIA and not BIA.

party expressed concerns that a reduction of investment will arise as a result of this merger.

49. SWAL has presented a number of arguments against these concerns. Some are noted above and concern the appropriate geographic scope, which the parties argue is national. In addition, the parties argue that the two airports are differentiated and that EIA is therefore not currently, nor is likely to become, a sufficient constraint on BIA. In particular, they note that EIA is currently substantially smaller than BIA and offers a different class of service to airlines and passengers (with no FSSAs flights), and, as it is based in a more rural area, it has a much smaller catchment area size. They also point to the fact that there is no evidence of airlines playing off the two airports prior to the merger.

50. Whilst these arguments are not without merit, the OFT has taken into consideration throughout this assessment the need to take account of the context of the continuing dynamic growth in the SW. In particular, we have considered whether the difference between EIA's short and medium-term growth in the hands of the operator of BIA may be materially less than in the absence of the merger. This may hold true notwithstanding the OFT's acceptance that the business case for the acquisition rests on growth from its current level immediately after the merger. In light of this the OFT cannot reasonably dismiss third party concerns about elimination of potential as well as actual competition via reduced airport investment and expansion.

Airport incentives and buyer power

51. SWAL argues that the key constraint on airports' pricing policies is the buyer power arising from the presence of spare capacity at (regional) airports at a time of high demand growth in air passenger traffic. It maintains that an airport's cost structure – of high fixed costs of investing in capacity but low running costs - provides it with an incentive to fill additional capacity, particularly given that much of an airport's revenues (around 50 per cent at some airports) come from non-aeronautical charges (including airport concessions and parking).

52. Furthermore, SWAL states that airlines can leverage the potential for future growth – which can be placed at any airport (within the UK) – when negotiating current charges. In other words, for airports to guarantee future growth, they need to keep current prices competitive.

53. SWAL also points to its internal documents to indicate that its business model depends on growth at both airports. Management documents forecast traffic growth from the current level of 4.6 million passengers at BIA to [ ] million passengers for 2015 and [ ] million for 2030 and an even high growth rate for EIA. They also point to a secured loan facility of £135 million for additional investment in capacity at both airports.

54. SWAL's arguments on this point might seem persuasive. However, the OFT considers that these arguments are too speculative to render the theories of harm outlined above

unrealistic. In particular, we note that the extent of growth potential will vary by airline. Charter airlines in particular are predicting little to no growth going forward, and may therefore be limited in their ability to leverage future growth against current charge increases. More generally, while there may be buyer power in the industry, this may be reduced by the merger – particularly for those airlines wishing to operate out of SW – which may mean that airlines would tolerate an increase in charges that would not have been possible pre-merger.

Entry and expansion

55. Entry in the industry – given the need for significant infrastructure investment – may take time, but it is not impossible. The key barriers to new entry in airports are the cost of land and the difficulties in getting planning permission.

56. We have not been presented with evidence of any new airport development plans in the SW that are advanced enough for us to consider them as potential constraints.

57. As regards expansion, at present capacity, expansion by other airports in the SW is limited by factors outlined in paragraph 24 above. Third parties have suggested that there is no suitable terrain on which Plymouth would be able to build a longer runway to enable it to be an effective competitor, while expansion at Newquay is unlikely to offer a sufficient constraint given its geographical position and poor surface access.

58. We therefore cannot rely on competitive discipline by way of entry or expansion.

Third party views

59. A large number of third party views were received by the OFT from customers, competitors (including unsuccessful bidders) and business organisations. In the context of the ECMR case, there were also representations for and against the merger made by Members of Parliament and of the European Parliament. Customers were roughly divided between those who were concerned and those who were unconcerned. Some concerns were also expressed by airports though the majority were unconcerned.

Conclusion

60. In the light of the above analysis, the OFT considers that there may be a realistic prospect of non-coordinated effects by virtue of the loss of an important competitive dynamic between BIA and EIA. Put differently, it is reasonable to regard the parties as first and second choices for a substantial number of passengers in the SW, and in turn to regard the parties as similarly important choices for airlines seeking to capitalise on demand in this region. Although constraints will exist on the merged entity, as discussed above, the OFT cannot at this stage of the investigation place sufficient reliance on these constraints to resolve its concerns. We have identified a number of

ways in which this unilateral effect may take place, none of which it is possible to dismiss based on present evidence.

61. The OFT therefore believes that were the merger to go ahead, SWAL may have both the ability and the incentive to either raise prices, reduce services at one or both airports or dampen investment at either BIA or EIA (or both), and that this gives rise to a realistic prospect of a substantial lessening of competition.

ASSESSMENT

62. The transaction at issue would combine Bristol and Exeter International Airports under common ownership. Although geographically close, the parties and third parties, notably customers, differ substantially on whether they are close competitors, and on the extent to which buyer power with reference to other airports (notably the London airports and others in the SW region) would neutralise any merger-related incentive on the combined entity's part to impose less favourable terms on airline customers at one or both of Bristol or Exeter airports.

63. For reasons discussed in more detail above, and on the basis of the available evidence, the OFT regards the concerns expressed by customers as credible, primarily in light of the available evidence, albeit limited, of preferences of airline passengers in the SW. As such, the OFT accordingly believes there is a realistic prospect of a substantial lessening of competition.

UNDERTAKINGS IN LIEU

64. Having concluded that the transaction should be referred to the CC, the OFT has considered whether there might be undertakings in lieu (UIL) of reference, pursuant to section 73 of the Act, which would address the concerns outlined above.

65. SWAL has offered a set of behavioural undertakings in relation to the theories of harm brought to its attention by the OFT. These are based on [ ]. Furthermore, information would be provided annually to the OFT relating to deals and charges and other support offered to airlines.

66. In order to accept UIL, the OFT must be confident that the competition concerns identified can be resolved by means of undertakings without the need for further investigation. The acceptance of UIL is appropriate only where both the concerns and the remedies proposed to address them are clear cut. The OFT therefore concludes that this is not an appropriate case to accept UIL.

DECISION

67. This merger will therefore be referred to the Competition Commission under section 33(1) of the Act.