

Completed agreement between Aer Lingus Limited and CityJet designated Activity Company

Decision on relevant merger situation and substantial lessening of competition

ME/6782/18

Please note that [✂] indicates figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

SUMMARY

1. On 28 October 2018 Aer Lingus Limited (**Aer Lingus**) entered into an agreement (the **Agreement**) with Cityjet Designated Activity Company (**CityJet**). As a result of the Agreement, Aer Lingus acquired landing slots at Dublin Airport (**DUB**) and London City Airport (**LCY**), with certain existing customer relationships also to be transferred, in addition to entering into a 'wet lease' under which CityJet would provide aircraft, crew, maintenance and insurance (**ACMI**) to Aer Lingus. These three components together are referred to as the **Target** and the transaction is referred to as the **Merger**.
2. Aer Lingus is a subsidiary of International Consolidated Airlines Group, S.A. (**IAG**). IAG, its subsidiaries and CityJet are together referred to as the **Parties**.
3. In the circumstances of this case, these three components (ie, the slots, customer relationships and wet lease) together amount to an enterprise, as they were obtained simultaneously from a single source, were previously used in combination, and their acquisition in combination resulted in economic continuity between the provision of scheduled air passenger services on the LCY-DUB route by CityJet until 27 October and the provision of scheduled flights on the same route from 28 October by Aer Lingus.
4. As a result of the Merger, the enterprises of Aer Lingus and the Target have ceased to be distinct. The share of supply test is met. The four-month period set out in section 24 of the Enterprise Act 2002 (the **Act**) has not yet expired.

The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.

5. The Parties submitted that the correct counterfactual for the assessment of the Merger is that, absent the transaction: (i) CityJet would have exited from providing scheduled air passenger services on the LCY-DUB route; (ii) there were no less anti-competitive counterparties available that could have entered into an agreement with CityJet that would involve the counterparty providing scheduled air passenger services on the LCY-DUB route; and (iii) the Merger does not represent a substantially less competitive outcome than the exit of CityJet and its sales from the LCY-DUB route.
6. The CMA is satisfied that CityJet had taken the decision, for strategic reasons, to exit the market. The CMA went on to consider whether there was any alternative counterparty to Aer Lingus which would have led to a less anti-competitive outcome.
7. CityJet did not market the LCY-DUB route to any airline other than Aer Lingus, as it considered Aer Lingus to be the only airline with the requisite capabilities (such as brand presence in London and Dublin, and existing infrastructure at LCY and DUB) and strategic focus to be able to provide scheduled flights on the LCY-DUB route.
8. None of the third-party airlines contacted by the CMA expressed an intention to enter the LCY-DUB route at this time (or suggested that they would have been interested in the assets that comprise the Target). This position is consistent with the available evidence in relation to those airlines' commercial strategies.
9. The CMA therefore believes that there was no realistic prospect of a less anti-competitive counterparty than Aer Lingus entering into an arrangement with CityJet for the LCY-DUB route.
10. Finally, the CMA considered what would have happened to its sales on that route if CityJet had, in the absence of the Merger, exited from providing scheduled air passenger services on the LCY-DUB route. As the assets that comprise the divestment business would likely have been deployed by CityJet to service other routes, the CMA considers that the capacity provided on the LCY-DUB route would likely have been removed from the market. As BA CityFlyer is the only other airline currently operating on the LCY-DUB route, the CMA considers that a similar proportion of CityJet's sales on the LCY-DUB route would have diverted to IAG under either scenario (ie as a result of the Merger or if CityJet exited the LCY-DUB route absent the Merger).

11. The CMA therefore believes that the requirements for an exiting firm counterfactual are met and that, in the absence of the Merger, CityJet would inevitably have exited the LCY-DUB route, with no replacement of the competitive constraint previously exerted on BA CityFlyer by CityJet.
12. On the basis of this counterfactual, the CMA believes that the Merger will not give rise to a realistic prospect of a substantial lessening of competition (**SLC**).
13. The Merger will therefore **not be referred** under section 22(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Parties

14. Aer Lingus is a Dublin-based airline operating scheduled passenger flights to destinations in the UK, Continental Europe and North America. Aer Lingus is owned by IAG.
15. IAG owns Aer Lingus, British Airways, BA CityFlyer, Iberia, LEVEL and Vueling (the **IAG airlines**). IAG is a Spanish-registered company with shares traded on the London Stock Exchange and on the stock exchanges of Madrid, Barcelona, Bilbao and Valencia (the Spanish Stock Exchanges) through the Spanish Stock Exchanges Interconnection System. The corporate head office for IAG is in London, UK.
16. CityJet is based in Dublin and was, until recently, one of Europe's leading regional airlines operating a fleet of around 45 aircraft. Since 2015, it has moved away from providing scheduled flights (taking the decision in early-2018 to exit operating scheduled flights completely), with its strategic focus shifting to wet leasing. Following this transaction with Aer Lingus, CityJet will no longer provide scheduled flights and will provide ACMI capacity to airlines across Europe. CityJet's turnover in 2017 was approximately £233 million worldwide. Total turnover generated from the LCY-DUB route in 2017 was approximately [X] million.

Transaction

17. Aer Lingus and CityJet entered into the Agreement on 28 August 2018 and the Agreement commenced on 28 October 2018. Its duration is [X] years, with Aer Lingus having the option to extend the Agreement for a further [X] years. Under the terms of the Agreement:

- (a) CityJet, as the lessor, is providing dedicated aircraft, as well as crew, maintenance and insurance to Aer Lingus, the lessee. Subject to certain changes that Aer Lingus can make to the flight schedule and route, CityJet is operating - on behalf of Aer Lingus - six daily round trips from DUB to LCY on weekdays, with a reduced service at the weekend. The CityJet aircraft are to be painted in Aer Lingus livery.
 - (b) CityJet has also transferred certain slots at Dublin airport and London City airport to Aer Lingus for the duration of the Agreement.
 - (c) Aer Lingus pays CityJet a 'rental' comprised of a [X]. The income received by CityJet does not depend on the number of passengers on the route or on the profitability of the route.
18. In addition to the assets transferred under the Agreement, CityJet has also sought to facilitate the transfer of certain customer relationships. More specifically, as further described below, nearly all CityJet customers who had already booked with CityJet for a flight on or after 28 October 2018 were transferred to Aer Lingus. Between the announcement of the Merger on 28 August 2018 and 27 October 2018, CityJet also referred prospective customers searching for flights between London and Dublin after 28 October 2018 to Aer Lingus' website.
19. CityJet submits that its strategic rationale for the Merger (as further described in the CMA's assessment of the counterfactual) was to implement its strategy to exit the provision of scheduled flights and to move its strategic focus to wet leasing. Aer Lingus submits that its strategic rationale for the Merger is: (i) to build on its strength on the London-Dublin route through a competitive product for point-to-point business travellers; (ii) to provide a competitive connecting proposition over Dublin onto Aer Lingus' North Atlantic network (which also supports IAG's ambitions to enhance its presence in hub-to-hub markets); and (iii) to have the opportunity to partner with BA CityFlyer on the route, presenting potential synergies.

Procedure

20. The CMA's mergers intelligence function identified this transaction as warranting an investigation.¹
21. The Merger was considered at a Case Review Meeting.²

¹ See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, paragraphs 6.9-6.19 and 6.59-60.

² See CMA2, from paragraph 7.34.

Background

22. The Parties supply scheduled air passenger services between London and Dublin (including on the LCY-DUB route).
23. IAG operates several services between London and Dublin:
 - (a) Aer Lingus operates scheduled air passenger services (ie, flights) on the London Heathrow-Dublin (**LHR-DUB**) and London Gatwick-Dublin (**LGW-DUB**) routes. It has been providing scheduled flights on the LCY-DUB route since 28 October 2018 as a result of the Merger;
 - (b) British Airways operates scheduled flights on the LHR-DUB route; and
 - (c) BA CityFlyer operates scheduled flights on the LCY-DUB route.
24. Prior to the commencement of the Agreement, CityJet operated scheduled flights on the LCY-DUB route (which was the last route on which CityJet operated scheduled flights). Since the commencement of the Agreement, CityJet no longer operates scheduled flights on any route, with only IAG airlines providing scheduled flights on the LCY-DUB route.
25. The only other providers of scheduled flights between London and Dublin are:
 - (a) Ryanair, which also operates flights on LGW-DUB, Stansted-Dublin and Luton-Dublin routes; and
 - (b) Stobart Air and Flybe, which operate a small number of flights on the route between Southend and Dublin pursuant to a franchise arrangement.

Jurisdiction

26. A relevant merger situation exists if the following conditions are satisfied:³
 - (1) two or more enterprises have ceased to be distinct enterprises at a time (within four months prior to reference) or in circumstances falling within section 24 of the Act;⁴ and
 - (2) either:
 - (i) the value of the target enterprise's UK turnover exceeded £70 million in its last fiscal year (the turnover test); or

³ Section 23 of the Act.

⁴ Section 24(1) of the Act.

- (ii) the enterprises ceasing to be distinct have a share of supply in the UK, or in a substantial part of the UK, of 25% or more in relation to goods or services of any description (the share of supply test).

Enterprises

27. The Parties submitted that the Target does not amount to an ‘enterprise’ within the meaning of the Act on the basis that:

- (a) The Target is not a business or part of a business as it concerns a single route (rather than a network of routes), and an airline is in the business of operating a network. Even if a single route could constitute part of an airline’s activities, the Target’s composition did not contain certain important components that are necessary to offer scheduled flight services. Aer Lingus did not acquire CityJet’s above-wing or below-wing ground handling operations, sales or revenue management back office operations, or the CityJet brand. In addition, certain components that would typically be indicative of an enterprise were missing from the Target. The wet lease did not, for example, result in a TUPE Regulation transfer of the pilots and other aircraft crew made available to Aer Lingus.⁵
- (b) The slots transferred to Aer Lingus simply formed part of a collection of inputs that will enable it to grow its operations organically. Aer Lingus could have procured the slots though exchanging them with other airline operators (including with another IAG carrier) given significant slot trading takes place at LCY, and there is availability of peak week slots in the LCY pool.
- (c) The commercial value of the existing customer relationships that were transferred to Aer Lingus was insignificant. CityJet’s existing bookings for flights post-28 October 2018 represented an inconsequential proportion of Aer Lingus’ total annual capacity and expected revenues on the LCY-DUB route ([REDACTED] seats with a value of approximately [REDACTED] compared to the total annual capacity of [REDACTED] seats and expected revenues of approximately [REDACTED]).⁶ The Parties also submitted that the CityJet website referring passengers to aerlingus.com was not part of a joint strategy between Aer Lingus and CityJet and that, having regard to the strength of Aer Lingus’

⁵ The Transfer of Undertakings (Protection of Employment) Regulations 2006.

⁶ IAG/Aer Lingus confidential response dated 3 December 2018 to CMA Issues Paper of 23 November 2018, paragraph 2.2.3.

own brand and promotional activity, the effect of the notice was unlikely to have been material.

- (d) The fact that Aer Lingus obtained the Target (ie, ACMI, slots, the facilitated transfer of certain CityJet customer relationships) simultaneously from a single source did not give Aer Lingus anything more than it might have acquired by going into the market and buying each of these components individually.
28. The CMA's assessment of whether assets being acquired amount to an enterprise depends on the specific facts and circumstances of each case (an assessment which can be, as the Supreme Court noted in *Eurotunnel*, finely balanced).⁷ In *Eurotunnel*, the Supreme Court noted that the question of whether a given set of assets forms an enterprise ultimately turns on 'economic continuity'.⁸
29. The CMA notes that the scope of the Target assets did not include certain activities that may typically form part of an airline's business operations (eg brand). It also did not involve a TUPE transfer (a recurrent feature of many business transfers). However, in addition to the wet lease, Aer Lingus also acquired landing slots at LCY and DUB and certain customer relationships. The CMA notes that these latter two additional components appear to be core elements of the business of providing scheduled flights and that, in the particular circumstances of this case, the combination of these with the wet lease appears to support a degree of economic continuity that may enable Aer Lingus to carry on the CityJet business previously supported by them.
30. With regard to the wet lease, the CMA notes that:
- (a) The absence from the Target of certain activities and assets (eg ground handling and brand) previously deployed by CityJet in combination with the wet lease does not prevent the finding of an enterprise if the Target nevertheless allows economic continuity between CityJet's and Aer Lingus' business (of providing scheduled flights on the LCY-DUB route). The CMA believes in this respect that the fact that the Agreement covers one route (rather than a network of routes) does not prevent the finding of

⁷ *Société Cooperative De Production Seafrance SA (Respondent) v The Competition and Markets Authority and another (Appellants)*, [2015] UKSC 75.

⁸ *Eurotunnel* notes at [39] '... if the assets of which the [acquirer] acquires control are to be regarded as constituting an "enterprise", (i) they must give him more than he might have acquired by going into the market and buying factors of production and (ii) the extra must be attributable to the fact that the assets were previously employed in combination in the "activities" of the target business. Plainly, the longer the interval between a target enterprise's cessation of trading and the acquisition of control of its assets, the less likely it is that either criterion will be satisfied. The alternative is to conclude that the target enterprise has ceased to exist because its business is no longer characterised by any "activities" capable of being continued by someone else. Ultimately the question turns on ... "economic continuity".'

a business (and accordingly, an enterprise).⁹ In this case, the CMA believes (for the reasons set out further from paragraph 31 below), that despite the fracturing of the Target from certain assets and activities that CityJet previously employed in combination on the LCY-DUB route, the Target amounts to an enterprise.

(b) While a TUPE transfer may be indicative of the transfer of an enterprise within the meaning of the Act, it is not a necessary condition.¹⁰ In this case, the absence of a TUPE transfer did not prevent Aer Lingus from obtaining, under the wet lease, the benefit of acquiring the necessary workforce (ie, the aircraft crew) to work on the flights previously operated by CityJet.¹¹

31. With respect to the landing slots, the available evidence indicates that the landing slots at LCY and DUB are strategically critical assets within the context of the LCY-DUB route – in particular, as both LCY and DUB are capacity-constrained airports at which demand for slots exceeds supply. CityJet acknowledged that DUB had a clear surplus of demand over supply.¹² Aer Lingus recognised that there had not been any recent slot trading at DUB, and submitted that it considered it unlikely that appropriate slots could be obtained through the pool allocation system to operate a LCY-DUB service unless an existing operator ceased or reduced its operations.¹³
32. This is also consistent with views submitted by third parties. Airport Coordination Limited (**ACL**), the slot coordinator for 39 airports (including LCY and DUB), noted that there was limited slot availability at DUB, especially during the summer season. ACL therefore believed that it would be very difficult for a new entrant to procure 3-4 rotations per day at DUB in the summer season.¹⁴ Virgin Atlantic noted that the limited availability of slots at peak times at LCY and DUB also made it difficult for new airlines to enter the LCY-DUB route.¹⁵

⁹ The Act does not require that a business (or part thereof) be of any minimum scale in order to constitute an enterprise. The CMA notes that an airline operating one scheduled route is still, in practice, operating an airline business (albeit one limited in scale).

¹⁰ CMA2, para 4.8. CMA2 notes that an assessment as to whether there is an enterprise must be based on the totality of all relevant considerations and may vary depending on the specific facts and circumstances of each case (para 4.8 and 4.11). The CMA notes that CMA2 also pre-dates *Eurotunnel* and must, therefore, be read in light of that judgment.

¹¹ The CMA notes in this regard that according to CityJet's statement in the issues meeting of 29 November 2018, there is currently a shortage of pilots.

¹² CityJet's response to Question 4 of the CMA's section 109 notice of 17 October 2018.

¹³ IAG's response to Question 1 of the CMA's section 109 notice of 4 October 2018.

¹⁴ CMA note of call with ACL, 22 October 2018.

¹⁵ Virgin Atlantic submission dated 12 November 2018.

33. The CMA therefore believes that there is no basis to conclude that the slots would have been readily available to Aer Lingus from alternative sources. Rather, their inclusion as part of the Target has been critical in enabling Aer Lingus to enter the LCY-DUB route. This also ensured that Aer Lingus did not suffer the commercial risk of having aircraft, crew, and customer bookings, but no slots through which to offer these flights.
34. With respect to the transfer and referral of certain CityJet customers, the CMA notes that the transfer of customer relationships is not a typical feature of an acquisition of 'bare' assets within the meaning of *Eurotunnel*. In this particular case, Aer Lingus was able to commence its scheduled flights on 28 October 2018 with the benefit of pre-booked customers and referrals from CityJet. This benefit was at least partly attributable to certain actions taken by CityJet from the announcement of the Agreement. Specifically:
- (a) CityJet offered customers already booked on its LCY-DUB flights from 28 October 2018 onwards either a refund or a default transfer to Aer Lingus if they took no action after notification. CityJet could have (but did not) offer customers the additional option of transferring to other airlines that operated on the wider London-Dublin route (BA CityFlyer flights from LCY, or to Ryanair or Flybe/Stobart flights from other London airports). In practice, approximately [90-100]% of CityJet's customers booked for flights after 28 October were transferred to Aer Lingus (which was the default outcome for customers who took no action, rather than opting for a refund).
 - (b) Prospective customers who attempted to use the CityJet website to book flights on the LCY-DUB route were re-directed by CityJet to (only) Aer Lingus' website. The CityJet website stated '*CityJet will end scheduled services on 27 October. For flights from 28 Oct please book on www.aerlingus.com.*' Similarly (as with passengers who had already booked post-28 October flights), CityJet's website could have (but did not) refer passengers to other airlines offering flights between London and Dublin.¹⁶
35. The CMA notes that CityJet's actions – to focus customers' alternative airline options on Aer Lingus only – were not prescribed by its requirement under EC Regulation 261/2004¹⁷ to offer, in the event of a flight cancellation, customers

¹⁶ The response to FAQs issued by CityJet to answer customers' queries also included the following: '[Q:] My booking has a CityJet flight before and after 28th October [A:] Your outbound flight is unchanged. You will receive a new itinerary for your return flight directly from Aer Lingus for the other flights'.

¹⁷ Regulation 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, 2004 OJ L46/1.

a choice between reimbursement or re-routing at the customer's convenience. Rather, CityJet chose to fulfil its regulatory obligations in a way that made Aer Lingus uniquely well-placed to capture diverting CityJet customers.

36. The CMA further notes that the fact that CityJet made these decisions unilaterally (rather than as part of a joint strategy with Aer Lingus) does not negate the fact that Aer Lingus' path to acquiring customers on this route was significantly facilitated by CityJet's actions to transfer/refer its own customer relationships. In addition, the CMA believes that little weight should be placed on the allegedly limited importance of the transferred customers for Aer Lingus' overall revenues on that route. Irrespective of their commercial significance for Aer Lingus, the transfer of some (rather than zero) CityJet customers is indicative of economic continuity between the CityJet business operating until 27th October 2018, and the Aer Lingus business that offered those same flights to prior CityJet customers the next day.
37. Finally, the available evidence indicates that, absent the Merger, Aer Lingus would have needed to undertake the following steps to enter the LCY-DUB route:
- (a) purchase, lease or otherwise contract with an ACMI or franchise provider for the appropriate aircraft to fly to and from LCY (purchasing aircraft has an estimated lead time of one to three years and the lead time for the other options is dependent on the availability of suitable aircraft);
 - (b) either (i) hire appropriately located and trained crew or re-allocate a selected group of its existing crew; or (ii) contract with an ACMI or franchise provider to supply the appropriate crew (with either option being liable to involve a significant lead time);
 - (c) obtain slots at LCY and DUB from another airline or through an internal reallocation of slots within IAG (as Aer Lingus would be unlikely to obtain the necessary slots through the pool allocation system due to limited slot availability at DUB generally and LCY at peak times); and
 - (d) start its scheduled operations without the benefit of pre-booked customers.¹⁸
38. The CMA notes that by proceeding to acquire the wet lease, slots and customer relationships from one single source simultaneously, Aer Lingus avoided both (i) the commercial efforts that acquiring each component separately would have entailed; and (ii) the risk that, once procured, these

¹⁸ IAG's response to Question 1 of the CMA's section 109 notice of 4 October 2018.

could not have been deployed immediately in combination. The simultaneous transfer of CityJet's customer relationships in addition to the wet lease and slots reduced the risk for Aer Lingus that it would be short of customers in its initial period post-commencement of the Merger. Conversely, the fact that Aer Lingus was transferred slots ensured that its leased aircraft, crew and transferred customers did not remain grounded.

39. Accordingly, the CMA believes, for the reasons set out above, that the Target has provided Aer Lingus with more than it might have acquired by going into the market and buying factors of production, given: (i) the difficulty of acquiring strategically important LCY and DUB slots; (ii) the facilitated acquisition of CityJet's existing customer relationships (a benefit that is not indicative of a collection of bare assets); and (iii) the benefits Aer Lingus enjoyed as a result of acquiring the LCY and DUB slots, the existing customer relationships and the wet lease simultaneously from a single provider.
40. The CMA also believes that the 'extra' that Aer Lingus has acquired is attributable to the fact that the assets were previously employed in combination by CityJet. Aer Lingus was able to deploy a seamless service to customers on the 28 October, due (at least in part) to the fact that those assets had previously been deployed in combination by CityJet in the same way on the LCY-DUB route. This demonstrated economic continuity between CityJet's business and Aer Lingus.
41. Consequently, the CMA believes that the Target is, or at the least may be, an enterprise within the meaning of section 129 of the Act.

Ceasing to be distinct

42. The Parties submitted that the transaction does not constitute a relevant merger situation because two or more enterprises have not ceased to be distinct. In particular, the Parties submitted that:
 - (a) The Agreement is akin to a supply agreement for service inputs and Aer Lingus will not assume any assets under its control. Instead, Aer Lingus is obtaining temporary access to capacity while CityJet retains full operational control of the aircraft and crew to provide its services to Aer Lingus.
 - (b) The Agreement is not of sufficient duration for enterprises to have ceased to be distinct. The wet lease is a service agreement of limited duration: [X] years with a possible [X]-year extension.
43. However, the CMA believes that the enterprises of IAG, including Aer Lingus, and the Target have ceased to be distinct on the basis that:

- (a) As a result of the Merger, Aer Lingus has acquired the ability to control the price, quality, service levels and timing of flights which were previously controlled by CityJet. It has therefore acquired the ability to determine strategic commercial behaviour in relation to these flights. The fact that ownership of assets has not been transferred from CityJet to Aer Lingus does not exclude the possibility that enterprises have ceased to be distinct (there being many enterprises which operate with leased rather than with self-owned equipment).
- (b) The Act does not require a merger to last for any minimum duration before it can amount to a relevant merger situation.¹⁹ The Agreement is for [X] years, with an option to renew for a further [X] years and could be further extended thereafter. There is no suggestion that the *status quo ante* (ie CityJet resuming its scheduled operations on the LCY-DUB route) will be restored when the Agreement expires. The CMA believes that the Agreement (which covers [X] to potentially [X] seasons) is of sufficient duration to have an impact on the competitive structure of the market for air travel between London and Dublin.²⁰

44. The CMA therefore believes that as a result of the Merger, the enterprises of IAG, including Aer Lingus, and the Target have ceased to be distinct.

Share of supply test

45. The CMA estimates, based on its analysis of data provided by the Civil Aviation Authority, that following the Merger:

- (a) Only airlines under the control of IAG are offering flights on the LCY-DUB route post-Merger. IAG's share of supply for scheduled air passenger services on the LCY-DUB route is now 100%, with an increment of around 60% as a result of the Merger.
- (b) Even taking a broader view and considering the share of supply on the London to Dublin corridor, IAG's share of supply post-Merger is over 55%, with an increment of around 6% as a result of the Merger.

¹⁹ This contrasts with the position under the EU Merger Regulation. CMA2 at paragraph 4.38, in discussing whether initial steps in a break-up bid would be investigated by the CMA, states: 'Where it appears that the subsequent steps may not take place within four months of the completion of the initial acquisition, the CMA will not risk losing its ability to refer the initial acquisition simply on the basis that it is intended that the current situation will not be permanent. To do so would risk the CMA breaching its duty to refer.'

²⁰ The CMA's [Merger Assessment Guidelines](#) (OFT1254/CC2), September 2010 at para 4.1.3 state that 'The Authorities will consider any merger in terms of its effect on rivalry over time in the market or markets affected by it.' The [Merger Assessment Guidelines](#) have been adopted by the CMA (see CMA2, January 2014, Annex D).

46. The CMA therefore believes that the share of supply test in section 23 of the Act is met.

Time period

47. IAG, including Aer Lingus, ceased to be distinct from the Target on 28 October 2018. The four-month deadline for a decision on reference under section 24 of the Act is therefore 28 February 2019.

Conclusion on jurisdiction

48. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.
49. The initial period for consideration of the Merger under section 34ZA(3) of the Act started 30 October 2018 and the statutory 40 working day deadline for a decision is therefore 24 December 2018.

Counterfactual

50. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual), and generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.²¹
51. In the present case, the Parties submitted that the correct counterfactual is one in which, absent the Merger, CityJet would have exited from providing scheduled air passenger services on the LCY-DUB route. The CMA's assessment of this counterfactual is set out below.

Exiting firm counterfactual

52. The exiting firm counterfactual is most commonly considered when one of the firms is said to be failing financially. However, exit may also be for other

²¹ [Merger Assessment Guidelines](#), from paragraph 4.3.5.

reasons, for example because the selling firm's corporate strategy has changed.²²

53. For the CMA to accept an exiting firm counterfactual, it would need to believe, based on compelling evidence, that the following cumulative conditions are met:²³
- (a) it is inevitable that CityJet would have exited the provision of scheduled air passenger services on the LCY-DUB route absent the Merger (**Limb 1**);
 - (b) there was no substantially less anti-competitive counterparty than Aer Lingus that would have entered into an agreement with CityJet that would involve the counterparty providing scheduled flights on the LCY-DUB route (**Limb 2**); and
 - (c) the Merger does not represent a substantially less competitive outcome than the exit of CityJet and its sales from the LCY-DUB route (**Limb 3**).
54. Where, based on the available evidence, the CMA cannot reach a sufficient level of confidence in relation to each of these conditions, it will adopt as the counterfactual the pre-merger conditions, provided this is realistic.
55. The CMA considers each of these limbs below.

Limb 1: would CityJet have inevitably exited from the provision of scheduled air passenger services on the LCY-DUB route absent the Merger?

56. CityJet told the CMA that it decided over the course of late 2017 and early 2018 to focus on its wet lease operations and to exit scheduled flight operations by the end of 2018, including on the LCY-DUB route. This followed a change in strategic direction since 2015, when it was acquired from Intro Aviation by a new business consortium led by CityJet's original founder.
57. CityJet submitted that as its wet lease business grew and its scheduled network decreased in size over the course of 2016 and 2017, it became more difficult for it to operate its scheduled routes without generating losses. CityJet told the CMA that the LCY-DUB route was CityJet's last remaining scheduled route and had made losses for at least the last three years, and that these financial losses were a contributing factor for CityJet's decision to exit this route. CityJet did not, however, suggest that the LCY-DUB route was no longer financially viable *absent* a change in strategic direction (and nor is

²² [Merger Assessment Guidelines](#), para 4.3.9.

²³ [Merger Assessment Guidelines](#), para 4.3.10

there any compelling evidence to this effect). The CMA therefore does not believe that it is inevitable that CityJet would have exited the provision of scheduled air passenger services on the LCY-DUB route for reasons of financial failure.

58. The CMA therefore considered, taking into account the losses incurred by CityJet on the LCY-DUB route, whether CityJet would have ultimately exited the route for strategic reasons.
59. Based on the available evidence, the CMA considers that the CityJet's decision to exit the LCY-DUB route was part of a wider strategic decision (which preceded the decision to enter into the Agreement) to move towards being a wet lease provider. In particular, CityJet's internal documents confirm that:
 - (a) From 2015, its new management team adopted a strategy that was initially focused on building and growing its operations as a wet lease provider, while retaining a small scheduled operation to act as a 'shop window' for potential wet lease customers. As CityJet's wet lease business grew, and its scheduled network decreased in size over the course of 2016 and 2017, it became more difficult for CityJet to operate its scheduled routes without generating losses.
 - (b) Consequently, CityJet began throughout 2016 and 2017 to transition its scheduled operations into a franchise operation in order to capitalise on the brand awareness and marketing capabilities of a larger airline partner. CityJet had discussions with Aer Lingus [✂].
 - (c) Over the course of late-2017 and early-2018, CityJet made the decision to focus on its wet lease operations and to exit its scheduled operations by the end of 2018, including on the LCY-DUB route. In late-2017 and early-2018, CityJet's Board discussed how to implement the exit of CityJet's scheduled operations.
 - (d) Absent the Merger, CityJet would have exited its scheduled operations on the LCY-DUB route and either: (i) re-utilised the aircraft being used on the LCY-DUB route to service a wet lease arrangement for a different route; or (ii) removed these aircraft from service and re-utilised the crew being used on the LCY-DUB route for other operations.

CMA conclusion on Limb 1

60. The exiting firm scenario is most commonly considered when one of the firms is said to be failing financially.²⁴ However, exit may also be for other reasons, for example because the selling firm's corporate strategy has changed.²⁵ Accordingly, whilst taking into account the fact that the LCY-DUB route had been loss-making for CityJet, the CMA went on to consider whether it had compelling evidence that CityJet would have ceased providing scheduled flights on this route for strategic reasons.
61. CityJet's strategic shift to focus on its wet lease business began around 2015, following a strategic review by new management. Between 2015 and August 2018, CityJet systematically proceeded to end all its scheduled operations. LCY-DUB was the final core scheduled operation that CityJet offered. This route was making significant losses and it would have been unsustainable for CityJet to continue operating scheduled operations on a single route. Moreover, the need to have LCY-DUB as a shop window for its wet leasing business had become less pressing, as CityJet was able to market its services through the portfolio of wet lease provisions that it was offering to the wider market.
62. The CMA has considered the available evidence carefully and reviewed extensive contemporaneous documents which indicates CityJet was committed to exit from the provision of scheduled air passenger services on this final remaining route. On the basis of this compelling evidence, the CMA concludes that Limb 1 of the exiting firm counterfactual has been met, and that CityJet would have exited the provision of scheduled air passenger services on the LCY-DUB route for strategic reasons (subject to the CMA's consideration of Limb 2 below). In other words, there is no realistic prospect that CityJet would have continued the provision of scheduled air passenger services on the LCY-DUB route absent the Merger.

Limb 2: was there a realistic prospect that, absent the Merger, a counterparty who would have been substantially less anti-competitive than Aer Lingus would have entered into an agreement with CityJet to provide scheduled flights on the LCY-DUB route?

63. The Parties submitted that it was unrealistic that CityJet would have found another airline to enter into a wet lease arrangement for the LCY-DUB route. CityJet did not market the LCY-DUB route to any airlines other than Aer Lingus, on the basis that it did not consider any other airlines to have either

²⁴ Ibid, paragraph 4.3.9

²⁵ Ibid

the requisite capabilities or strategic interest to enter the LCY-DUB route. CityJet told the CMA that an airline would need to have 'frequency, scale, market awareness and sales presence, and/or the ability to offer onward connections either over Dublin or over London City onto other parts of its network to make the London City to Dublin route viable' (and that only Aer Lingus fits this profile).²⁶

64. The Parties submitted that in practice, this meant the pool of potential counterparties was limited to airlines that had:
- (a) Sufficient brand presence at both hubs: CityJet noted that Aer Lingus was uniquely well-placed with strong brand awareness at both the Dublin and London markets with the associated customer base and awareness of Aer Lingus being a travel option in the LCY-DUB pair.²⁷
 - (b) Pre-existing infrastructure/base in either DUB or LCY, without which it was considered that it would be difficult for an airline to operate a single route profitably.
 - (c) Sufficient scale to offer onward connections either over DUB or over LCY onto other parts of its route network: Aer Lingus hubs out of Dublin and offers a significant transatlantic operation out of Dublin with 95% weekly departures (approximately 70% of all transatlantic seats out of Dublin) serving 13 gateways. This included US immigration and customs pre-clearance at Dublin, enabling seamless onward connections.²⁸
65. The Parties submitted that network carriers based in continental Europe that operate a hub-and-spoke model (ie a model in which an airline operates flights from several non-hub (spoke) cities to the hub airport, with passengers traveling between 'spoke' locations connecting through the hub) would not satisfy all of these criteria. The CMA notes that this position is supported by the available evidence, which indicates that no European network carrier (other than Aer Lingus) has a hub located in either DUB or LCY and that there are almost no examples of an airline operating a 'stand-alone' flight that does not connect to one of its hub airports.
66. The Parties also submitted that it would not be commercially viable for low cost carriers (**LCCs**) to operate this route. This was on the basis that LCCs typically operate a model to generate revenues by high volumes and load factors on aircraft with significantly larger capacity than LCY could

²⁶ CityJet's submission to the CMA dated 21 November 2018.

²⁷ CityJet's submission to the CMA dated 21 November 2018.

²⁸ CityJet's Response to the CMA's Issues Letter of 23 November 2018, dated 28 November 2018.

accommodate (LCY requires smaller aircraft types due to limitations on runway size).²⁹

67. For the CMA to conclude that Limb 2 has been satisfied, it would need (on the basis of compelling evidence) to be confident that there was no substantially less anti-competitive counterparty.³⁰ When considering the prospects for an alternative counterparty, the CMA will look at available evidence supporting any claims that there was genuinely only one possible counterparty.³¹
68. The CMA contacted third party airlines, including airlines currently operating:
- (a) on the London to Dublin corridor;
 - (b) transatlantic flights from London airports and/or Dublin airport to North America; and
 - (c) out of London City airport.
69. The CMA also contacted certain other third-party airlines that operate flights within Europe.
70. The evidence received by the CMA from these third-party airlines supported the Parties' submissions that no other airline would have had either the capabilities or strategic intention to enter into an arrangement with CityJet to provide scheduled air passenger services on the LCY-DUB route. Specifically:
- (a) Several airlines, including European airlines such as Lufthansa, Swiss and Luxair, noted that to be sustainable as a point-to-point route under a wet lease-type arrangement, it would be necessary to build market presence and brand awareness at both ends of the route (ie in London and Dublin) in order to attract a sufficient volume of passengers, which would require significant marketing expenditure.
 - (b) A European airline stated that airlines, as a general rule, tend to focus on their 'home markets' where the bulk of their infrastructure is located. A single route outside of that market would be unlikely to generate the required frequency and revenue volumes that would make the high overhead costs of establishing adequate infrastructure at those 'non-home' bases worthwhile.

²⁹ IAG/Aer Lingus confidential response to the CMA dated 3 December 2018.

³⁰ [Merger Assessment Guidelines](#), para 4.3.10

³¹ [Merger Assessment Guidelines](#), para 4.3.17

- (c) Several low cost carriers (**LCCs**), including Ryanair, confirmed that the LCY-DUB route did not fit their business models given LCY would not be able to accommodate its larger aircraft, and wet leasing was not part of their strategic plans. This group included LCCs already active on the London to Dublin route.
- (d) One regional carrier confirmed that entering the LCY-DUB city pair was not part of its current strategy [REDACTED]. The CMA notes in this respect that the carrier has previously set out its strategy to reduce its overall fleet size and concentrate on profitable routes.³² [REDACTED],³³ [REDACTED]³⁴ [REDACTED].
- (e) Transatlantic carriers including Delta and [REDACTED] indicated that the route was not suitable to 'feed' their long-haul flights. London City Airport also indicated that it would be difficult to operate LCY-DUB as a point-to-point route without being able to feed connecting passengers into a wider network, given LCY's particularly high operating costs and restrictions on the type of aircraft that could operate there.

71. Overall, none of the third-party airlines contacted by the CMA expressed any credible interest in entering the LCY-DUB route at this time. This position is fully consistent with and supported by the available evidence in relation to the pre-existing commercial strategies of those third-party airlines, as well as the available evidence in relation to the limited incentives for airlines to invest in a single route (given the infrastructure and marketing costs that would be required to operate the route effectively).

CMA conclusion on Limb 2

72. The Wet Lease Agreement was not marketed to any airlines other than CityJet and therefore the CMA has sought to rigorously test the Parties' submission that there was no alternative counterparty. The CMA believes, on the basis of the views advanced from third parties, taken together with the available evidence in relation to the pre-existing commercial strategies of third-party airlines and the specificities of the LCY-DUB route, that there is compelling corroborative evidence that there was no realistic prospect of a less anti-competitive counterparty than Aer Lingus.

73. In light of the evidence set out above, the CMA believes that Limb 2 of the exiting firm counterfactual is met. The CMA notes that this conclusion is highly fact-specific (concerning as it does, a single airline route). In circumstances

³² [REDACTED].

³³ [REDACTED].

³⁴ [REDACTED].

where exiting businesses fail to run a meaningful sale process, the CMA would typically be unlikely to be able to reach the conclusion that there was no realistic prospect of a less anti-competitive purchaser (and therefore to adopt an exiting firm counterfactual), particularly within the context of a Phase 1 investigation.³⁵

Limb 3: would the exit of CityJet and its assets from the LCY-DUB route be a substantially less anticompetitive outcome than the Merger?

74. The CMA considered what might happen in the absence of the Merger, given there is no less anti-competitive counterparty willing to provide scheduled flights on the LCY-DUB route (Limb 2). The CMA believes on the basis of the available evidence that:
- (a) CityJet's exit absent the Merger would have resulted not only in a reduction in customer choice on the LCY-DUB route, but also in a reduction in capacity on that route. On ceasing to operate a LCY-DUB service, CityJet would likely have been deployed by CityJet to service other routes. Even if CityJet decided not to use the slots for another route and instead returned them to the pool for allocation to other airlines, these slots would not be reserved for new airlines that want to operate the LCY-DUB route. ACL confirmed that it could choose to allocate the slots to an airline that wants to operate a different route. This would reduce the competitive constraint CityJet had previously posed to other airlines operating between London and Dublin (in particular, Ryanair).
 - (b) As BA CityFlyer is the only other airline currently operating on the LCY-DUB route, the CMA considers that a similar proportion of CityJet's sales on the LCY-DUB route would have diverted to IAG in either scenario (ie as a result of the Merger or if CityJet exited the LCY-DUB route absent the Merger).
75. In light of the evidence set out above, the CMA believes that the Merger does not represent a substantially less competitive outcome compared with what would have happened to CityJet's sales in the result of its exit from the LCY-DUB route.

³⁵ The CMA was able to establish that there was no realistic prospect of a less anti-competitive purchaser in this case because of the limited scope of the target business and the relatively limited, clearly defined group of potential airline counterparties for CityJet (there being restrictions on the type of entities that may offer scheduled air passenger services, and since non-industrial counterparties such as private equity funds would not realistically have interest in acquiring a single airline route).

Decision

76. Consequently, the CMA does not believe that it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC within a market or markets in the United Kingdom.
77. The Merger will therefore **not be referred** under section 22(1) of the Act.

Colin Raftery
Senior Director, Mergers
Competition and Markets Authority
21 December 2018