

# 2 Conclusions

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## The reference

2.1. In this inquiry we are concerned with the contemplated merger of BIA, a body corporate incorporated in the UK, and BCA, a wholly-owned subsidiary of Shorts. We are required by the first question in our terms of reference (see Appendix 1.1) to investigate and report whether arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation (a 'qualifying merger situation'), as defined in section 64(8) of the Act in that enterprises carried on by or under the control of BIA will cease to be distinct from enterprises carried on by or under the control of BCA.

## The merger situation

2.2. BIA made an unsolicited conditional offer to acquire BCA on 2 May 1995. Shorts has told us that BCA is for sale and that it will be seeking bids from a number of parties. BIA has made it clear to us that if it is cleared to bid again for BCA, it intends to do so. We conclude that arrangements are in contemplation which, if carried into effect, will result in enterprises carried on by or under the control of BIA ceasing to be distinct from enterprises carried on by or under the control of BCA.

2.3. A further condition for a qualifying merger situation is that one of two tests is satisfied. One test is the 'share of supply' test. Under this test we are required to be satisfied that, as a result of the enterprises ceasing to be distinct, at least one-quarter of goods or services of a particular description in the UK, or a substantial part of the UK, will be supplied by one and the same person (or the persons by whom the enterprises are carried on), or, if this is already the case, that the share of supply of these goods or services by that person or persons is increased. BIA supplies about 63 per cent and BCA about 26 per cent of airport services in Northern Ireland. We note that in Northern Ireland as a result of the merger the share of airport services supplied by enterprises controlled by BIA would increase, and enterprises that would be controlled by BIA after the acquisition of BCA would supply about 89 per cent of airport services in Northern Ireland (see paragraph 4.14).

2.4. In considering whether it is appropriate for us to regard an area as 'a substantial part of the United Kingdom' within the meaning of section 64(3) of the Act we have had regard to the judgment of the House of Lords in *R v MMC ex parte South Yorkshire Transport Ltd.*<sup>1</sup> Their Lordships held that the words in question must on their true construction connote a part 'of such size, character and importance as to make it worth consideration for the purposes of the Act'. Northern Ireland is a distinct part of the UK constituting some 5.8 per cent of its land area (including inland water) with a population equivalent to some 2.9 per cent. Moreover it is heavily dependent on air services for its links with the UK mainland. Taking these factors into account we have no doubt that the area is 'of such size, character and importance as to make it worth consideration for the purposes of the Act'.

2.5. We therefore consider that the share of supply test in the Act is satisfied. Pursuant to our terms of reference we accordingly exclude from our consideration the alternative assets test prescribed by section 64(1)(b) of the Act.

2.6. We conclude that arrangements are in progress or contemplation by BIA which if carried into effect will result in the creation of a merger situation-between BIA and BCA-qualifying for investigation. As the merger has not been implemented the second question in our terms of reference relating to the actual creation of a merger situation (see Appendix 1.1) does not require an answer. We have therefore to consider the third question in our terms of reference, whether the creation of the merger situation may be expected to operate against the public interest.

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<sup>1</sup> *Weekly Law Reports*, 15 January 1993, pages 22 to 33.

## **The companies**

2.7. Prior to privatization the International Airport was operated by NIAL, a subsidiary of Northern Ireland Transport Holding Company. NIAL was privatized on 20 July 1994 by means of a management and employee buy-out. Management and employees hold 50 per cent of the shares in Belfast International Airport Holdings Limited (BIAHL) which owns BIA; the rest of the shares are held by [ \* ] (30.9 per cent) and other institutions. A special share is held by the Government, an arrangement primarily to ensure the continuance of military facilities at the airport. £5 million is payable to the Government if the International and City Airports come under common ownership within ten years of privatization.

2.8. Shorts is owned by Bombardier, a Canadian company with interests primarily in passenger transport and aerospace manufacturing. It acquired Shorts in October 1989. The group is based in Montreal and has production facilities in nine countries.

2.9. Shorts has a long history of manufacturing aircraft in Belfast and formerly used the runway of what is now the City Airport in connection with that business. In 1983 Shorts opened the runway to commercial airport operations. Shorts is presently engaged in the manufacture of aircraft components. It is closely integrated with the rest of Bombardier's aerospace operations and is also a party to a missile manufacturing programme which has effectively become a joint venture with Thomson-CSF of France. In 1993 Shorts acquired Airwork Limited to expand its aviation support business.

2.10. BCA is Shorts' operating subsidiary for the City Airport business.

## **The Belfast airports**

### ***The International Airport***

2.11. The International Airport is in a rural location near Lough Neagh, about 17 miles by road from Belfast, with good road links to the city centre affording a journey time by car of about 25 minutes. There is a half-hourly bus service to the city centre which takes about 40 minutes. The nearest railway station is four miles away at Antrim. The airport is open 24 hours a day and there are no noise abatement procedures or constraints on the types of aircraft that can operate there. It has a public use aerodrome licence (see paragraph 2.38).

2.12. BIA contracts out such services as air traffic control (ATC), aircraft handling, and ramp handling. En-route ATC is provided by National Air Traffic Services (NATS). Within about 40 miles of Belfast, the NATS centre at Prestwick transfers control to NATS staff located at the International Airport who also provide approach and visual ATC under contract to BIA.

2.13. The airport has purpose-built facilities for domestic and international passenger flights and for handling cargo and mail. It has two runways with parallel taxiways and all-weather landing equipment. The passenger terminal has an annual capacity of 3.5 million passengers and restaurant, shopping and other facilities. In 1994 the airport had 2.04 million passengers and some 38,000 air transport movements (ATMs) (including freight and mail, but excluding military traffic and civilian light aircraft) (see Appendix 3.1).

2.14. The airport's charging structure for passenger aircraft comprises a landing charge based on maximum take-off tonnage and a charge per passenger, known as the passenger load supplement (PLS). Airlines pay additional charges to concessionaires for many of the contracted-out services. BIA had a turnover of £22.8 million in the year ended 31 March 1995 and charges for core services

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\*Details omitted. See note on page iv.

(see paragraph 2.62) accounted for [\*] per cent of that (see Table 4.2). The balance came from ancillary activities, such as concessions for shops, and car parks.

2.15. Domestic<sup>1</sup> scheduled passenger services, which are our primary concern in this inquiry (see paragraph 2.32), accounted for [\*] per cent of the International Airport's revenue from core activities in the year ended 31 March 1995 (see Table 4.2). They are presently operated from the airport by British Airways Plc (BA), British Midland Airways Ltd (BM), Loganair Ltd (Loganair) and Maersk Air Ltd (Maersk) (both operating as British Airways Express<sup>2</sup>), Knight Air Ltd (Knight), Air Belfast Ltd (AB) and Business Air. They provide services to London Heathrow, London Stansted, Manchester, Birmingham, East Midlands, Glasgow, Leeds/Bradford and Jersey.<sup>3</sup> The Heathrow services, supplied by BA and BM, are predominant, accounting for more than 70 per cent of domestic scheduled passengers travelling to and from the airport in 1994. There are international scheduled passenger services to Amsterdam, and New York and Boston (via Shannon) and numerous international charter flights.

### ***The City Airport***

2.16. The City Airport is located in the harbour area of Belfast two miles from the city centre on the North Down side of Belfast Lough. It is less than ten minutes by car to the city centre and five minutes by rail from an adjacent station. The airport's urban location makes aircraft noise a sensitive issue, resulting in planning constraints on its operations. A planning agreement with the Department of the Environment (Northern Ireland) (DoE(NI)) includes the following restrictions:

- (a) programmed flights only permitted to use the airport between 6.30 am and 9.30 pm;
- (b) a limit of 38,000 ATMs a year;
- (c) operators not to offer more than 1.5 million seats a year on scheduled flights from the airport;
- (d) only jet aircraft complying with Chapter III<sup>4</sup> noise pollution standards to be accepted; and
- (e) a required bias towards approaches and climb-outs over Belfast Lough.

Restriction (c) is not free from ambiguity (see Appendix 3.2, paragraph 13). The airport has an ordinary use aerodrome licence (see paragraph 2.38).

2.17. The airport's single runway is long enough to permit the operation of aircraft up to the size of a Boeing 757 or Airbus 320 but at present is only able routinely to handle aircraft up to the size of a British Aerospace (BAe) 146. The taxiway and apron facilities presently available restrict the number of ATMs that can be accommodated (see Appendix 3.2, paragraphs 21 and 22).

2.18. The fairly cramped terminal mainly comprises a converted hangar and provides quite limited passenger facilities. But there are a snack bar, a licensed bar and a newsagent/giftshop, and although the terminal is stretched at peak times, passengers value the opportunity to get through the

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<sup>1</sup>ie within the UK, the Channel Islands and the Isle of Man.

<sup>2</sup>A BA franchise enabling the franchisee to use BA livery and ticketing, and to benefit from BA marketing.

<sup>3</sup>The service to Jersey operates only during the summer.

<sup>4</sup>The quietest category of aircraft as defined by the International Civil Aviation Organization (ICAO).

\*Figures omitted. See note on page iv.

terminal quickly. It is, for example, feasible for a businessman to leave his place of work in the city centre and to board his flight within half an hour. The terminal accommodated 1.2 million passengers in 1994, and in BCA's view it might accommodate up to 1.7 million with some changes to the internal layout. There were some 32,000 ATMs in 1994 (excluding military traffic) (see Appendix 3.2). Apart from a service to Dublin, which has recently ceased, and a few charter flights, commercial use in 1994 was entirely by domestic scheduled traffic.

2.19. Many services, including ramp handling, are provided in-house [ *Details omitted. See note on page iv.* ]. En-route ATC services at the City Airport are the same as those provided by NATS for the International Airport, but BCA staff are responsible for approach and visual ATC (see paragraph 2.12).

2.20. The airport's published charges relate to general aviation and diverted flights and comprise a landing charge and a navigation charge, both per tonne, and a PLS. However, BCA told us that the published charges were only the starting point for negotiations with the airlines, and that charges to scheduled users were based on the PLS without any tonnage element (see paragraph 4.46).

2.21. Domestic scheduled passenger services accounted for about 96 per cent of the City Airport's revenue from core activities in the year ended 31 January 1995 (see Table 4.2). They are operated by Jersey European Airways Ltd (JEA); Manx Airlines Ltd (Manx), operating as British Airways Express; and Gill Airways Ltd (Gill). They provide services to 21 domestic destinations including six that overlap with services from the International Airport: London Stansted, Manchester, Birmingham, Leeds/Bradford, Glasgow and Jersey.<sup>1</sup>

## **The merger in contemplation**

2.22. Shorts stated that when it had been acquired by Bombardier in 1989, BCA had been retained although airport management had not been part of either party's core business. The issue of airport ownership had arisen again in 1994 when BIA had been privatized, and it had been decided not to make a bid. Moreover, recognizing that considerable investment in the City Airport would be required, it had been decided to seek a buyer for BCA. In the event, the decision to dispose of BCA had been precipitated by a bid by Sarcon Diamond Limited (Sarcon) in March 1995 for BCA and the adjacent Sydenham site (see Appendix 3.2, Figure 1) in the sum of £24 million, subject to due diligence and contract. Memorandum heads of agreement were signed and the arrangement made public.

2.23. BIA explained that on 2 May 1995 it had made an indicative offer for BCA and the Sydenham site at a price in the range £25 million to £27 million subject to due diligence. It had no access to detailed information about the City Airport or the value of the Sydenham site and had pitched its bid at a level above that of Sarcon as a means of entering into negotiations.

2.24. Shorts told us that when Sarcon withdrew its bid in June, it had been decided that BCA should be put up for sale and Barclays de Zoete Wedd Ltd (BZW) had been appointed to advise on the disposal. Shorts said that it would plan to retain the use of the runway at the City Airport. The plan was that any new owner's lease from the Belfast Harbour Commissioners (BHC) should specify that if the runway should ever cease to be used for commercial operations, then the runway would revert to Shorts (see paragraph 2.88).

2.25. We asked BIA about the price it had offered for BCA. It told us that its indicative proposal had simply been a negotiating ploy, and had been subject to due diligence. The £5 million payable

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<sup>1</sup>The service to Jersey from the International Airport operates only during the summer.

to the Government following a successful bid (see paragraph 2.7) represented the available synergies and cost savings that would result from the merger. A tier of administration would be eliminated, overheads would be reduced and significant economies would be effected-mainly in ATC and marketing, and by contracting out various activities. The merger would also be a way of achieving a concentration which would affect the perception of airlines as to the potential international traffic and thus attract greater contributions from the international market, without rebalancing domestic flights between the two airports (see paragraph 6.9). This could be done by operating the airports as Terminal A and Terminal B of a single enterprise. The travel time between the airports was of the order of 25 minutes and it would be able to provide both a dedicated shuttle service between them and a city centre check-in. As to the value of the Sydenham site, BIA could not come to a view until it had completed due diligence. We return to the matter of BIA's conditional offer for BCA in paragraph 2.61.

2.26. Shorts told us that, although it was not privy to BIA's plans, BIA as an existing operator in the province clearly had more options for the allocation of airport resources in Northern Ireland than an alternative purchaser would have. BIA would presumably be able to reduce substantially the cost burden of acquiring BCA by disposing of its interest in the whole of the Sydenham site (see paragraph 6.70).

## **The supply of airport services in Northern Ireland**

2.27. We start with modes of travel to and from Northern Ireland, and then deal with shares of supply of airport passenger services in the province, the area where the Belfast airports' services overlap. We go on to discuss features of the supply of airport passenger services in Northern Ireland, the regulatory system and competition between the Belfast airports before turning to the public interest issues.

### ***Modes of travel to and from Northern Ireland***

2.28. Of the 5.8 million people who entered or left Northern Ireland in 1993 using public transport (excluding buses and coaches), 53 per cent travelled by air, 38 per cent by boat (see paragraphs 4.31 and 4.32), and 9 per cent by the Belfast-Dublin rail link (see Table 4.7). No data are available on those using private transport.

2.29. Travel times by road and rail are relatively long between Belfast and Dublin compared with the duration of a typical domestic flight. This suggests that scheduled flights from Dublin to the UK are not a close substitute for domestic flights from Belfast for most travellers (see paragraph 4.29).

2.30. Sea travel is particularly suitable for people who want to take a car and is also an attractive option for other people travelling to areas close to Stranraer and Liverpool. The Prestwick service instituted recently from the City Airport is a potential competitor for the SeaCat service from Belfast to Stranraer. However, the great majority of passengers flying from the Belfast airports do not fly to destinations near Stranraer, and their travel time would be increased very substantially if they switched to travelling by boat. The service by sea to Liverpool is limited and takes much longer than the frequent air services to Manchester. We conclude that there is only limited scope for substitution between the market for flights from Belfast and the market for sea travel (see paragraph 4.34).

### ***Shares of the supply of airport passenger services in Northern Ireland***

2.31. It can be seen from Table 2.1 that the Belfast airports supplied about 99 per cent of airport passenger services in Northern Ireland in 1994.

TABLE 2.1 The supply of airport passenger services in Northern Ireland, 1994

	<i>Passenger numbers</i>	
	<i>m</i>	<i>%</i>
International Airport	2.04	62
City Airport	1.23	37
City of Derry Airport	0.03	1
Other airstrips*	-	-
Total	<u>3.30</u>	<u>100</u>

Source: CAA.

\*Negligible.

2.32. Domestic scheduled services account for about 80 per cent of Northern Ireland airport passenger services and are the one significant area of overlap between the Belfast airports (see paragraph 2.62). Table 2.2 shows airports' shares of these services in 1994.

TABLE 2.2 The supply of domestic scheduled passenger services in Northern Ireland in 1994

	<i>Passenger numbers</i>	
	<i>m</i>	<i>%</i>
International Airport	1.41	53
City Airport	1.22	46
City of Derry Airport	<u>0.03</u>	<u>1</u>
Total	<u>2.66</u>	<u>100</u>

Source: CAA.

The catchment areas of both Belfast Airports cover the whole of the province (see paragraph 4.11). Interlining<sup>1</sup> via UK airports is important, particularly from BIA to Heathrow.

2.33. Some 80 per cent of the Belfast airports' passenger traffic is domestic, compared with about 20 per cent for UK airports on average, and 38 per cent for UK airports excluding the London airports. This indicates the great importance of domestic air services to a province separated from the mainland by the Irish Sea. It is clear that people in Northern Ireland fly on trips of a kind that elsewhere in the UK would be made by rail or road. In this connection it is worth noting that many people from Northern Ireland have found jobs on the mainland and need to visit relatives and friends in the province.

2.34. Almost all international flights from Belfast are charter flights from the International Airport. Nearly all passengers flying abroad by scheduled flights transfer to an international flight at a London airport or Manchester. In contrast, for the UK as a whole, about two-thirds of international flights are scheduled and a third charter. Even excluding flights to and from the London airports a third of UK international flights are scheduled.

### ***The regulatory system***

<sup>1</sup>Air travel which involves changing from one flight to another, usually at a hub airport.

2.35. The regulatory system, summarized below, is described in detail in paragraphs 4.3 to 4.7.

### *Economic regulation*

2.36. With effect from 1 March 1996 the Belfast airports will be subject to economic regulation by the Civil Aviation Authority (CAA) under Part IV of the Airports (Northern Ireland) Order 1994. The Order closely follows the Airports Act 1986 (the 1986 Act) which applies to airports in Great Britain. In short, the Order enables the CAA to impose such conditions as it considers appropriate on airport operators concerning trade practices or pricing policies, which are, broadly, discriminatory, financially unsound or which unfairly exploit their bargaining position.

2.37. The Order also enables the DoE(NI) to 'designate' airports which are subject to economic regulation. The Department of Transport's criteria for the designation of airports include:

- (a) the extent of competition from other airports or other modes of transport;
- (b) prima facie evidence of excessive profitability or abuse of a monopoly position;
- (c) the scale and timing of investment, and their implications for profitability; and
- (d) the efficiency and quality of services.

The only airports in Great Britain that have been designated are Gatwick, Heathrow, Stansted and Manchester (by the Secretary of State under the 1986 Act). Designated airports are subject to the imposition of mandatory conditions. Each designated airport is subject to quinquennial review by the CAA and, unless otherwise directed by the Secretary of State, by the MMC, for the purpose of setting the formula governing the maximum amount of charges for airport services which can be levied by the airport operator.

### *Licensing*

2.38. The CAA grants public use and ordinary use aerodrome licences. A public use licence contains the following condition: 'The aerodrome is licensed for public use and shall at all times when it is available for the take-off or landing of aircraft be so available to all persons on equal terms and conditions.' The condition is not found in an ordinary use licence: such a licence enables use of the aerodrome only by the holder of the licence and persons specifically authorized by him.

## **Competition between the Belfast airports**

### ***Views of the parties***

2.39. We received diametrically opposed views on whether there is competition between the Belfast airports. BIA and Shorts contended that there was little or no competition. The third parties contended that there was competition, and that it was difficult to separate airport competition from airline competition. The views of the main parties are set out in Chapter 6 and the views of the third parties are set out in Chapter 5. The following paragraphs summarize those views.

### *BIA's views*

2.40. BIA took the view that the two airports were not in effective competition with each other. The City Airport, when it opened for public use in 1983, had welcomed the smaller aircraft which had not been encouraged by the previous public sector management at the International Airport. Thus the City Airport had attracted new routes. BIA acknowledged that after privatization in 1994 the new management of the International Airport had been concerned about the growth of traffic at the City Airport; but in practice they had been unable to do anything to influence airline choice. The factors which did influence airlines were outside airport management control. In BIA's view, the key factor which determined an airline's choice of airport was route profitability, which in turn was dependent on traffic density, yield and inter-airline competition.

2.41. BIA argued that if airlines were actively choosing between the Belfast airports, one would expect to see them choosing to move their services from one airport to the other, but in fact such occurrences were rare. BIA contended that there could be a degree of competition between airports on two grounds: to win the battle to be a major hub, and to capture the maximum amount of charter traffic. However, this competition between airports was not relevant to the Belfast airports. Moreover, the economics of airport provision meant that there were no competition benefits of having separately owned airports to offset the disbenefits associated with the implied losses of economies of scale, user density and critical mass (see paragraph 6.31).

2.42. BIA stated that the relevant market from a public interest point of view was not that between airports for airline traffic, but between airlines for air passengers. Airport charges were not a factor in attracting airlines to airports, but once an airline was established at a particular airport, that airport had to maintain charges at an equitable level, and to treat airlines operating on the same routes in the same way. Traffic had gone to the City Airport largely because it was there, and business, once established, had grown because of the convenient location. Both Belfast airports were keen to get whatever traffic they could, but in the final analysis this was outside their control.

2.43. In BIA's view, the airlines at the City Airport saw themselves as serving niche markets and would be reluctant to come and compete at the International Airport. BIA had introduced incentives after privatization to attract airlines to the International Airport, but such incentives had had no effect on the airlines. BIA told us that in 1994 BA had asked for reduced charges, suggesting that otherwise it would move to the City Airport; but in the event BIA had not felt able to help and BA had stayed put. BIA added that many of the aircraft currently at the International Airport could not operate from the City Airport because of its operational limitations on the size of aircraft and environmental restrictions on noise levels. On the question of offering discounts, BIA said that it did offer discounts to airlines on new routes but this did not affect the airlines' decision to come to the airport. The offering of discounts was custom and practice in the industry.

2.44. BIA believed that because of the regulation coming into effect on 1 March 1996 there were quite significant powers available (see paragraphs 2.36 and 2.37) to prevent it from taking advantage of its position in relation to setting airport charges. However, there were already very strong downward forces on prices at the International Airport as a result of pressure from the airlines.

2.45. We asked BIA for certain internal documents. These showed that BIA had been concerned about competition from the City Airport as late as March 1995 (see paragraph 2.65 and Appendix 6.1).

#### *Shorts' views*

2.46. Shorts said that the extent to which the two Belfast airports competed, actually or potentially, in the same markets was very limited. The two airports each currently provided facilities which enabled the airlines to offer scheduled domestic flights to Stansted, Birmingham,

Glasgow, Jersey,<sup>1</sup> Leeds/Bradford and Manchester. However, this competition did not have any great significance for airlines' fares, which were very similar on most of these routes from both airports.

2.47. Shorts argued that the routes served only from the City Airport (Gatwick, Luton, Aberdeen, Blackpool, Bristol, Cardiff, Edinburgh, Exeter, Guernsey via Gatwick, Isle of Man, Liverpool, Londonderry, Newcastle, Prestwick and Southampton) had been created by airlines building up services from that airport, and serving a particular market; they owed nothing to competition between the airports. Nor did Shorts accept that such competition had been a factor in opening up a wider choice of destinations in the UK.

2.48. As to potential competition, Shorts considered that the scope was limited. Although BCA's strategic plan for 1995 had set as a milestone the establishment of a Heathrow route, this was unlikely to materialize. Therefore Heathrow would continue to be served from the International Airport only. At the City Airport, two carriers (Manx and JEA) accounted for over 90 per cent of passenger throughput in 1994, and were in effect 'captive' to that airport. The main attraction that the City Airport had for airlines was its location rather than attractive charges. Airports could in theory compete for the business of particular airlines, but in practice the airlines' ability to change airports was limited. JEA in particular had built up a profitable business at the City Airport over the years; if it were to move to the International Airport it would almost certainly lose some of that business. It could also be argued that by operating out of different airports, airlines were shying away from competition that they would have had to face if they had tried to compete from the same airport.

2.49. Shorts said that regulatory constraints were not the ideal method of controlling charges and prices. It was important for airports to work closely with their customers. It thought BIA now realized that and was unlikely to handle the merged enterprise very differently from the way BCA had handled the City Airport.

2.50. We asked Shorts for certain internal documents. These showed that Shorts had been concerned about competition from the International Airport in its 1995 strategic plan (see paragraph 2.66 and Appendix 6.1).

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<sup>1</sup>The service from the International Airport to Jersey operates only during the summer.

### *Third parties' views*

2.51. As already indicated (see paragraph 2.39), the views of third parties were in striking contrast to those of the main parties. A number of airlines and consumer bodies, as well as the CAA and the DoE(NI), maintained that competition between the Belfast airports had seen the development of many new routes to regional destinations in Great Britain and that competition between airports and competition between airlines was difficult to disentangle. Many local authorities in Northern Ireland made representations to the effect that separate ownership of the airports would be preferable to common ownership as the community would otherwise be deprived of choice and competition. The CAA said that the range of services from Belfast to Great Britain regional points was greater than it would otherwise have been, because of the City Airport. The DoE(NI) said that airlines operating from the City Airport had introduced more new routes from Belfast than would have been introduced if the International Airport had been the only commercial airport; in the DoE(NI)'s view a significant factor in the introduction of new routes was BCA's pricing policy, whereby it shared risks with airline operators. The airlines almost unanimously agreed with this view and declared that airport charges were a substantial part of their costs and that the presence of two competing Belfast airports enabled them in their negotiations with the airports to put pressure on airport charges. This was fundamental to the long-term development of airlines and air services in Northern Ireland.

2.52. We received a good deal of evidence about airport charges in relation to airlines' costs. We are satisfied that airport charges are a significant proportion of an airline's costs on UK domestic routes-up to about a third of total operating costs (see paragraph 4.49). JEA and Gill told us that increases in airport charges were inevitably reflected in air fares. BM told us that in the last three years it had been able to decrease average fares partly as a result of the freeze on the International Airport's charges (see paragraph 5.27).

2.53. BA observed that it was difficult to conclude that competition between the airports had led to growth, but nor could one conclude that it had not led to growth. There were too many other factors, for example the growth in competition from services originating in the Irish Republic; the changing security situation; and the fact that surface competition played a different role in respect of routes to and from Belfast than elsewhere in the UK.

2.54. BA also believed that the statements of the airports to the effect that the two airports were complementary could be true only if there was no overlap in their catchment areas or if an operator had no choice about which airport to use. That was not the case. BA disagreed that 'captive' was an appropriate word to describe the status of airlines at an airport. Airlines always had the choice to move their operations between airports even if there might be a significant cost in doing so. Inter-airline competition was enhanced by competition between airports.

2.55. JEA stated that the routes served only from the City Airport owed everything to competition. In virtually every case, a new service had been begun at the City Airport either in competition with an existing service from the International Airport or by a transfer of a service operated from the International Airport.

2.56. The General Consumer Council for Northern Ireland said that competition between the airports had led to improvements in air services, such as an increase in the choice of destinations, a higher frequency of scheduled departures, and a wide selection of fares available. The Consumer Council and the City of Derry Airport stated that the benefit to consumers from competitive market development was illustrated by JEA's move to turn the City Airport into a regional hub with regular services to Londonderry.

2.57. A number of airlines put it to us that competition between the airports had stimulated competition between airlines and provided the user with a greater choice of carrier. The evidence on overlapping routes supports this view (see paragraphs 2.62 and 4.55 to 4.59). Airlines and other

parties argued that the pricing and other policies of the City Airport had enabled it to provide competitive advantages to carriers over the International Airport. Head-to-head competition at the International Airport between all these carriers was not a viable proposition.

2.58. Airlines and other interests, including consumer groups, believed regulation would be less effective in controlling prices than the existing competition. The CAA also told us that it saw regulation as second best to competition (see paragraph 5.118); the common ownership of the two airports subject to the constraining regulatory powers would not be as good as separate ownership.

### ***Summary of views of the parties***

2.59. The Belfast airports' position can be summed up as being, essentially, that the airports have not been in effective competition in the past because the growth in regional services has simply arisen as a result of the City Airport's existence and favourable location; that the airports are hardly in competition because it is the airlines which compete on the scheduled domestic routes; that airports can do nothing to attract airlines because airlines are not influenced by airport charges in choosing airports; and that consequently the scope for potential competition between the airports is virtually non-existent. Any desire by the merged enterprise to abuse its dominant position would be restrained by the regulatory system. A substantial body of third party opinion is, in contrast, that the growth in regional services was significantly assisted by competition between the airports; that competition between airlines on domestic scheduled routes is facilitated by the existence of and competition between the two airports; that airports' charging structures do matter to airlines; and that the merger in contemplation would put in jeopardy smaller airlines' ability to compete with the larger airlines. Major airlines (BA, BM and JEA) using the Belfast airports and other parties including the CAA believed regulation would not be an adequate substitute for the competition between the airports brought about by separate ownership.

### **Public interest issues**

2.60. Three main issues arise from the merger in contemplation:

- (a) whether BIA's unsolicited conditional offer of £25 million to £27 million represents a premium price and indicates an attempt to purchase monopoly power;
- (b) whether competition between the Belfast airports has had a beneficial effect on prices charged to and quality of service enjoyed by airlines and passengers; and
- (c) whether the proposed merger would eliminate competition between the Belfast airports, with adverse consequences for airlines and passengers in terms of price, quality of service and choice.

Arising out of issue (c), we particularly canvassed with BIA and Shorts the view of some third parties that BIA would eventually close the City Airport if it acquired BCA.

## ***BIA's unsolicited offer***

2.61. Some third parties argued strongly that BIA's unsolicited conditional offer, to which there has to be added the £5 million payable to the Government, indicated an attempt to purchase monopoly power (see paragraphs 2.7 and 5.37). BIA, however, indicated that the extra £5 million it would have to pay following a successful bid for BCA represented no more than the synergies available to it as an existing airport operator (see paragraph 2.25). The marginally higher offer than the Sarcon bid had simply been a ploy to get to the negotiating table. The firm offer it would make in due course would be entirely dependent on due diligence; it had no knowledge of BCA's profitability beyond the not very informative published accounts. We cannot reach any view on this issue in the absence of a firm offer for BCA from BIA.

## ***Competition and choice***

### *Competition*

2.62. It is convenient to deal with issues (b) and (c) together. The services provided by airports can be divided into core services associated with the take-off and landing of aircraft and getting passengers, baggage and freight on and off aircraft; and ancillary services such as restaurants and car parks. While airlines are the direct customers of core services, the airlines' choice of routes depends on passenger demand. As we have seen (see paragraph 2.32), overlap between the Belfast airports is almost wholly on domestic scheduled passenger flights. Five<sup>1</sup> domestic routes are presently served by both airports. Of these routes, three (Manchester, Birmingham and Glasgow) have substantial volumes of traffic from each of the two Belfast airports (see paragraph 4.57).

2.63. Passengers' preferences for particular airports depend primarily on availability of flights, and on location.

2.64. Airports can attempt to interest airlines in their services by setting and structuring airport charges so that the airport is carrying some of the airlines' risk. They may, for example, do this by setting charges according to the PLS, rather than basing part of the charge on tonnage. (BCA has adopted this competitive strategy with success.) The feature may be particularly attractive to small start-up airlines, or to larger airlines opening new routes. Airports may also actively market the flight opportunities available from the airport and offer airlines services such as earmarked lounges, office space, and ticketing and check-in facilities.

2.65. BIA told us that it accepted that in the past it had operated under the false impression that the two airports in Belfast actively competed with each other, and that its marketing strategy had been based on this premise. Thus we note that the SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis which formed part of BIA's Management Buy-Out Memorandum of July 1994 refers to the threat of further development of BCA. And as recently as 27 March 1995 BIA's Board Minutes record that it was agreed that efforts should be directed towards ensuring the relocation of JEA to the International Airport whilst ensuring that the current airlines there did not become disillusioned (see Appendix 6.1). Not long afterwards, on 2 May, BIA made its offer to purchase BCA. Our attention was drawn to an article of 22 June 1995 in *The Irish Times* claiming that BIA 'stated at the time that if it did not succeed in buying the City Airport it would continue to compete aggressively with it'. BIA said that *The Irish Times* was referring to a discussion held with a journalist towards the end of February/beginning of March 1995, and that BIA's realization that the Belfast airports were not in competition dated from March 1995 onwards.

2.66. At our request, Shorts sent us BCA's 1995 five-year strategic plan. In that document BCA says that BIA remains the main competitor for UK traffic; that 'increased competition is becoming

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<sup>1</sup>Jersey is served from both airports only during the summer.

apparent from the privatised BIA in the form of pricing incentives and aggressive route marketing'; and that 'BCA has continued to take market share from BIA on UK domestic routes'. BCA also says that a key strategic issue is 'how to negate competition from the privatised BIA' (see Appendix 6.1).

2.67. We also observe that BIA tried to entice both JEA and Gill to leave the City Airport, and that BA was offered attractive terms by BCA to leave the International Airport (they all chose not to leave). BM told us that BIA's and BCA's vigorous competition to attract services could be demonstrated by the example of BM's East Midlands service. When this service was reorganized within Airlines of Britain Holdings plc (ABH) in January 1995, it was decided on grounds of cost and quality of service to switch the service from the City Airport (where it was operated by Manx) to the International Airport where it would be operated by BM. Thus, BM said, the decision to switch turned upon factors well within airport management's control-airport charges and quality of service.

2.68. The evidence of BIA's and BCA's internal records alongside the evidence of most of the airlines leave us in no doubt that the Belfast airports have sought to compete vigorously under separate ownership (we set out some of the ways in which airports compete in paragraph 2.64). We acknowledge that once an airline is established at an airport it will not lightly decide to move to another airport because of both the costs involved and the possible loss of revenue if some passengers find that other airport inconvenient and/or a rival airline steps in to operate the original service. Although this raises some doubts as to the extent to which incumbent airlines are influenced by competition between the Belfast airports, we are clear that they are so influenced in their choice of airport. We should not expect any such competition to continue under joint ownership. Manx put the position succinctly:

Commercial entities compete effectively with one another through a variety of (sometimes quite subtle) differentials, many of which depend upon timing, investment and confidentiality in their introduction. Such matters are inconsistent with common ownership, especially against a background of a professed strategy to develop 'complementary roles' and 'integrated systems' [see paragraph 5.62].

BIA's acquisition of BCA would eliminate the threat it has perceived from the development of the City Airport's operations (see paragraph 2.65). There would be no incentive for BIA to bring the entrepreneurial spirit to the City Airport's operations which has been so marked under Shorts' ownership and which is likely to continue under separate ownership, given the City Airport's attraction for both airlines and passengers. Choice of airport under joint ownership might remain but much would depend on how BIA acted in practice as regards the City Airport.

2.69. We reject BIA's and Shorts' argument that the Belfast airports do not effectively compete. Nor do we accept that regulation will be an adequate substitute for competition between the airports. The CAA itself told us that regulation was second best to competition (see paragraph 2.58). We would expect loss of competition between the airports to result in higher airport charges than would apply in the absence of the merger in contemplation; a reduction in competition between airlines (see paragraph 2.57); and arising from these a reduction in routes and services offered by airlines and/or an increase in air fares (see paragraphs 2.51 and 2.52).

### *Closure of the City Airport*

2.70. JEA and Gill, both airlines using the City Airport, and other third parties including Belfast City Council considered that sooner or later, under the ownership of BIA, the City Airport would close. Four airlines (BA, BM, JEA and Maersk) and other third parties thought BIA might attempt to direct traffic to the International Airport by more subtle means-for example by starving the City Airport of investment.

2.71. Both BIA and Shorts argued that it would be in BIA's own commercial interest to keep the City Airport open and in good order. Shorts also told us that if, hypothetically, commercial operations at the City Airport ceased with the result that the runway was used only for Shorts' business, Shorts could start commercial airport operations again. The cost of keeping the airport open merely for the few flights that Shorts needed for manufacturing would be too high and Shorts would be back in the airport business. BIA informed us that it would not attempt to redistribute traffic between the Belfast airports, and it would honour existing deals with the airlines using the City Airport, subject to due diligence. Although it was not sure whether the planning restrictions could be eased, BIA told us that if it owned both airports and found that its airline customers strongly favoured an expansion of the City Airport, then taking into account the relative investment needs at each airport, it would seek a relaxation of the planning constraints in order to maximize volume and revenue. Unlike other bidders, however, BIA would not see this as imperative to the financial viability of the City Airport. Future expansion could be handled at the International Airport, boosting BIA's overall profitability. By contrast, an independent operator might well see the need to see traffic expand significantly at the City Airport in order to recoup its investment.

2.72. As both the Belfast airports are successful and profitable enterprises, we think it is unlikely that in the short term BIA would act to close the City Airport, and it would no doubt wish to honour existing deals with airlines. However, following a merger with BCA we do not consider that BIA would have the incentive to develop the City Airport as a thriving going concern.

2.73. There is a distinction between BIA as owner of the International Airport and any other party: no owner other than BIA would benefit from traffic being transferred to the International Airport. We consider that there is a greater likelihood of the City Airport being closed in the longer term under BIA's ownership than if it continues under separate ownership.

### *Choice*

2.74. Closure of the City Airport would certainly reduce consumer choice, but leaving aside BIA's option of closing the airport, we believe BIA is unlikely to encourage the airlines to expand services from the City Airport beyond its existing capacity while there remains significant spare capacity at the International Airport. We formed the clear view that, while the City Airport remained open, BIA's preferred course would be to maintain it at a level of activity no higher than the present. As a result we would expect airlines and passengers over time to enjoy less choice with the Belfast airports under common control than they would if the City Airport remained independent: an independent owner would have a greater incentive to develop the City Airport to its full potential. This indicates a divergence of interest between BIA on the one hand and the airlines and passengers on the other hand concerning the further development of the City Airport to accommodate both new routes and additional airlines.

### ***Benefits of the merger in contemplation***

2.75. BIA told us that there would be scope for savings on staff costs of £[ \* ] a year from efficiency gains arising from the merger, including £[ \* ] on ATC, although it recognized that at least in theory ATC savings could be achieved by co-operation between the two airports even if they remained in separate ownership. We note that the effect on employment would not be great. Indeed the Northern Ireland Committee of the Irish Congress of Trade Unions initially told us that it thought the primary issues at present arising from the merger in contemplation were mainly of concern to consumers. After further consideration and consultation, it opposed the merger on the ground that a powerful monopoly would be created (see paragraph 5.138).

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\*Figures omitted. See note on page iv.

2.76. BIA said that there was a direct benefit for air services in Northern Ireland from presenting Belfast as one market: this could not be done effectively with two separately owned airports. By marketing the two airports as a single entity BIA felt it could go some way towards convincing international airlines that there was the critical mass of domestic flights to feed international flights.

2.77. As we have already indicated (see paragraph 2.74), we believe BIA's preferred course as owner of the City Airport would be to maintain it at a level of activity no higher than the present, making only essential capital investment, although it told us that it would in principle be prepared to discuss expansion with the airlines using the City Airport. BIA also said that the merger would enable the City Airport to abandon what BIA believed to be a costly but necessary requirement for any stand-alone operator to expand the airport, both in physical terms and the number of ATMs a year, in order to meet its investment and debt service obligations. Accordingly the adverse effects on the environment of actions such as extended opening hours and providing for larger aircraft to be taken by such an investor would be avoided (see paragraph 6.40).

2.78. Shorts took a similar view, although it noted that it was not privy to BIA's detailed plans. In particular, it said that BIA as an existing operator in the province clearly had more options for optimizing the allocation of airport resources in Northern Ireland than an alternative purchaser would have, and the planning agreement constraints on the City Airport would not be disturbed.

2.79. A further benefit of the merger would be that £5 million would be payable by BIA to the Government (see paragraph 2.7).

2.80. We have carefully considered the potential benefits arising from the merger in contemplation but believe them to be outweighed by the detriments to competition and choice set out in paragraphs 2.69 and 2.74. In particular, we are not persuaded that joint ownership will make any material difference to the growth of international traffic from the Belfast airports: we note the launch in August 1995 of a scheduled service from the International Airport to New York and Boston (see Appendix 3.1, paragraph 8).

### **Conclusions on the public interest**

2.81. We conclude that the merger in contemplation may be expected to operate against the public interest, with the particular effects adverse to the public interest set out in paragraphs 2.69 and 2.74, viz:

- (a) higher airport charges than would apply in the absence of the merger;
- (b) a reduction in competition between airlines;
- (c) arising from (a) and (b) a reduction in routes and services offered by airlines and/or an increase in air fares; and
- (d) a reduction in choice for airlines and passengers.

2.82. We are therefore required under the Act to consider what action, if any, should be taken for the purpose of remedying or preventing the particular adverse effects which we have identified as arising from the merger situation.

### **Recommendations**

2.83. We considered whether the adverse effects listed in paragraph 2.81 could be addressed by not permitting the merger at all or by permitting it only if one or more of the following remedies were put into effect:

- (a) an undertaking by BIA to submit to price controls on the merged enterprise;
- (b) an undertaking by BIA to:
  - (i) continue to permit airlines currently using the City Airport to do so on the same or comparable terms and conditions;
  - (ii) continue to maintain existing opening hours and facilities at the City Airport and to honour existing incentive and market support deals with airlines and tour operators; and
  - (iii) operate the City Airport under a public use licence;
- (c) designation by the Secretary of State of both airports, under the Airports (Northern Ireland) Order 1994;
- (d) an undertaking by BIA to honour any understandings or agreements with the Ministry of Defence (MoD); and
- (e) an undertaking by BIA not to oppose another operator entering the market in the Belfast catchment area, through the planning process or with pricing mechanisms or otherwise.

We put these matters in hypothetical terms to BIA and Shorts, but in the event we did not further pursue (e) because there was general agreement that there was no prospect of another airport operator entering the market in the Belfast catchment area.

### ***BIA's views on possible remedies***

2.84. As to price controls ((a) above), BIA said that it did not consider that Belfast should be treated differently from other UK regional airports. There were constraints on overcharging as a result of reviews by the British Air Transport Association and also guidelines from the International Air Transport Association. Those constraints were internationally recognized within the industry; and were implemented. In addition the CAA had to give permission to levy or change charges. Regarding (b)(i), BIA said that it would guarantee to keep the City Airport open but could not guarantee to do so on comparable terms and conditions, because it did not know the terms and conditions at the City Airport. With regard to (b)(ii), maintaining existing opening hours at the City Airport would present no difficulty. As to the honouring of existing incentive and market deals, BIA said that it did not know what these were. Regarding a possible requirement that the merged enterprise should operate the City Airport under a public use licence ((b)(iii)), BIA said that it would be happy to look at that. With regard to designation ((c)), BIA's position was that designation of the airports would be unnecessary. As for a requirement to honour any agreements with the MoD ((d)), this could not be considered until BIA knew what agreements the MoD had with BCA.

2.85. BIA subsequently developed and put to us the following proposals for undertakings in the event that it had control of, or acquired a controlling interest in, BCA:

1. To keep the City Airport open during its current permitted operating hours for commercial air transport services.

2. To honour existing contractual arrangements between BCA and its airport users as to the levy of airport charges. (BIA added that it was currently unaware of such contractual arrangements and that this undertaking was subject to the completion of due diligence.)
3. To ensure that airport charges at the City Airport are just and reasonable, not discriminatory, are based upon sound economic principles and on generally accepted accounting practices within the UK.
4. To carry out such maintenance and repair work to the runway, apron and taxiway at the City Airport as may be required from time to time by the CAA's airport licensing requirements.
5. To apply for a public use licence for the City Airport if so requested by all air carriers operating from the City Airport.
6. Not to take any steps, or attempt to influence, the distribution of existing commercial air transport operations as between the City Airport and the International Airport.
7. Taking account of existing planning constraints and obtaining any necessary consents, to have regard to the development of air transport in Northern Ireland and to efficiency, economy and safety of operation in the provision by air carriers of commercial air transport services at the City Airport.
8. Taking account of such planning constraints, to allow the expansion of such services and facilities up to the reasonable capacity limit of the existing terminal building at the City Airport.
9. To encourage the development of new routes at both airports in order to secure additional scheduled and non-scheduled services to and from Northern Ireland, subject to the terms of any public use licence and to any other future regulation of airport charges.
10. To provide adequate facilities for users of both airports for consultation with respect to matters affecting their interests.

### ***Shorts' views on possible remedies***

2.86. Commenting on the remedies listed in paragraph 2.83, Shorts thought price controls ((a) above) would be most unreasonable, because such a condition would be taking away the right of BIA to negotiate its terms with the airlines. Sufficient controls would be in place, both in a regulatory sense through the CAA and from the pure commercial sense of an airport wanting to work with its customers in maximizing its return. As to (b)(i), Shorts said that an undertaking to continue *ad infinitum* to operate on comparable terms and conditions as now would not be workable in practical terms: it would be too difficult to monitor. The parties had to be allowed to negotiate on a proper commercial basis. With regard to a possible undertaking to continue to maintain existing opening hours at the City Airport ((b)(ii)), Shorts said that it did not think such an undertaking would be unreasonable. As to the possibility that a new merged enterprise might be required to operate the City Airport under a public use licence ((b)(iii)), Shorts said that some of the airlines might feel more comfortable about the merger situation if the City Airport had such a licence. With regard to designation ((c)), Shorts thought the regulatory regime afforded sufficient protection to airlines without designation. As for a requirement to honour any agreements with the MoD ((d)), Shorts said that apart from the QUAS (Queens University Air Squadron) site it had an arrangement to provide an air traffic service for military movements over the Belfast area in particular, and it could not see any reason for not continuing to provide that sort of service. As to prohibition of the merger, Shorts said that this would in practice have the effect of preventing the Belfast airports merging forever, because new entry into the Northern Ireland airport market was extremely unlikely.

2.87. Shorts thought an effective safeguard would be to require BIA to undertake to keep the City Airport open, it being inherent in such an undertaking that BIA would maintain a level of services and make any essential investment so as to allow current airline operations to continue and to meet their growth expectations.

2.88. Concerning the question of the possible reversion to Shorts of the runway site at the City Airport and its ability to recommence commercial airport operations, Shorts gave the following assurance:

Shorts undertakes that, in the event that the assets and liabilities constituting the business of Belfast City Airport ('BCA') are purchased by Belfast International Airport Limited (or any of its associated companies) ('BIAL'):

- (i) Shorts will use its reasonable endeavours to secure that the arrangements for such sale will provide that, if commercial air transport operations from BCA have been discontinued for any reason and the Belfast Harbour Commissioners are unable to find an alternative operator for BCA, a new lease of the Runway Site will be offered to Shorts; and
- (ii) Shorts will ensure that, in the event that Shorts is offered such a new lease of the Runway Site, it will be under no contractual restriction in favour of BIAL not to recommence commercial airport operations on the Runway Site.

### ***Third parties' views on possible remedies***

2.89. Many third parties believed the proposed merger would be so detrimental that it would not be possible to impose suitable safeguards. Nevertheless, the following safeguards were suggested: both airports should be retained in existence; airport charges should be subject to regulation by the CAA; the City Airport should be required to operate under a public use licence; and the City Airport's current hours of operation and other essential facilities must be maintained. BA suggested

that the CAA ought to be ready to take on an additional non-statutory role with regard to the Belfast airports if necessary and Gill proposed a supervisory board on which the BCA airlines could have a voting majority. Luton Airport proposed that the new merged entity should be subject to five-yearly MMC review; and that BIA be required to honour existing incentive and market support deals with airlines and tour operators. The MoD said that it would require assurances that its agreements would continue to be honoured. North Down Borough Council suggested that a condition of Government approval for the merger might be a daily direct service from Northern Ireland to Brussels.

### ***Conclusions on remedies***

2.90. We have carefully considered the views of the main and third parties on remedies. BIA has volunteered to give undertakings with regard to the continuing operation of the City Airport (see paragraph 2.85). We note that such undertakings were put forward to obviate adverse effects. However, we do not think that such undertakings will be adequate in practice to prevent the adverse effects we have identified, nor to remedy such adverse effects if, as we foresee as likely over time, it ceases to be in BIA's best interests to promote the City Airport as a vigorous and thriving concern or even perhaps to keep it open at all (see paragraph 2.73). In particular, we do not consider that undertakings 8 and 9 will be of any significant benefit, given that the capacity of the terminal at the City Airport is already stretched at peak times (see paragraph 2.18). Thus we believe the concerns of the airlines and consumer interests regarding the future of the City Airport are well-founded. We recognize that a limited regulatory regime, designed among other things to cater for the absence of competition, will come into play in Northern Ireland on 1 March 1996 for the Belfast airports. As the CAA frankly told us, however, regulation is second best to competition. The regulatory systems applying to airports are mainly designed to deter predatory behaviour and to control charges, whereas competition can be expected to bring benefits, both to airlines and to passengers, in terms of choice and range of services as well as levels of charges and prices. We therefore believe a competitive environment is likely to go much further in preventing the adverse effects set out in paragraph 2.81 than would a regulatory system.

2.91. Shorts' assurance concerning the possible reversion of the runway site at the City Airport and its ability to recommence commercial airport operations there (see paragraph 2.88) attempts to meet our concern that BIA may in due course close the City Airport. However, the assurance understandably does not commit Shorts to reopen the airport. Moreover, closure of the City Airport coupled with the events and uncertainties leading up to closure would be likely to be commercially damaging to the airlines and disruptive for passengers using the airport, with commercial repercussions for the airport itself. Our concern about the possible closure of the City Airport by BIA therefore remains.

2.92. We have therefore concluded that the adverse effects we have identified in paragraph 2.81 can only be satisfactorily addressed by prohibition of the merger in contemplation. This we recommend.