

7 Views of third parties other than regulatory bodies

Contents

	<i>Page</i>
Introduction	181
Airlines	182
AB Airlines PLC	182
Air 2000 Limited	182
Air Lanka Limited	183
BAC Express Airlines Ltd	183
Britannia Airways Limited	183
British Midland Airways Limited	185
British Regional Air Lines Group plc	185
Comair Limited	186
Delta Air Lines	186
Deutsche BA	186
easyJet airline company limited	187
Emirates	188
European Aviation Air Charter Ltd	188
Meridiana SpA	188
Ryanair Limited	188
TAP-Air Portugal	189
Virgin Atlantic Airways Limited	189
Airports	194
BAA plc	194
Newcastle International Airport Ltd	194
Others	195
Air Transport Users Council	195
CityFlyer staff	197
Consumers' Association	198
Transport and General Workers Union	198
Individuals	199
Mr Peter Atkinson MP	199
Mr John K McCall	199
Mr C C Pell	200
Mr Phillip Pettitt	200
Mr W Robinson	200
Mr Robbie Shaw	200

Introduction

7.1. We invited views from a wide range of airlines operating from both Heathrow and Gatwick, and also from a number of regulatory and other bodies. This chapter summarizes the evidence we received excluding that received from regulatory bodies which is contained in Chapter 8. Oral

hearings were held with Air 2000 Limited, the Air Transport Users Council, British Midland Airways Limited, Britannia Airways Limited, Ryanair Limited, CityFlyer staff and Virgin Atlantic Airways Limited.

Airlines

AB Airlines PLC

7.2. AB told us that the acquisition of CityFlyer by BA would create a monopolistic position in terms of slot holdings with reasonable times for arrival and departures at Gatwick. Whilst 46 per cent of all slots would be assigned to BA the effect of the merger if approved would be to raise the peak movement slot holding to in the region of 60 per cent plus. This disproportionate holding of slots within peak times would create formidable barriers to competition.

7.3. The peak slots would allow BA to maximize on yields through offering business timings whereas other airlines that wished access would only be able to obtain leisure timings. There was already intense competition within the leisure market through low fares which were unsustainable in the long term unless access was permitted to peak slots for charter carriers.

7.4. The inquiry should also consider the effect of the growing position of Go as a BA subsidiary and its rapidly increasing slot position at Stansted.

Air 2000 Limited

7.5. Air 2000 Limited (Air 2000) told us that the proposed merger would adversely affect competition at Gatwick and the public interest generally.

7.6. With around 5 per cent of total slots Air 2000 was the third largest slot holder at Gatwick after BA. However, with continuing growth in traffic at Gatwick, access to and retention of slots was increasingly difficult for all operators, whether scheduled or charter. As a consequence, the choice available to the air traveller wishing to fly from point to point was becoming less and less.

7.7. At the IATA Scheduling Conference for summer 1999, no new slots had been allocated at Gatwick for the commencement of new services. Air 2000 considered that the reason for the proposed merger was purely for BA to exercise control over the substantial CityFlyer slot holding to the exclusion of any potential competitor. As the CityFlyer franchise was already marketed as a BA product through the BA reservation system, there could be no other tenable reason. Air 2000 told us that if the merger went ahead BA and CityFlyer would have 43 per cent of the slots at Gatwick. At that figure BA would have achieved a critical mass that provided them with the flexibility to juggle their programme to make use of those slots.

7.8. While competition for airlines such as BA might be perceived as being from other scheduled carriers, Air 2000 told us that charter operators can and do offer competition to scheduled carriers. However, the EC slot allocation regulation appeared not to recognize this and awarded charter operators a low priority for receipt of slots thus helping to reinforce the position of scheduled carriers. Indeed in terms of overall slot share, the total holdings by charter operators at Gatwick had declined from over 35 per cent in summer 1994 to less than 30 per cent in summer 1998.

7.9. With such disparity in slot holdings at Gatwick, Air 2000 objected to the merger of the two largest slot holders as being anti-competitive and against the best interests of the consumer. It believed that the merger had as its objective a restriction of competition and was contrary to Articles 85 and 86 of the Treaty of Rome.

7.10. On the effect of the merger on charter operators' night movements at Gatwick, Air 2000 told us that a BA-owned CityFlyer might be less inclined to hand back as freely as at present if its parent could make use of what would have become common property slots. Where slots were handed back late, the programmes planned by other carriers would be at an advanced stage and the slots might in

effect be wasted. Handback delay could therefore be a strategic weapon. On BA's plans for future use of its noise and movements quota at Gatwick (see paragraph 5.264), Air 2000 commented that BA could amend these plans in the future to reflect prevailing market conditions and asked if BA could be bound not to exceed its projections.

7.11. Air 2000 told us that if the merger went ahead then BA through its directly owned subsidiaries and franchisees would control 43 per cent of Gatwick's voting power and would, for example, be able to veto proposals to produce any alternative method by which to allocate the night movements quota.

7.12. Air 2000 told us it was also concerned that, should the merger proceed, BA would seek to move the former CityFlyer services from the South to the North Terminal from where all other core BA services operated. The resulting congestion would have a detrimental impact on Air 2000's operations as would any subsequent enforced move from the North Terminal to the busy South Terminal. However, it also believed that should the North Terminal become virtually an exclusive scheduled service facility it would not remain open during the night period and hence its capacity would be wasted. Air 2000 told us that night-time rotations were a vital part of the economics of airport usage. Perhaps more damaging was the fact that all night-time operations would be forced through the South Terminal which was already overstretched. Ultimately this would only lead to the frustration of new services and a reduction in competition. Air 2000 also told us that it was concerned that BA's increased voting power would be used to the detriment of Air 2000 and the charter community at Gatwick to determine how gates, jetties and pier-served stands were allocated to individual carriers at individual terminals.

7.13. Air 2000 told us that the current relationship between BA and CityFlyer was between a franchisee and franchisor and not permanent. If the merger went ahead the relationship would become permanent and control would pass to BA.

Air Lanka Limited

7.14. Air Lanka Limited told us that it had no objection to the proposed merger.

BAC Express Airlines Ltd

7.15. BAC Express Airlines Ltd (BAC Express) told us that the merger would not be beneficial for the aviation industry or the general public. If the merger went ahead, BA would inherit the grandfather rights of CityFlyer's slots at Gatwick. These slots would add to the large number already held by BA, and would give it over 40 per cent of the slots at one of the busiest airports in the world.

7.16. BAC Express considered that this would lead eventually to increased fares. In addition, the temptation would be for BA to stop flying some of the less profitable short-haul CityFlyer routes and use the slots for some of BA's more profitable routes. This would result in a reduction of destinations available from Gatwick.

Britannia Airways Limited

7.17. Britannia, the UK's second largest airline, told us that it represented all UK leisure airlines on the Brussels-based airline trade association and its views were, therefore, representative of the charter business. Britannia told us that Gatwick was of major importance to charter airlines which, currently, represented more than 40 per cent of the passenger throughput. The TDRs originally denied access for charter airlines to Heathrow. Although the TDRs were subsequently rescinded, Heathrow was effectively full by then and charter airlines had been unable to return. As a consequence, Gatwick had to serve a wider and more heavily populated catchment area than would have been the case if Heathrow was also available for charter.

7.18. Because leisure passengers were price sensitive, charter airlines (which served this sector) had to provide low fares while still operating modern aircraft types. This was achieved by operating their aircraft intensively. Typically, each charter aircraft based at Gatwick was required to operate three rotations (round trips) daily to the Western Mediterranean, or the equivalent. This operation normally required one movement at night, usually a landing. Without the ability to operate at high levels of utilization, the viability of the operation was negated: hence the importance of maintaining the ability for charter airlines to obtain the necessary slots and especially movements at night. Britannia told us that the loss of one slot could invalidate the presence of an aircraft at Gatwick because the airline could then only obtain two rotations and the costs would become non-viable. If the aircraft was then withdrawn some daytime availability could be reallocated to the scheduled carriers which could take advantage of single slots and would further compound the problem in terms of slot availability.

7.19. Because of the high number of night movements required relative to their daytime movements, charter airlines did not obtain their needed night movements at the initial allocation under the current (VPP-based) allocation system. On the other hand, short-haul scheduled airlines (such as CityFlyer) built up large banks of night movements which they did not require and which were handed back to the pool for reallocation by ACL.

7.20. The system had worked reasonably until BA expanded its Gatwick operation and transferred a number of long-haul flights from Heathrow, a process which was expected to continue. Historically, BA hugely underused its night allocation at Gatwick. That was increasingly now no longer the situation. Britannia and the other charter airlines were finding it increasingly difficult to obtain the slots they needed. Airlines, and charter in particular, were having to commence a summer season flying programme without having any certainty of obtaining a sufficient allocation to complete the season's programme. Without the return of CityFlyer's slots to the pool, charter airlines would be unable to obtain their required night movements.

7.21. A new allocation procedure for Gatwick had been devised and would shortly be put to the vote at the scheduling committee. The new procedure was more closely related to the need for movements at night and Britannia believed it was fairer and more sensible than the current VPP-based system. However, the proposed system was flawed and would not take account of situations such as BA's acquisition of CityFlyer, for two reasons. First, it would make inadequate allowance for the additional noise quota required to enable the charter operators to increase the size of their aircraft in response to capacity constraints at Gatwick. Second, Britannia understood that the proposed system would allow trading of slots with money being involved, to which charter airlines were opposed because it would favour large state and ex-state-owned airlines. Britannia noted that the European Commission Competition Directorate (DGIV) was opposed to the sale of slots and the recent decision in *R v ACL ex p Guernsey Transport Board* did not invalidate this point.

7.22. BA had indicated informally that it preferred the existing allocation system which better satisfied its future aspirations. Britannia suspected that BA and its allies would vote against the new proposal. If it did, and even with the proposed new procedure, charter airlines would face difficulties in the future over night movements.

7.23. Those difficulties, though, would be mild compared with the situation should BA acquire CityFlyer. Then, the whole entitlement of BA and CityFlyer would be available to BA and would be increasingly utilized. At best, any hand-back of unneeded slots could be delayed and used as a strategic weapon against airlines other than BA and its franchisees and partners. At worst, charter airlines' operations at Gatwick would not be viable.

7.24. On BA's plans for future use of its noise and movements quota at Gatwick (see paragraph 5.264), Britannia commented that these were only theoretical intentions which BA could easily change, for example in response to likely forthcoming changes in airline regulation and airport access rules (especially relating to Heathrow). Other airlines should not have to rely on the beneficence of BA for their continued operation at Gatwick.

7.25. Britannia did not accept the argument that QC was currently freely transferable between airlines and therefore the merger would make no difference in this respect (see paragraph 6.182). Britannia also submitted that similar concerns would arise for the charter operators if another major scheduled airline took over CityFlyer.

7.26. Britannia told us it was concerned that if BA were to take over CityFlyer it might use the CityFlyer slots on profitable leisure routes given that business traffic was declining. Britannia also considered that a significant factor in BA's decision to take over CityFlyer was the advantages it would derive from an enlarged bank of slots and the ability to use this as it wished in the future as it had done following the BCal and Dan-Air takeovers.

7.27. Britannia told us that it was concerned about the allocation of airlines to terminals and particularly that if BA took over CityFlyer charter airlines might be required to move out of the North Terminal so that CityFlyer could be accommodated there.

7.28. Britannia recommended that BA be refused permission to acquire CityFlyer. Failing this, the VPP system should be abolished and only the EC slot allocation rules (including grandfather rights) should apply in the allocation of night movements. An alternative might be the removal of CityFlyer's night entitlement on a permanent basis.

British Midland Airways Limited

7.29. British Midland told us that it was the second largest operator of scheduled services at Heathrow (British Midland's primary hub) operating 695 flights a week to 21 UK domestic and European destinations. BA was the logical purchaser of CityFlyer because of its long-standing franchise co-operation with CityFlyer. Arguably, only a purchase by BA could ensure the continuation of the franchise arrangement currently providing users with access to BA's global hub at Gatwick.

7.30. The combination of BA's and CityFlyer's operations would strengthen BA's market presence at Gatwick by giving it control of the second largest holder of slots. Undoubtedly, there would be concerns raised that the merger might be against the public interest, if BA were to significantly change CityFlyer's current network of UK domestic and European services.

7.31. However, there was no reason to suggest that the proposed merger would restrict consumer benefits or result in anti-competitive behaviour. In the overall context of the air services market at Gatwick or south-east England, there would be no significant visible change to current operations. BA alone operated a hub-and-spoke operation. Except for a transition in the legal ownership of CityFlyer to BA, British Midland understood that CityFlyer would retain its autonomy and continue to use BA livery, on-board product etc. British Midland told us that it thought it less likely that there would be a radical change to CityFlyer's current operation if BA purchased it rather than a third party.

7.32. As the ownership of CityFlyer entailed control of its slot holding at Gatwick, there would be an opportunity for BA to use those slots to withdraw CityFlyer's existing intra-European services, and to replace them with long-haul services. However, BA was already the single largest operator of slots at Gatwick and it was unlikely that BA would need to change CityFlyer's network. The impact on the consumer, therefore, was likely to be minimal, assuming that BA maintained CityFlyer's current route network.

7.33. British Midland was not aware of any other prospective buyers currently interested in purchasing CityFlyer, other than Virgin Atlantic. Virgin Atlantic, which had publicly expressed its wish to purchase CityFlyer, had no prior experience in providing short-haul services or operating a hub-and-spoke network. It was primarily a long-haul operator. It would most likely use CityFlyer's slot holdings at Gatwick to transfer a number of CityFlyer's current short-haul slots to its own long-haul routings, which British Midland considered would be against the public interest.

British Regional Air Lines Group plc

7.34. British Regional Air Lines Group plc (British Regional) declared an interest in that it was a BA franchisee. It saw no threat to competition and therefore had no objection to the acquisition proceeding, as CityFlyer already operated closely with BA, using its reservations, flight numbers, and corporate identity.

7.35. British Regional told us that, to the best of its knowledge, all major airlines were advised that CityFlyer was for sale early in 1998, and a series of presentations were arranged by the broking bank. Any other potential purchaser had had an opportunity to enter negotiations had they so wished.

Comair Limited

7.36. Comair Limited told us that it had no objection to the proposed acquisition of CityFlyer by BA and considered the proposal as a positive development.

Delta Air Lines

7.37. Delta told us that it was the third largest airline in the world, when measured in terms of revenue, and the largest in terms of passengers, boarding 105 million passengers in calendar year 1998.

7.38. CityFlyer was a short-haul carrier, which did not compete with Delta and which already operated as a BA franchise. In the short term, therefore, the impact on competition of this acquisition would not be significant. In the longer term, however, this acquisition would increase BA's dominance at Gatwick, where demand for slots and facilities exceeded supply, thereby limiting other carriers' ability to compete effectively.

7.39. Gatwick was slot constrained at peak periods, which included, in particular, the time window for transatlantic arrivals and departures. It was very difficult for US carriers to obtain slots at Gatwick. This was not a constraint Delta had faced, as Delta was not permitted to increase service levels under Bermuda 2. However, Delta had faced difficulties in changing flight timings to optimize connecting opportunities in the USA because of the slot situation. Delta also aspired to increase its service levels to London and the experience of other US carriers that had been awarded additional authority to serve the UK suggested that it was exceedingly challenging to obtain suitable Gatwick slots.

7.40. By contrast, having absorbed CityFlyer, BA would be able to transfer slots from CityFlyer's short-haul operations to its own long-haul operations and thereby enjoy great flexibility to optimize and grow its operations at Gatwick. This flexibility was not available to other carriers.

7.41. This effective increase in its operations would also tighten BA's stranglehold on facilities at Gatwick. Access to CityFlyer's operating slots would permit BA to expand its operations in the North Terminal, thereby gaining access to even more pier-served stands and further degrading the service levels of Delta and other competing carriers.

7.42. BA dominance at Gatwick, combined with its strong position at Heathrow, where slots and facilities were in equally short supply, would limit the choice in air services that were available to the public.

Deutsche BA

7.43. Deutsche BA told us that its view, as Germany's second largest domestic carrier and a BA subsidiary, was that the acquisition would be pro-competitive for traffic between the UK and Germany. CityFlyer provided vital links to enable passengers in Bremen, Cologne and Düsseldorf to connect to other international and intercontinental routes at Gatwick and thereby provided an alternative to Lufthansa services from Frankfurt. Lufthansa had a monopoly on those domestic routes as a result of its super-dominant position at Frankfurt where it controlled about 67 per cent of slots. CityFlyer had grown the Germany-UK route as a franchise of BA over a number of years. Without the substantial feed to and from the BA connection over Gatwick, it was questionable whether these routes would be commercially viable or be flown as extensively. Without the BA CityFlyer services, German passengers would face less choice and higher prices.

7.44. The addition of CityFlyer's slots to BA's slot portfolio at Gatwick was not a relevant competitive consideration since CityFlyer had not been in direct 'head-to-head' competition with BA on these routes. Consequently Deutsche BA would not expect any market effects from the merger.

easyJet airline company limited

7.45. easyJet told us that it considered that the proposed acquisition was against the public interest. BA had a dominant position in the London market. BA conceded dominance during its strike-out application of easyJet's High Court writ over alleged cross-subsidization of Go (May 1998).

7.46. easyJet believed that a substantial market existed in the catchment area south of London which was currently not served by any low-cost carrier. Gatwick was the airport best placed to serve this market but suffered from severe slot congestion. This meant that low-cost carriers were left with no option but to serve the London market exclusively from Luton and Stansted. If the proposed acquisition was allowed to take place, BA's share of the slots at Gatwick would increase further, thus forming a greater barrier to entry for the low-cost entrant who wished to serve the South London market.

7.47. Even if low-cost entry into the South London market was achieved, the fact that BA, following the acquisition, held such a large percentage of the total slots at Gatwick would enable BA to (a) ensure that its services operated with superior timings compared with those of its competitors; and (b) allow BA greater freedom to redeploy services in response to competitor activity, whereas competitor response was likely to be constrained by lack of slots.

7.48. The increased presence of BA at Gatwick would lead to increased control and influence of the airline in respect of airport facilities/infrastructure development and allocation. Facilities developed to suit BA's requirements at high cost were different from those required by a low-cost carrier and were likely to lead to higher airport charges. The acquisition would mean that BA would enjoy increased control of the market via its frequent flyer and travel agent loyalty schemes.

7.49. easyJet believed that the consumer would suffer detriment as a result of the acquisition. Barriers to entry would result in a lack of healthy competition and would leave BA in a position to charge higher fares without facing the discipline imposed by competition. CityFlyer was an independent carrier serving a number of points both in the UK and Europe which were also served by BA out of Heathrow. As pressure on slots at Heathrow mounted, the acquisition would enable BA to consolidate European services to one London airport only and use the other slots for more valuable transatlantic services.

7.50. The concept of a powerful dominant airline allowing a smaller one to use its brand identity for an unknown fee in order to develop markets using the smaller airline's lower cost base had been around for a number of years. Both franchisees of Virgin Atlantic failed, strengthening the conviction that survival was not about the brand of the franchisor (Virgin had one of the best in the industry) but about market dominance. easyJet considered that the franchise concept allowed BA to manipulate its trade unions and accumulate slots using a start-up status.

7.51. easyJet was concerned that when CityFlyer was consolidated with BA, it would be impossible to know if each individual service was run at a profit or a loss. Therefore competing against BA as a low-cost carrier would become increasingly difficult.

7.52. It was easyJet's view that if the proposed acquisition was allowed to proceed it would be against the public interest because it would increase existing barriers to entry to the London, and the South London market place. Divestment of slots to address the adverse effects on competition would be a potential remedy but would be difficult to manage. The only solution that would ensure that BA's dominance in the market place was not increased was to prohibit the acquisition.

Emirates

7.53. The airline, Emirates, told us that the acquisition by BA of CityFlyer would change little and its impact on the travelling public and on competitors would be of little consequence. Therefore, Emirates did not consider that the action contemplated by BA would operate against the public interest.

European Aviation Air Charter Ltd

7.54. European Aviation Air Charter Ltd said that it had no objection to the proposed merger.

Meridiana SpA

7.55. Meridiana SpA (Meridiana) told us that it was concerned about the strong control exercised by BA at Gatwick through means of wholly-owned partners, franchisees and, of course, in its own name. Based upon 1999 summer season slots allocated, as of January 1999, Meridiana believed BA controlled 36.8 per cent of the slots.

7.56. With the acquisition of CityFlyer this number would jump to 49.4 per cent, much of it at peak times. With its large fleet size and variety, BA would be able to interchange slots to enter new markets at prime time or to increase capacity on chosen markets through either frequencies or the use of higher-density aircraft.

7.57. Meridiana asked the Commission to maintain competition in the market by providing the conditions in which other smaller airlines could operate.

Ryanair Limited

7.58. Ryanair believed that the supply of scheduled air services to and from south-east England would be restricted, should the merger be allowed.

7.59. It was already conceded by BA that if the merger proceeded, BA would control 42 per cent of all slots at Gatwick. Within that 42 per cent, BA's dominance of peak hour slots would be even greater. For example, in the 0700 to 0900 period CityFlyer already held 21 per cent of the 48 arrival slots available. This, added to BA's existing dominance of Gatwick's peak hours, and taken together with BA-controlled franchise operations, would leave BA controlling in excess of 60 per cent of peak-hour slots into Gatwick. The morning peak-hour arrivals were crucial to other airlines including Ryanair, to build commercially viable schedules in order to operate balanced multiple frequencies throughout the business day, allowing airlines other than BA to carry day return traffic across the Gatwick hub. Ryanair told us that 40 per cent of its passengers on the Gatwick-Dublin route interconnected. BA's dominance of peak-hour slots, and therefore of the hubbing opportunities at Gatwick, would unquestionably reduce consumer choice, and drive up fares. If the merger were allowed BA would control 100 per cent of UK mainland domestic feed into Gatwick.

7.60. Should the merger proceed, BA's natural inclination to develop feeder traffic through alliance, franchise or subsidiary would preclude other airlines including Ryanair from developing feeder traffic on to other carriers. Gatwick was an expensive and congested airport by European standards and therefore high-yield interline traffic was essential to the viability of Gatwick routes, even to carriers such as Ryanair which would not normally rely on this type of traffic. BA had consistently sought to drive down the 'pro-rate' interline fares offered to Ryanair, and was likely to continue to exploit this position further as its dominance of Gatwick grew by the absorption, *inter alia*, of CityFlyer's Dublin/Gatwick operation.

7.61. There was an inevitability about BA transferring CityFlyer's slots currently used for regional services to more lucrative long-haul services, and cascading the regional services to airports in the London system with available capacity, including Stansted. This would further increase BA's

dominance of the London system as a whole, and choke the expansion of other independent carriers at these airports and potentially stunt the growth of low-fare airlines that were doing so much to widen customer choice in south-east England.

7.62. Ryanair contended that for these reasons the merger would operate against the public interest and, therefore, should be disallowed. Alternative propositions might be for CityFlyer slots to go back into pool if the current CityFlyer operation were to be changed or for CityFlyer to be confined to short-haul routes.

TAP-Air Portugal

7.63. TAP-Air Portugal told us that the merger would reduce interline options within the UK. Any merger which focused on a single market (domestic UK) caused an increase of concentration that ultimately hindered the market access opportunities for other carriers. By constraining interlining options BA was gaining a greater market share and further protecting its business environment.

Virgin Atlantic Airways Limited

7.64. Virgin Atlantic submitted that the merger should be prohibited.

Summary

7.65. Virgin Atlantic told us that the proposed merger would seriously restrict competition. It would erect new barriers to entry and strengthen existing ones and would effectively remove the threat of entry of new competitors to BA at Gatwick. By acquiring CityFlyer, BA would also increase its share of scheduled slots at Gatwick from 40 per cent to over 56 per cent. BA would directly and indirectly control 70 per cent of the scheduled slots at Gatwick. BA already had 37 per cent of Heathrow slots. In general terms Heathrow and Gatwick did not compete. To the extent that there was substitutability between the two airports, it was asymmetrical. For passengers using Gatwick, Heathrow could be an acceptable substitute. But passengers using Heathrow (especially business travellers, for whom Heathrow was the primary airport) would not necessarily be prepared to use Gatwick.

7.66. There were virtually no slots available on a commercially realistic basis which would enable viable entry into either Heathrow or Gatwick. Virgin Atlantic subsequently told us that the decision handed down in *R v Airport Coordination Limited ex parte The States of Guernsey Transport Board* (Maurice Kay J, 25 March 1999) did not settle what constituted a lawful transfer of slots: as a result the uncertainty about whether it would be possible to acquire slots by way of transfer rather than exchange would continue to have a deterrent effect on new entry through slot allocation at Gatwick as well as at Heathrow. The proposed merger would enable BA to remove the last significant opportunity for any of its competitors to penetrate the market for scheduled air services in south-east England, with consequent effects both on travellers to destinations in that area and to those travelling on elsewhere via Heathrow or Gatwick. It would also exacerbate other competition problems posed by BA's activities.

7.67. BA had dramatically increased its holding of slots at Gatwick, through the takeovers of BCal and Dan-Air. With each takeover, BA's share of scheduled slots more than doubled, rising from 8.98 to 23.07 per cent in 1988 and 16.71 to 37.40 per cent in 1993. Both BCal and Dan-Air were facing financial difficulties at the time of their takeover. There were no such concerns about CityFlyer's financial viability.

7.68. As a result of the merger, BA would control all aspects of CityFlyer's business, including the use of the slots which it currently held at Gatwick. Not least, BA could ensure that those slots did not become available for use by its competitors.

The Commission's jurisdiction to investigate the proposed merger

7.69. It was clear that BA's share of the market in scheduled air services to and from south-east England far exceeded 25 per cent, and that the acquisition of CityFlyer would significantly increase that market share. BA's share of passengers in the key Heathrow market amounted to 43 per cent. At Gatwick, the acquisition would result in an increase in BA's share of passengers from 46.4 to 54.2 per cent. Market shares for passengers alone, however, concealed the disproportionate benefit which the acquisition would confer on BA vis-à-vis slots, the essential ingredient in market entry and expansion. Virgin Atlantic therefore considered that the relevant market for assessing the merger was air services from Gatwick. Competition for services over competing hubs in Europe was not a major factor. Virgin Atlantic also submitted that the Commission should take account of the European Commission's consideration of the proposed alliance between BA and American Airlines to which the issue of slots and their availability was relevant.

The adverse impact of the proposed merger on competition

7.70. The proposed merger would enable BA to erect an almost impenetrable barrier to entry for competitors at Gatwick. This in turn would reinforce BA's dominance at Heathrow and on routes to and from south-east England generally. There were routes on which BA and CityFlyer currently competed. Competition would either be eliminated or greatly reduced on those routes by the proposed merger. Stansted did not yet have the critical mass to compete with Heathrow and Gatwick. It had the ability to develop as an effective alternative hub but this would probably take in excess of ten years.

7.71. Virgin Atlantic told us that Gatwick and Heathrow tended to constitute separate markets. The findings of a 1993 CAA report¹ stated that flights from Heathrow attracted far more business passengers than those at other London airports. Historical price movements indicated that lower on-demand fares at other airports were not matched at Heathrow while price changes at Heathrow affected pricing elsewhere in the London area. BA already dominated Heathrow; if BA were allowed to increase its already dominant share of slots at Gatwick, it would succeed in foreclosing the possibility of competition in the supply of scheduled air services into south-east England.

7.72. BA dominated Gatwick. It currently had 39.9 per cent of scheduled service slots, more than twice that of CityFlyer which was the next largest holder of Gatwick slots with 16.6 per cent. Its subsidiaries had a further 3.9 per cent of slots. If permitted to take over CityFlyer, BA would directly control 60.4 per cent of scheduled service slots at Gatwick (including those used by its subsidiaries) in addition to its share of 37 per cent at Heathrow. In Virgin Atlantic's view, a presence at Heathrow and Gatwick was essential for scheduled services and neither Luton nor Stansted offered realistic opportunities for rival carriers to compete with BA.

7.73. Virgin Atlantic told us that it had started operations at Gatwick 15 years ago and built up its business slowly and steadily. It had wanted to build a short-haul network at Gatwick but had not been able to obtain the necessary slots. It had been able to begin establishing a base at Heathrow in 1991 after the Government changed the TDRs. Thereafter it had made the building of that base a higher priority than building its base at Gatwick. In recent years the absence of a short-haul network at Gatwick had been a constraint upon the development of Virgin Atlantic's long-haul business.

7.74. It was now almost impossible to obtain commercially viable slots at Gatwick. There were insufficient slots available to allow competitive new entry or expansion of services for those airlines already established at Gatwick. This was demonstrated, it said, most recently at the IATA Scheduling Conference for summer 1999 in Berlin when, for example, only one carrier obtained any new slots at Gatwick for summer 1999—but not for a daily service, and not at viable times.

7.75. Virgin Atlantic told us that it had had, in effect, to buy slots at a cost of £2.5 million for one set of daily scheduled long-haul slots, which were not even at the same times every day. It had also had effectively to buy charter slots for Virgin Sun which were also not at the same times each day.

¹CAP 623, CAA 1993, *Airline Competition in a Single European Market*.

The slots used by Virgin Express were leased from Sabena which code shared with Virgin Express. Virgin Atlantic told us that buying slots was getting to be the only way to obtain them.

7.76. The acquisition of CityFlyer would complete BA's dominance of slots, and thereby strengthen its network which it could use anti-competitively to foreclose competition. Virgin Atlantic considered that the Commission should focus primarily on scheduled slots because these were fundamentally different from slots used by charter airlines. Charter slots could often be seasonal, not on consecutive days (or even at the same time each day) and outside the peak hours; as such, they would not be substitutable for scheduled services. With its 60.4 per cent share of scheduled service slots, BA would be in a position to 'shuffle the pack' of slots under its control to reschedule services to optimal times so as to maximize its advantage over its competitors and, more importantly, deny competitive entry.

7.77. If the merger were to be prohibited, CityFlyer would continue to control the use of its slots and there would remain the possibility of CityFlyer being taken over by another non-dominant carrier or of CityFlyer exchanging slots with other airlines and new entrants for its own commercial reasons.

7.78. BA's proposed takeover of CityFlyer would enable it to use its leverage over slots at Heathrow and Gatwick to move or reduce services to less profitable short-haul destinations, and use the slots from those routes for new or expanded services to long-haul international destinations. BA had used this slot-shuffling technique several times to great effect in the recent past. For example, when it bought Dan-Air in 1992, BA acquired the three times daily Heathrow-Inverness services. It subsequently moved this service to Gatwick to free up slots at Heathrow which it may be assumed were used for more lucrative long-haul flights. Similarly, BA transferred flights (operated by its subsidiary, Brymon) serving Plymouth and Newquay to operate from Gatwick rather than Heathrow to release slots to operate long-haul transatlantic services.

7.79. BA had also moved long-haul services from Heathrow to Gatwick to make more slots available for other services from Heathrow. It transferred its East and Central African services and its South and Central American services (on which it faced no significant competition) from Heathrow to Gatwick in summer 1996 and winter 1996/97 respectively. Services on which BA faced competition from Virgin Atlantic, to the USA, Japan, Hong Kong and South Africa, remained at Heathrow.

7.80. From Gatwick, CityFlyer currently operated three routes within the UK and the Channel Islands, to Newcastle, Guernsey and Jersey. BA served Jersey and Newcastle from Heathrow. After the takeover, the merged enterprises' services from Heathrow and Gatwick to Newcastle would enjoy a monopoly on those routes. BA might choose to axe flights serving Newcastle from Heathrow in order to use the slots thus freed at Heathrow for more profitable long-haul services. In this way, BA was free to add capacity on routes where BA's competitors were unable to mount a competitive response because they could not get slots. Similarly, if the merger were to go ahead, BA might choose to axe services at Gatwick.

7.81. CityFlyer also currently served nine European destinations outside the UK and Channel Islands. Its destinations of Amsterdam, Cologne/Bonn, Düsseldorf, Luxembourg and Zürich were served also by BA from Heathrow. Again, BA might choose to axe one or more of these overlapping services at Heathrow or Gatwick in order to release slots for new services on long-haul routes. It was unlikely to face new or additional competition on short-haul routes on which it reduced services, because no slots would be available to competitors.

7.82. Virgin Atlantic told us that any increase in the size of BA as a result of the merger would increase its dominance of the travel trade and hence its hold over travel agents and corporate customers generally, by leveraging its wider network when offering commission overrides and corporate discounts, and through its frequent flyer programme. Virgin Atlantic told us, that in its view, if BA merged with CityFlyer, its operating costs would rise to the level of BA's costs.

Virgin Atlantic's proposals for CityFlyer

7.83. Virgin Atlantic told us that the principal reason why BA wanted to buy CityFlyer was to stop Virgin Atlantic doing so. Virgin Atlantic had spoken to HSBC in early 1998 about buying CityFlyer but had said that it did not want to enter into an auction with BA. Virgin Atlantic had subsequently, some three months before BA concluded the deal, offered to pay £5 million more than the BA offer. It believed that BA had made an offer on the condition that HSBC would not talk to Virgin Atlantic further and that it had been foreclosed from making an offer. Virgin Atlantic had telephoned HSBC constantly but had been unable to ascertain the figure BA was willing to pay for CityFlyer.

7.84. CityFlyer had a consistent record of profitability in recent years. Moreover, BA was not the only prospective purchaser. For its part, Virgin Atlantic remained committed to pursuing the acquisition and would be willing to match the £75 million offered by BA and to undertake to ensure CityFlyer's ongoing commercial viability. Virgin Atlantic had written to the CityFlyer shareholders with an offer on 1 March 1999. CityFlyer's holding of 16 per cent of the scheduled slots represented an opportunity for Virgin Atlantic to set up a second hub at Gatwick and for Virgin Atlantic or some other carrier to create a viable second carrier force to compete with BA.

7.85. Virgin Atlantic said that if it had 16 per cent of the slots at Gatwick it would be able to fulfil all its long-haul needs for the next 50 to 70 years and be able to expand with the advantage of a small hub, in a major way in competition with BA. Virgin Atlantic told us that it was difficult for it to be definite about its intentions with regard to CityFlyer because it had not yet received any information about the business. However, Virgin Atlantic told us that once the quality of service had reached a suitable standard it would rebrand CityFlyer. It would be its intention to maintain the CityFlyer network as a means of providing the feed traffic for Virgin Atlantic's long-haul services. It would also discuss the subject with Virgin Express. On the only short-haul route on which Virgin competed with BA from Gatwick (Brussels), Virgin's fares were considerably lower (£29 for Virgin Express as against £177 for BA as at 1 March). Based on its history of fares, Virgin Atlantic would operate the CityFlyer short-haul routes with fares considerably less than they were today and this would benefit the public. Virgin Atlantic told us that it believed CityFlyer staff would like to see Virgin Atlantic involved rather than BA.

7.86. Virgin Atlantic's offer of £75 million was based on CityFlyer as a going concern. By juggling slots in the future Virgin Atlantic could expand both its long- and short-haul operations. Virgin Atlantic believed its brand name was as good as, if not better than, BA's. Virgin Atlantic did not believe that the removal of certain peak slots from the CityFlyer operation would necessarily make CityFlyer's schedules economically non-viable because of the flexibility provided by a bank of slots. Indeed, the acquisition of CityFlyer's slot portfolio would enable Virgin Atlantic to acquire less attractive slots at Gatwick and create viable slots for long-haul services without necessarily reducing the number of slots used by CityFlyer.

7.87. Virgin Atlantic told us that it thought BA would be interested in passenger feed from a Virgin Atlantic-owned CityFlyer. If passengers wished to interline with BA they could continue to do so, as happened already. Virgin Atlantic would promote flights from Europe to London having first improved the quality of service. It would discuss these matters with CityFlyer. Virgin Atlantic had traditionally relied on point-to-point traffic but connecting passengers were becoming increasingly important as it expanded and operated thinner routes.

7.88. Virgin Atlantic would be careful not to damage CityFlyer by slot reallocation. It expected that two or three new long-haul services from Gatwick could be launched each year. It had no plans to repack parts of CityFlyer and sell it to the highest bidder. It considered that it would be the only airline in a position to create a hub or mini-network from the acquisition. There were unlikely to be job losses in CityFlyer because any additional long-haul flights would require more people than short-haul flights did.

Terminal capacity, ground handling and other services at Gatwick

7.89. If the proposed merger between BA and CityFlyer were permitted, the prices charged to users of air services were likely to rise as a result of an increase in BA's power to determine charges for services provided at Gatwick for handling aircraft. Through its voting power in the AOC at Gatwick, BA was able to influence, for example, the allocation of night movements at Gatwick, and issues such as the selection of new ground handling agents.

7.90. Virgin Atlantic said that BA controlled all hangars capable of housing B747 aircraft at Gatwick and would continue to do so until at least 2002. BA had recently benefited from preferential allocation of pier stands and stands for washing and parking of aircraft, at the expense of other handling companies (for example, Gatwick Handling Limited) and carriers (for example, Air 2000, Delta and Emirates). This situation had now in part been alleviated by the completion of the construction of two additional washstands. Virgin Atlantic noted that planned expenditure over the next 11 years in the North Terminal was 63 per cent higher than expenditure on the South Terminal thus favouring facilities and infrastructure used by BA.

7.91. Virgin Atlantic told us that the proposed takeover would have an impact on terminal capacity at Gatwick. If BA proceeded with its acquisition of CityFlyer, it would be logical for it to move CityFlyer's flights to the North Terminal so as to provide easier transfers. Such a move would inevitably have an impact on other users at the North Terminal, and might leave them with little option but to move to the South Terminal, where both the piers and the check-in desks vacated by CityFlyer would be unsuitable for use by long-haul operators. Any such operators which moved from the North Terminal to make room for CityFlyer would therefore be disadvantaged.

7.92. Given the slot constraints at Gatwick, the likelihood that an operator would start new short-haul services from the airport was small. If CityFlyer moved to the North Terminal, the stands on the south pier, which were unsuitable for long-haul aircraft, would become underused. This would be an inefficient use of the airport's resources. If Virgin Atlantic were to take over CityFlyer, CityFlyer's flights would remain at the South Terminal. Passengers transferring between CityFlyer's flights and Virgin Atlantic's long-haul services would be able to make convenient same-terminal connections.

The Heathrow-Shanghai route

7.93. Virgin Atlantic told us that the CAA had awarded the Heathrow-Shanghai route to Virgin Atlantic in order to promote competition with BA and other large carriers and to give Virgin Atlantic the opportunity to grow. In reaching this decision the CAA had noted that Virgin Atlantic's ability to expand had been hampered by the problems of acquiring slots at appropriate times at Heathrow and Gatwick. This decision had been upheld by the Secretary of State.

Conclusion

7.94. Virgin Atlantic submitted that the most significant anti-competitive impact of the merger was not that BA would control CityFlyer but that BA would henceforth command complete control over CityFlyer's slots, which were essential to the operation of air services. BA's control of slots would mean that BA controlled entry. BA would be in a position to add capacity whenever, and wherever, it felt challenged by a competitor or considered that traffic was sufficient to justify a new route. The acquisition of control over a substantial number of new slots conferred upon BA an ability to threaten new entrants with the introduction of new BA services which threat itself constituted a barrier to entry.

7.95. For the reasons set out above Virgin Atlantic believed that the Commission should find against the proposed merger. Any remedy short of requiring BA to divest all CityFlyer's slots at Gatwick would be insufficient to prevent the foreclosure and stifling of competition. In particular, without divestment of slots, there was practically no likelihood of any new competitive entry into the market of air services from Gatwick in the foreseeable future.

Airports

BAA plc

7.96. BAA told us that as the owner and operator of Gatwick Airport, BAA had a clear interest in the outcome of the Commission's investigation.

7.97. The full and efficient use of Gatwick was a key component of BAA's London airports development strategy the objective of which was to meet the growing needs of air travellers by the most efficient development and utilization of the three London airports for which it was responsible. In the past the development of air services at Gatwick had suffered from a series of failures and defections by scheduled airlines. The commitment by BA to the creation of its Gatwick hub and the contribution to the network of services provided by the CityFlyer routes had been important factors in allowing the airport to reach its current level of traffic.

7.98. Given the pressures on Heathrow capacity, Gatwick now needed to grow further, if total demand for air travel in south-east England was to be met. It was therefore vital to the airport that whatever decision was reached by the Commission, the services currently offered by CityFlyer were operated by a strong operator, working with major long-haul airlines to maintain and develop the Gatwick network. Ownership of CityFlyer by BA or the continued operation of its services in association with BA would comply with these objectives. Any decision which let these services and the slots fragment would be likely to damage the interests of air travellers generally by weakening the prospects for the growth of services at the airport.

7.99. BAA told us that the fair treatment of airport users was ensured by section 41 of the Airports Act 1986 which required the airport operator to manage the airport without pursuing unreasonable discrimination. Airport operators were also bound by international agreements, European law (Article 86) and UK competition law which upheld the fair treatment of consumers and users. Airport users who considered that they were being unfairly treated had the ability to make a complaint to a variety of competition authorities, usually the CAA. The MMC's most recent review of BAA's activities reported no evidence that users were being unfairly treated at Gatwick. At a local level, the fair treatment of users was of paramount concern to the airport's management team and part of GAL's task was to provide users with a common standard for essential services.

Newcastle International Airport Ltd

7.100. Newcastle International Airport Ltd (Newcastle Airport) told us that its comments were based upon a recognition that access to London's airports from the North-East of England were essential to the economic well-being of the region. Its view, therefore, was coloured by a need to ensure that both frequency and suitability of aircraft type were maintained on the route between Newcastle and Gatwick.

7.101. Both CityFlyer and BA had shown a high level of commitment in improving the service between the North-East and London. Newcastle Airport had no evidence to suggest that if BA were to acquire CityFlyer it would lead to a reduction in either capacity or standard of service. However, Newcastle Airport would wish to see the existing route between Newcastle and Gatwick preserved and developed and, given the risk of slots being used for other routes, it would wish to receive assurances on capacity, frequency and aircraft type.

7.102. On the other hand, were the merger prevented, then this might lead to an acquisition of CityFlyer by a third party airline. From the airport's perspective this would be an unknown quantity and might proceed without the assurances that there would be the same level of commitment to serving the North-East of England. In the circumstances Newcastle Airport would support the acquisition of CityFlyer by BA.

Others

Air Transport Users Council

7.103. The AUC told us that if the merger was allowed, it was likely that in the short term the services would continue as at present. However, the slots at Gatwick that were grandfathered to CityFlyer would transfer to BA and it seemed likely that, in the longer term, some of these would be used instead for more profitable long-haul services. If the merger was disallowed it seemed likely that CityFlyer would continue to operate under franchise to BA. Both airlines had benefited from the franchise and, if CityFlyer remained under the present management, the AUC could see no reason why either party should wish to withdraw from the agreement. Equally, if ownership of CityFlyer were transferred to institutional investors, they would presumably wish to retain the benefit of the agreement and there was no obvious reason why BA would wish to do otherwise. Only if CityFlyer were acquired by a competitor to BA would the franchise agreement be terminated.

7.104. The key question was whether consumer benefit would be enhanced or reduced by discontinuing some of CityFlyer's existing services to release Gatwick slots for long-haul services. It followed that consumer benefit was not necessarily maximized by approving the merger and so giving BA the decision as to whether to use the slots for short-haul feeder services or for long-haul operations.

7.105. BA had previously transferred a significant number of its less profitable domestic and long-haul routes from Heathrow to Gatwick. The AUC told us it was doubtful that there was effective competition between Heathrow and Gatwick. As a result, BA now operated an extensive long-haul network out of Gatwick, notably to South and Central America and East and Central Africa. It required CityFlyer's slots to continue this process.

7.106. With one or two exceptions, the slots released at Heathrow had largely been used to increase frequency on existing routes. In particular, services had been increased on high-density business routes where market share was strongly dependent on frequency of operation. This had led to an oversupply of economy class seats on such routes and BA had announced its intention of addressing this by replacing its Boeing 747s with 777s, which have 150 fewer seats.

7.107. It seemed unlikely that the benefit to business passengers of the high frequencies on these routes was greater than could be generated by serving more destinations. Such extravagant use of scarce resources must therefore weigh against BA's case for approval of its proposed merger with CityFlyer. However, the question was not whether the airline could make better use of these Heathrow slots but how this use compared with the current use of Gatwick slots by CityFlyer. With its smaller commuter aircraft, CityFlyer was carrying relatively few passengers over short distances; so their loss of benefit might be comparable with the modest gains to business passengers of higher frequencies on high-density long-haul routes.

7.108. An assessment of the loss of benefit from the reduction of the routes currently served by CityFlyer turned on the availability of alternative services. The AUC said that it did not have resources to carry out a full quantitative analysis but qualitatively it would expect this to reveal that CityFlyer served two distinct categories of passengers: connecting passengers transferring to other air services at Gatwick; and those with an origin or destination in south-east England, who accessed Gatwick using surface transport.

7.109. For connecting passengers, few alternative services were likely to be available. On the other hand, BA would most probably wish to maintain those services which fed those passengers on to their long-haul network. The relevant market for the second group of passengers was potentially that of scheduled services to all London airports (Gatwick, Heathrow, Stansted and Luton). The extent to which these passengers would be catered for if CityFlyer's services were reduced depended on the availability of alternative services and the extent to which other airports provided a real alternative to Gatwick.

7.110. In the view of the AUC, the most likely conclusion would be that the loss of benefit from reduction in CityFlyer services would significantly exceed the gains from increased frequency on long-haul routes. If that were the case, the AUC would conclude that the merger was not in the long-term public interest. This conclusion would be reinforced by more general concerns that this acquisition would further strengthen BA's dominant position at Heathrow and Gatwick and enable it to set prices unconstrained by market forces.

7.111. The above analysis was based on the assumption that if the merger were disallowed CityFlyer would continue to operate its current range of services under franchise to BA. For the reasons given above, the AUC believed, that was the most likely outcome. Indeed, if the franchise agreement was as beneficial to CityFlyer as the AUC believed, the airline's value would be significantly reduced without that agreement, so making its acquisition by a competing airline even less likely. However, it might still be an attractive proposition to an airline such as Virgin Atlantic that could itself benefit from a short-haul feeder network at Gatwick. Moreover, Virgin Atlantic or one of the major charter airlines might see this as an opportunity to acquire CityFlyer's substantial portfolio of slots for use in their main business. British Midland might also be interested in acquiring slots to fulfil its aspirations of establishing a long-haul network.

7.112. Loss of the BA franchise would threaten the viability of a number of CityFlyer's existing routes. The AUC therefore came back to the question of whether the alternative use of the slots that were employed to operate those routes would generate more consumer benefit than would be lost as a result of the discontinued services.

7.113. The AUC felt reasonably confident that that would not be the case if the slots were transferred to charter services. Charter passengers generally travelled point-to-point and were willing to make relatively long surface access journeys to join their flight. Conversely, scheduled services carried significant numbers of connecting passengers and therefore needed to operate from a hub airport. The AUC was not suggesting that this would justify excluding any existing charter services from Gatwick but, from the point of view of passenger benefit, it would seem to be a retrograde step for scheduled services to be replaced by charter operations.

7.114. Acquisition of CityFlyer by Virgin Atlantic would offer the potential benefit of strengthening competition between Virgin and BA by providing Virgin with its own short-haul feeder network at Gatwick (in addition to the Virgin Express service to Brussels). Moreover, like BA, Virgin Atlantic would be likely to wish to transfer some of the newly-acquired slots to its long-haul services, so enhancing competition in that market. However, the AUC would not expect feed from Virgin Atlantic's long-haul services and access to its distribution system to be as beneficial to the CityFlyer routes as the current BA franchise. To the extent that this pushed some of the existing services into loss, Virgin Atlantic might be faced with absorbing slots faster than it could reasonably expand its long-haul network. The net result would almost certainly be a reduction in consumer benefit in the short term. Even in the longer term, it would depend on how Virgin Atlantic chose to employ those slots as to whether the loss of benefit from discontinuation of some of CityFlyer's existing services would be recovered.

7.115. British Midland had announced its intention of operating long-haul services to the USA. It might therefore be interested in acquiring CityFlyer so as to provide the slots for such services. Like BA, it would be likely to transfer services from Heathrow to Gatwick. In the case of British Midland, these would be short- and medium-haul services, possibly those which duplicated routes already flown by CityFlyer. The Heathrow slots so released would be used to operate long-haul services in competition with BA. Of all the possible outcomes considered, this was likely to produce greatest consumer benefit.

7.116. The AUC's reservations concerning the possible loss of some of CityFlyer's existing services and the likely use that would be made of the slots so released might be addressed by granting conditional approval to the merger. They could not see how conditions could be framed to meet their underlying concern about BA's policy of using up scarce airport capacity by reducing aircraft size and increasing frequency on routes that were already well served. However, an undertaking to ring-fence the acquired slots for use on European and domestic scheduled services, while being rather more restrictive than the AUC would have wished, would go a long way to meet those concerns.

7.117. Approval subject to such an undertaking would maintain the existing level of consumer benefit from CityFlyer's services but would do nothing to increase that benefit. The only outcome that would offer the potential for increased benefit to air users would be for CityFlyer to be acquired by Virgin Atlantic or British Midland and for some of its slots to be used to operate long-haul services in competition with BA.

CityFlyer staff

7.118. A committee of CityFlyer staff told us that they represented 471 of the staff of CityFlyer who had signed a petition in support of the proposed acquisition. There were 650 staff in all.

7.119. The company's relationship with BA since its formation had been critical to its success. The history of independent airlines at Gatwick contained few success stories, with airlines such as Air Europe, Dan-Air, BCal, Laker and others having ceased operations with substantial numbers of job losses over the last 20 years. However, thanks to its franchise agreement with BA, CityFlyer had been able to trade profitably in every year except its first and it was consequently a stable employer offering long-term job security to its employees.

7.120. CityFlyer's staff recognized that it was essential for the venture capital institutions which took the preliminary risk of backing the company in 1991 to be able to realize their investment. The imposition of conditions upon the proposed merger, or an outright refusal of permission for it, would have adverse consequences for employment and career prospects.

7.121. Whilst it was likely that the status quo would prevail in the short term, CityFlyer staff were concerned that it might well force the venture capitalists into a position where a sale to a party other than BA became the only option available to them to recoup their investment. It was likely that other bidders would seek to strip the company of its slots.

7.122. CityFlyer staff told us that many of the staff had experienced the uncertainty and anguish which resulted from airline failures. They had invested considerable time and energy into making the company the success it was today and it would be a tragedy if the company was taken over purely so that another airline could use its slots to expand. Even if jobs were made available to CityFlyer staff by another purchaser, there were no guarantees that they would be able to enjoy the same opportunities for progression.

7.123. The BA agreement gave them an element of security in that CityFlyer was a valuable provider of connecting passengers to the BA long-haul services at Gatwick and BA had pledged to maintain the company as a separate short-haul operation at Gatwick with its own management.

7.124. In terms of competitive issues, CityFlyer staff failed to see how the sale agreement would change the way in which they did business and thereby affected their competitors. CityFlyer traded as a BA franchise and its passengers purchased tickets from BA, travelled on an aircraft in BA livery and were served by ground staff and cabin crew in BA uniforms. CityFlyer staff argued that continuing this arrangement could not represent a threat to CityFlyer competitors.

7.125. CityFlyer staff were not party to the discussions between BA and CityFlyer's management and shareholders, but they understood that in proposing to purchase CityFlyer, BA was merely responding to the desire of the venture capitalists to realize their investment. They did not believe that the sale would strengthen BA's position at Gatwick to a level other than that which it currently enjoyed through the franchise agreement.

7.126. CityFlyer's staff told us that they were concerned about the plans that Mr Branson had put forward for CityFlyer should Virgin Atlantic buy it. Reports that the franchise agreement with BA would be terminated and that CityFlyer would be remoulded as a no-frills operation would have serious consequences. Their fear was that the loss of the BA franchise agreement would cost jobs at CityFlyer and would change the routes and aircraft types which it operated. They felt that of the many potential bidders for CityFlyer only BA had economic incentives not to asset strip CityFlyer. In their view, the Virgin group would run CityFlyer as a short-haul operation to hold slots so that once its new aircraft arrived it could remove the slots it wanted to expand long-haul services with catastrophic

consequences for CityFlyer and the jobs of CityFlyer staff. Although CityFlyer was a low-cost operator, a large number of its routes would not continue to operate should it become a no-frills airline, likewise none of CityFlyer's current fleet would deliver the required seat-mile costs necessary for a profitable operation of that type. These facts led CityFlyer staff to believe that Virgin Atlantic was trying to acquire CityFlyer purely for long-haul expansion.

7.127. Comments from Mr Branson that the acquisition of CityFlyer by Virgin Atlantic was the last chance for a 'second airline force' in the UK confirmed to them his long-haul expansion motive. CityFlyer staff considered that if Mr Branson had wanted a short-haul operation even if he had only viewed it as a method of gaining slots, he could have started one. CityFlyer had been operating from Gatwick since 1991 whereas Virgin Atlantic started flying seven years earlier. Virgin Atlantic could have seen that growth from Gatwick would become more difficult. CityFlyer staff felt that if Mr Branson had not had the foresight to grow his operation, they should not be made to pay the price.

7.128. CityFlyer subsequently told us that the news that Virgin Atlantic had offered to buy CityFlyer for the same price as BA, should BA be restricted from doing so, was a serious development. If BA were not allowed to buy CityFlyer, the Virgin Atlantic offer would limit the possibility of CityFlyer's directors and shareholders finding another investor who would be prepared to let CityFlyer operate as now. CityFlyer staff told us that they were convinced that the franchise agreement with BA was vital to CityFlyer's success, and if the deal was not approved it was likely that the only options left to its current investors would be a sale to Virgin Atlantic or a sale for assets. Both of these options would destroy CityFlyer as a going concern.

Consumers' Association

7.129. The Consumers' Association (CA) told us that competition in aviation would be adversely affected by a number of elements of the proposed purchase. Whilst the direct effect of the acquisition was unlikely to be particularly deleterious and might, in fact, be initially beneficial, the longer-term effect would be to foreclose Gatwick to serious market entry by a rival carrier.

7.130. The potential advantages to consumers of the acquisition lay in the possibility of enhanced intralining between BA flights and improved connections. However, because CityFlyer had been operating as a BA franchise for some time CA assumed that a degree of this had happened already. The ability of BA to maintain regional services might also be enhanced by the ability to use CityFlyer to feed passengers through to their long-haul services.

7.131. The potential negative implications of the purchase centred on the control that BA would exercise over a significant element of the slot pool at Gatwick and the effective foreclosure of future market entry or expansion by existing carriers. The control over the slot pool was only a problem if that pool was used as a 'fighting fund' to counter competition or ward it off. The degree to which this might happen was difficult to gauge, as feeder services would be significant providers of revenue for long-haul services. The foreclosure of the market was a more significant concern given the status of Gatwick as a slot-constrained airport. Whilst BA itself might not strategically wish to foreclose market entry, the control of about 60 per cent of the scheduled slots and about 40 per cent of the total slot pool would have the same effect as a strategy of foreclosure.

7.132. The balance sheet for consumers of this proposed acquisition did contain some potential pluses (in terms of protection of regional links and schedule co-ordination) as well as the more obvious minuses (control of the slot pool and foreclosure of the market). However, on balance CA thought that the proposed acquisition should not be allowed to proceed.

Transport and General Workers Union

7.133. The Transport and General Workers Union (T&G) told us that it was in favour of the proposed merger for the following reasons:

- (a) CityFlyer had operated on a BA franchise basis for some time and as such had enjoyed a period of growth leading to the creation of more than 400 additional jobs. These jobs would not have appeared without the franchise arrangements.
- (b) The benefit for BA had been the traffic that had been fed to their services by CityFlyer. This had the effect of securing BA jobs as well as increased employment.
- (c) The T&G believed the merger would in effect mean that on the ground (or in the air) nothing changed. It was its understanding that both BA and CityFlyer would continue to operate as separate entities with their own boards, staff, etc.
- (d) CityFlyer's operations were an integral part of BA's hub-and-spoke system operating out of Gatwick, a system that its members had put a great commitment into and had watched their personal investment prosper, leading to job security and reasonable remuneration.
- (e) The proposed merger would ensure UK job retention and hopefully expansion for BA and CityFlyer staff.

7.134. The T&G understood from press reports that the sale of CityFlyer was an open process and well known within the industry prior to CityFlyer's acceptance of the BA bid. It was aware that other potential purchasers had the opportunity to consider making bids and that the sale was transparent. Its assessment was that there would be no increase in BA branded slots at Gatwick as a result of this acquisition going ahead.

Individuals

Mr Peter Atkinson MP

7.135. Mr Atkinson told us that he was the Member of Parliament for Hexham, which was in the North-East. Newcastle Airport was vital to his constituency and it was important that the feeder services to London's airports were maintained for onward connections. There was considerable concern that CityFlyer might be valued more for its slots than for the service it provided to regional airports such as Newcastle.

7.136. CityFlyer was controlled by a venture capital company which was seeking to maximize its investment and therefore the airline would be sold. If it was to be sold then BA was the best purchaser as it had a current link-up with CityFlyer and would, more than any other airline, want to maintain the feeder services to Gatwick, where it was continually locating more services.

Mr John K McCall

7.137. Mr McCall told us that as a member of the public, he was opposed to the merger, as he had little doubt that the result would be a falling off in the number of short-haul regional services, which were currently offered to those who lived in south-east England.

7.138. There had been a reduction in regional air services at Heathrow and Gatwick. The reason was the shortage of commercially attractive slots at each airport. As a result airlines made the best use of the slots they held. International long-haul slots were more profitable than regional slots. All of CityFlyer's slots were used for short-haul regional services.

7.139. Mr McCall believed that if the merger proceeded it was likely that in time BA would redeploy the CityFlyer slots on more of its long-distance flights which had much less relevance to those living in the Gatwick catchment area.

7.140. Mr McCall understood that BA already held more than 30 per cent of the Gatwick slots. To add CityFlyer's considerable slots to BA's existing dominance would create an unacceptable concentration.

Mr C C Pell

7.141. Mr Pell told us that BCal and Dan-Air had been absorbed by BA, and Air Europe had ceased to trade. Mr Pell considered that the removal of independent operations by BA should be halted. BA, at the time of privatization, had acquired the world's most extensive network; a network which operated from two of the world's busiest airports; aircraft, maintenance, infrastructure, ground equipment etc; and the write-off of its debts.

7.142. These factors gave BA an unfair advantage. BA's new airline Go was also posing a threat to other operators on an unfair basis because of unfair leasing rates and purchase power at BA, a guaranteed pilot pool and workforce from BA following early retirement, and existing ground handling facilities.

Mr Phillip Petitt

7.143. Mr Petitt told us that he was employed as a pilot by CityFlyer. It was his opinion that the proposed acquisition of CityFlyer by BA was good for the staff and the travelling public.

7.144. The two companies had worked closely together since 1993. This had benefited the travelling public by offering a standard product on routes that BA might not be able to operate itself and enabled the public to obtain the benefits of Executive Club membership and Air Miles etc on CityFlyer's routes.

7.145. The co-operation between the companies had allowed CityFlyer access to the worldwide BA reservations system which had benefited the company by extending its capability to sell tickets, the travelling public by providing knowledge of CityFlyer's routes and the ability to buy tickets for the CityFlyer network.

7.146. The two companies had, however, operated separately and it was understood that this would continue to be the case. CityFlyer would have a new shareholder so that when considering matters such as runway slots it could not be stated that BA would control CityFlyer slots.

7.147. The proposed acquisition had been brought about by the City investment companies that assisted the formation of the company in 1991 wishing to sell their shareholdings. If the acquisition by BA was not approved those investors would still wish to sell their shares. Mr Petitt said he considered that most other prospective purchasers would be airlines which would want to purchase the company for its runway slots and then close it down with a loss of jobs. If CityFlyer were sold to another bidder CityFlyer would lose the BA franchise along with the benefits to both passengers and staff.

Mr W Robinson

7.148. Mr Robinson told us that he did not consider BA should be permitted to acquire CityFlyer because it already had a significant proportion of the slots at Heathrow and Gatwick. Airlines such as Virgin Atlantic were finding it difficult to obtain slots for new services and routes. Virgin Atlantic had stated its willingness to purchase CityFlyer which Mr Robinson considered would redress the balance so far as slot availability was concerned. An alternative possibility was for BA to acquire CityFlyer but, at the same time, to give up half of CityFlyer's slots to other carriers.

Mr Robbie Shaw

7.149. Mr Shaw told us that if the proposed merger between BA and CityFlyer was allowed to proceed, BA would have close to 50 per cent of the slots out of Gatwick, which was anti-competitive.

7.150. Over the last few years airlines such as Aer Lingus and Manx had applied for and been refused slots at Gatwick, yet BA had been allocated more slots. Mr Shaw wondered whether BA had too much influence in the slot allocation committee at Gatwick.

7.151. Apart from Guernsey and Jersey, which were operated by JEA as well as CityFlyer, there was no competition on domestic services out of Gatwick. BA operated to Aberdeen, Edinburgh, Glasgow and Manchester with no competition. Air UK (now KLM uk) used to operate to Edinburgh and Glasgow, until forced off the former, and paid to pull out of the latter. Mr Shaw told us that BA fares to Manchester needed to be compared with journeys of a similar distance where there was competition.

7.152. Mr Shaw considered that the proposed merger should not be permitted. Other airlines should be given slots to operate domestic services from Gatwick, just as British Midland was allowed to do so from Heathrow.