Competition Act 1998

No Grounds for Action Decision

No. MPINF-PSWA001 – 04

Alleged abuse of a dominant position by Flybe Limited

(Case MPINF-PSWA001)

OFT1286

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

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>INTRODUCTION</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>Summary of findings</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>THE FACTS</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>Introduction</td>
<td>7</td>
</tr>
<tr>
<td>B</td>
<td>The two main parties</td>
<td>7</td>
</tr>
<tr>
<td>C</td>
<td>The complaint</td>
<td>15</td>
</tr>
<tr>
<td>D</td>
<td>The OFT’s investigation</td>
<td>16</td>
</tr>
<tr>
<td>3</td>
<td>THE STORY OF HARM</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>The Chapter II prohibition and Article 102 of the Treaty on</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>the Functioning of the European Union</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>Alleged abuse on non-dominated markets</td>
<td>18</td>
</tr>
<tr>
<td>C</td>
<td>Characterisation of the potential associative links in this case</td>
<td>19</td>
</tr>
<tr>
<td>D</td>
<td>Consideration of associative links in this case</td>
<td>20</td>
</tr>
<tr>
<td>E</td>
<td>Consideration of potential abuse</td>
<td>20</td>
</tr>
<tr>
<td>4</td>
<td>DEFINING THE RELEVANT MARKETS</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>Introduction</td>
<td>22</td>
</tr>
<tr>
<td>B</td>
<td>Focal products</td>
<td>25</td>
</tr>
<tr>
<td>C</td>
<td>The alleged target market: the Newquay – London Gatwick route</td>
<td>26</td>
</tr>
<tr>
<td>D</td>
<td>The putatively dominated markets: Flybe’s routes from Exeter Airport</td>
<td>31</td>
</tr>
<tr>
<td>E</td>
<td>Conclusion on the relevant markets</td>
<td>53</td>
</tr>
<tr>
<td>5</td>
<td>DOMINANCE</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>Introduction</td>
<td>55</td>
</tr>
<tr>
<td>B</td>
<td>Assessment of market power</td>
<td>55</td>
</tr>
<tr>
<td>C</td>
<td>Assessment of other constraints</td>
<td>57</td>
</tr>
<tr>
<td>D</td>
<td>The Newquay – London Gatwick route</td>
<td>58</td>
</tr>
<tr>
<td>E</td>
<td>Flybe’s routes from Exeter Airport</td>
<td>61</td>
</tr>
<tr>
<td>F</td>
<td>Assessment of potential competition</td>
<td>63</td>
</tr>
</tbody>
</table>
G Conclusion on dominance

6 LEGAL AND ECONOMIC ASSESSMENT
A Associated markets
B Alleged abuse – analysis of costs and revenues
C Assessment of evidence regarding the alleged related market abuse and the strength of any associative links
D Objective justification
E The OFT’s conclusions on Flybe’s conduct

ANNEXE A – MARKET DEFINITION CATCHMENT PROFILE
ANALYSIS AND EVENT STUDY
ANNEXE B – ANALYSIS OF COSTS AND REVENUES
1 INTRODUCTION

A Summary of findings

1.1 In February 2009, Flybe entered the Newquay to London Gatwick air route in competition with Air Southwest. In March 2009, Air Southwest submitted a complaint to the OFT alleging abusive predatory conduct by Flybe.

1.2 In the OFT's view, the complaint raised two plausible stories of harm. First, that Flybe's conduct may have been designed to exclude Air Southwest from the Newquay to London Gatwick route. Second, that Flybe's conduct may have involved deliberately making losses with the expected benefit of not only excluding Air Southwest from the Newquay to London Gatwick route but also from its wider operations as the sole scheduled airline operating out of Plymouth Airport. And if Plymouth Airport were to close following Air Southwest's withdrawal from Plymouth Airport, passengers who would previously have flown from Plymouth Airport to destinations also served by Flybe from Exeter Airport might switch to Flybe's routes flown out of Exeter Airport, thus strengthening Flybe's position of dominance on certain routes at Exeter Airport.

1.3 The OFT is called on to decide whether Flybe's entry on to a new route in competition with Air Southwest amounts to predation, aimed at driving Air Southwest out of either the Newquay to London Gatwick route or Plymouth Airport or whether Flybe's conduct amounts to normal competition.

1.4 The OFT considers this to be a finely balanced case. Taking all of the available evidence in the round, however, the OFT considers that it does not have sufficient evidence to support a finding that Flybe's conduct amounts to either direct predation on the Newquay to London Gatwick route, or predation designed to foreclose Plymouth Airport. Therefore, it concludes that it has no grounds to take action against Flybe.

1.5 In making this decision, the OFT has placed significant emphasis on the fact that Flybe is a new entrant on to the Newquay to London Gatwick route. In doing so, it considers that the case law dealing with predatory conduct by incumbents is clearly distinguishable from the particular facts in this case.
Consequently, the OFT does not consider that the conditions of the prohibition contained in Section 18 of the Competition Act 1998 and/or Article 102 of the Treaty on the Functioning of the European Union are met.

**Alleged predation on the Newquay to London Gatwick route**

For a finding that conduct was abusive, competition law generally requires that the conduct should take place on the market in which the undertaking in question is dominant. In carrying out its assessment of the alleged predation on the Newquay to London Gatwick route, the OFT notes that Flybe is not dominant on the relevant market due to the constraint from actual competition with Air Southwest. Therefore, the OFT concludes that Flybe’s conduct on the Newquay to London Gatwick route cannot be an abuse in itself.

**Alleged predation and related markets**

Competition law recognises that abusive conduct will not necessarily be confined to the market in which the undertaking in question is dominant, but may take place on a market 'closely associated' to the dominated market.

The OFT notes that it does emerge from the case law that abusive conduct can be found on distinct but closely associated markets, where the conduct in question is likely to protect or strengthen the position on the dominated market. Furthermore, the case law establishes that a finding of an abuse of a dominant position in relation to conduct on the associated, non-dominated market and having effects on that associated market can only be justified by 'special circumstances'.

The OFT notes that the case law is not clear as to the full extent of what might constitute 'special circumstances' and what would be sufficient to establish a related-market abuse. In such circumstances account should be taken, amongst other things, of the supply and demand structure on the markets, the characteristics of the products or services offered, as well as any 'associative links' between the markets. Such associative links need to be sufficiently proximate to establish a related-market abuse.

The OFT considers that Flybe has a dominant position on two small scale origin and destination pair routes which are potentially relevant to the analysis in this case. These have their origin at Exeter Airport (Exeter Airport Markets).
1.12 The OFT has considered whether the potential exit of Air Southwest from the Newquay to London Gatwick route would, in turn, result in the exit of Air Southwest from Plymouth Airport and consequently would enable Flybe to protect or strengthen its dominant position on the Exeter Airport Markets.

Links between the Exeter Airport Markets and the Newquay to London Gatwick route

1.13 There is a plausible theory that the effect of displacing Air Southwest from the Newquay to London Gatwick route may undermine Air Southwest's remaining operations from Plymouth Airport to the extent that Plymouth Airport would close. Although the OFT notes questions have been raised about the operational limitations of Plymouth Airport notwithstanding the alleged conduct of Flybe.

1.14 While there is some evidence to suggest that passengers from Plymouth Airport might switch to Exeter Airport if Air Southwest did exit the Devon and Cornwall region and Plymouth Airport did close, there is also evidence to suggest that potentially another operator might enter the market in Air Southwest's place and Plymouth Airport remain open despite Air Southwest's exit. Indeed, the OFT notes that Air Southwest was put up for sale in May 2010,\(^1\) with press reports indicating that several suitors were showing an interest in the company. Subsequently, in September 2010, it was announced that an agreement had been reached whereby Air Southwest would be sold to Eastern Airways, subject to regulatory approval. The proposed deal appears to envisage the continuation of ASW's services under the ASW brand.\(^2\)

1.15 On this basis, the OFT concludes that the evidence of the proximity of the links between the Exeter Airport Markets in which Flybe is dominant, and the Newquay to London Gatwick market, where Flybe is a new entrant, is very finely balanced. Whilst in principle capable of forming the basis of an alleged related-market abuse, the OFT has questions concerning the strength of the links that need to be in place for the story


of harm to carry through. In particular, if Air Southwest had to withdraw from the Newquay to London Gatwick route and, if it did exit the wider Devon and Cornwall region, Plymouth’s operational limitations as an airport and the underlying viability of air services from Plymouth Airport may be at least a contributing factor to such an exit. In addition, to the extent that air services from Plymouth Airport are viable, the OFT notes the possibility that Flybe’s potential gains from eliminating Air Southwest could be negated should a successor to Air Southwest materialise.

1.16 The OFT has nevertheless considered, if it were the case that the links were sufficiently proximate between the Exeter Airport Markets in which Flybe is dominant and the Newquay to London Gatwick route, whether there is evidence that Flybe’s conduct amounts to predation.

Below cost pricing by Flybe on the Newquay to London Gatwick route

1.17 The seminal case on predation in its traditional sense is AKZO. It deals with the situation where there is a dominant incumbent. In this case the Court Of Justice held that prices below average variable costs by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive.

1.18 The OFT recognises that the situation of Flybe entering a new route is very different from a situation in which an incumbent dominant operator makes losses in response to new entry. It may often be necessary for an undertaking to incur losses when it initially enters a new market, as it will take time for the product or service to establish a market presence and generate revenues (in this instance, for the airline operator to build up passenger numbers). Such losses may be part of the normal competitive process, even if the entry ultimately results in the new entrant displacing an incumbent operator. In this case, the OFT has therefore considered not only Flybe’s actual revenues for the 18 months since it entered the Newquay to London Gatwick route, but also its revenue projections and the period over which it anticipates incurring losses following its entry.

1.19 The losses incurred by Flybe in the circumstances of this case, where Flybe is a new entrant, may amount to normal, albeit robust, competition for the reasons set out below.

1.20 Flybe's internal documentation shows that it was aware that it would make losses on the Newquay to London Gatwick route in the first two years of operation and only just cover its average avoidable costs in the second year. The OFT considers that Flybe's average avoidable costs of entry, used as a more appropriate measure than average variable costs in this case, have exceeded its revenues on the Newquay to London Gatwick route in its first 18 months of operation. However, the OFT notes that Flybe has forecast losses of a similar scale when starting up other new routes.

1.21 Further, the OFT is aware that factors such as the general economic downturn at the time of the launch of the Newquay to London Gatwick route and the cloud of volcanic ash which disrupted flights earlier this year may well impact negatively on Flybe's outturn thus potentially resulting in Flybe incurring greater losses over an extended timeframe.

1.22 The OFT considers that it will often be necessary for an airline to incur losses when it initially enters a new market. Further given, in particular, the evidence that Flybe has incurred similar scale losses on other routes, the OFT considers that, in this case, the evidence of revenues below average avoidable costs is not sufficient for it to conclude that Flybe's conduct was abusive. In the OFT's view, such losses may amount to normal, albeit robust, competition in the circumstances of this case, where Flybe is the new entrant.

**Flybe's intentions**

1.23 The OFT has also examined all the internal documentation about Flybe's plans and preparations for the launch of its Newquay to London Gatwick route provided to it by Flybe. It considers that such documentation does not provide sufficient evidence that Flybe's principal intention when entering on to the Newquay to London Gatwick route was to eliminate Air Southwest nor does it demonstrate that Flybe's conduct in so doing was commercially irrational.
Conclusion

1.24 In the OFT’s view this is a complex and finely-balanced case. Following a careful assessment and taking all of the available evidence in the round, the OFT considers that it does not have sufficient evidence to support a finding that Flybe’s alleged conduct amounts to predation either on the Newquay to London Gatwick route, or in respect of a related market. Therefore, it has no grounds to take action against Flybe. This conclusion is founded on:

- the fact that the OFT considers that Flybe is not dominant on a relevant market covering the Newquay to London Gatwick route and is only dominant on the small scale Exeter Airport Markets

- evidence which indicated that the links between the Exeter Airport Markets, in which Flybe is dominant, and the Newquay to London Gatwick market, in which it is not, were limited due to the fact that Plymouth Airport’s operational limitations may at least be a contributing factor to any possible exit by Air Southwest and also by the possibility of a new entrant at Plymouth Airport, even if Flybe’s conduct managed to eliminate Air Southwest from the Newquay to London Gatwick route and from Plymouth Airport more widely

- the absence of factors indicating that Flybe’s entry on to the Newquay to London Gatwick route marks a departure from normal, albeit robust, competition in the particular circumstances of this case

- the absence of sufficient evidence that Flybe’s intentions were predatory and not part of a normal and competitive strategy.
2 THE FACTS

A Introduction

2.1 In March 2009, the OFT received a complaint from Air Southwest (ASW) regarding alleged predatory entry by Flybe on the Newquay to London Gatwick route (Newquay – London Gatwick). In short, ASW alleged that Flybe intended to eliminate it from the route, with the wider intention of forcing it to close down altogether, thereby eliminating nearly all of Flybe’s competition in Devon and Cornwall.

B The two main parties

ASW

2.2 ASW is an air carrier that holds an operating licence granted by the Civil Aviation Authority (CAA). It operates scheduled air services from its bases in the south west of England, located at Plymouth City Airport (Plymouth Airport) and Newquay Cornwall Airport (Newquay Airport) and some services from Bristol International Airport (Bristol Airport) to destinations within the UK, the Channel Islands and the Republic of Ireland using 50-seat Dash 8-300 aircraft.


4 ASW briefing note for the OFT received on 9 March 2009

5 Ibid, page 1

6 www.airsouthwest.com/about/

7 www.plymouthairport.com/

8 www.newquaycornwallairport.com/

9 www.bristolairport.co.uk

10 www.airsouthwest.com - For UK destinations, ASW operates flights from Plymouth to Bristol, Glasgow, Leeds Bradford, London Gatwick, Manchester and Newcastle, from Newquay to Bristol, Glasgow, Leeds Bradford, London Gatwick, Manchester and Newcastle, and from Bristol to Leeds Bradford, Manchester, Newquay and Plymouth. ASW operates flights from Plymouth and Newquay to Cork and Dublin, from Plymouth and Bristol to Jersey and from Plymouth to Guernsey
2.3 ASW is a relatively small airline. According to statistics from the Civil Aviation Authority (CAA)\(^{11}\) from 2009 it is the seventeenth largest airline by number of passengers on UK domestic routes (it carried 220,000 passengers – one per cent of the total number of annual departing domestic terminal passengers in 2009).\(^{12}\) ASW’s turnover in 2007/08 was £19.9m, with a profit of £1.2m.\(^{13}\) Equivalent figures for 2008/09 were turnover of £22m and a profit of £350,000.\(^{14}\)

2.4 ASW is a subsidiary of the Sutton Harbour Group (SHH),\(^{15}\) which also owns, amongst other things, the 150 year lease for Plymouth Airport, the airline’s home base (ASW is the sole operator from Plymouth Airport). SHH had a turnover of £29.2m and a pre-tax profit of £5.5m in 2008.\(^{16}\) Equivalent figures for 2009 were a turnover of £29.3m and a loss of £3.4m.\(^{17}\)

2.5 ASW commenced operations in 2003, initially picking up the Plymouth – Newquay – London Gatwick route dropped by British Airways (BA) in its regional network cuts.\(^{18}\) According to ASW, routes were quickly added from Plymouth Airport, Newquay Airport and Bristol Airport to Manchester and Leeds Bradford, from Newquay Airport to Cork and Dublin, and from Plymouth Airport and Bristol Airport to Jersey.\(^{19}\) ASW maintains

\(^{11}\) www.caad.co.uk

\(^{12}\) CAA spreadsheet ‘Annual Departing Domestic Terminal Passenger Statistics - 2009’, available on request from the CAA

\(^{13}\) ASW briefing note for the OFT received on 9 March 2009, page 2, table 1

\(^{14}\) Ibid

\(^{15}\) www.sutton-harbour.co.uk In addition to ASW and Plymouth Airport, SHH owns and operates Sutton Harbour in Plymouth (which is home to Sutton Harbour Fisheries, Sutton Harbour marina village and an estate of harbour frontage investment properties). SHH also has a regeneration division, which includes rentals from investment properties and regeneration activities

\(^{16}\) www.sutton-harbour.co.uk/images/userimages/shacccounts08.pdf, page 36

\(^{17}\) www.sutton-harbour.co.uk/images/userimages/SHACCOUNTS09.pdf, page 34

\(^{18}\) Page 1 of ASW briefing note for the OFT received on 9 March 2009

\(^{19}\) Ibid
that the airline's commercial strategy has primarily been to build routes from its two main operating bases at Plymouth Airport and Newquay Airport, focusing mainly on routes which can be flown at least once daily, on a year-round basis. Further, ASW explained that the development of a 'hub' operation at Bristol Airport has allowed it to operate through-services and crossover-services (for example Plymouth – Bristol – Manchester, Newquay – Bristol – Leeds Bradford) which, according to ASW, afford multiple selling opportunities in order to create viable passenger loads.\(^\text{20}\) In addition to the Plymouth – Newquay – London Gatwick service, routes to Glasgow, Newcastle, Cork and Dublin also operate as a Plymouth – Newquay combination, creating, according to ASW, viable services in these relatively thin regional markets.\(^\text{21}\)

2.6 With regard to the Newquay – London Gatwick route, ASW was operating four triangulated flights daily (Plymouth – Newquay – London Gatwick), 7 days a week in both directions at the time Flybe launched its Newquay – London Gatwick route. ASW’s flights on this route start at Plymouth Airport, but the timetable for its flights on the Newquay – London Gatwick leg, at the time Flybe launched its flights, was as follows:

- 07:20 depart Newquay Airport, arriving at London Gatwick 08:30
- 11:05 depart Newquay Airport, arriving at London Gatwick 12:15
- 14:45 depart Newquay Airport, arriving at London Gatwick 15:55
- 18:15 depart Newquay Airport, arriving at London Gatwick 19:25.\(^\text{22}\)

2.7 ASW’s timetable for flights from the London Gatwick – Newquay route at the time Flybe launched its Newquay – London Gatwick was as follows (note that the first three flights travelled via Plymouth):

- 09:05 depart London Gatwick, 10:45 arrive at Newquay Airport

\(^\text{20}\) Ibid, pages 1 and 2

\(^\text{21}\) Pages 1 and 2 of ASW briefing note for the OFT received on 9 March 2009

\(^\text{22}\) Page 18 of ASW briefing note for the OFT received on 9 March 2009
2.8 ASW’s current timetable for the Newquay – London Gatwick leg of its route is the same as listed above in paragraph 2.6.24

2.9 SHH announced in February 2010 that ASW had entered into a strategic alliance with Eastern Airways25 and then in May 2010 it made a further announcement that it was putting ASW up for sale.26 In September 2010, SHH announced that it had reached agreement to sell ASW to Eastern Airways, subject to regulatory approval. The proposed deal appears to envisage the continuation of ASW’s services under the ASW brand.27

Flybe

2.10 Flybe28 has its headquarters at Exeter International Airport (Exeter Airport).29 Its turnover in 2007/08 was £536m, with a profit before tax of £35.4m.30 Flybe has

23 Ibid

24 www.airsouthwest.com/travel.php?id=6


28 www.flybe.com

29 www.exeter-airport.co.uk

published accounts for 2008/09, which show turnover of £572.4m and a profit of £4.1m after tax. Flybe operates 203 routes across 13 countries, including to and from 38 UK airports, and carried 7 million passengers in the year to 31 March 2008 and 7.3 million in the year to 31 March 2009. According to CAA statistics, Flybe was the second largest UK domestic airline, behind only easyJet, carrying five million passengers (22 per cent share of annual departing domestic terminal passengers) in 2009. Flybe also has a franchise agreement with Loganair. Loganair is privately owned, but since 26 October 2008 has operated flights using Flybe livery and staff. Loganair flies between 18 airports as part of Flybe’s route network.

2.11 69 per cent of Flybe is owned by Rosedale Aviation Holdings Limited, 16 per cent of shares are owned by Flybe’s staff through an Employee Share Scheme. The final 15 per cent is owned by British Airways as a consequence of Flybe’s acquisition of BA Connect.

2.12 Flybe operates direct routes from Exeter Airport to 10 destinations in the UK and Channel Islands and 13 outside the UK but within the European Union. The only other

32  www.flybe.com/en/company_information/. 26 of these routes, 10 airports and one country are exclusively served by Flybe’s franchise partner, Loganair.
35  CAA spreadsheet 'Annual Departing Domestic Terminal Passenger Statistics - 2009', available on request from the CAA
36  www.loganair.co.uk
37  www.loganair.co.uk/loganair/press-office/22/flybe-and-loganair-q&amp;mp%3Ba
39  www.flybe.com/company_information/ownership.htm
The airline operating scheduled flights from Exeter Airport is Skybus.\(^{40}\) According to Skybus's current online timetable, it operates between one and five flights a week, depending on the time of year, from Exeter Airport to St Mary's Airport on the Isles of Scilly.\(^{41}\) This does not overlap with any of Flybe’s routes from Exeter Airport.

2.13 Flybe also operates routes from Newquay – Edinburgh and Newquay – London Gatwick.\(^{42}\) At present, it faces competition from ASW on the Newquay – London Gatwick route but no competition on the Newquay – Edinburgh route. The other scheduled airlines currently operating direct flights from Newquay Airport, besides those operated by ASW detailed in paragraph 2.2 above, are bmibaby\(^{43}\) (Newquay – East Midlands between until 12 September 2010 and Newquay – Manchester until 30 October 2010), Jet2\(^{44}\) (Newquay – Belfast International until 4 September 2010), Lufthansa\(^{45}\) (Newquay – Dusseldorf until 11 September 2010) Ryanair\(^{46}\) (Newquay – Alicante until 28 October 2010) and Skybus\(^{47}\) (Newquay – St Mary's Airport on the Isles of Scilly until 30 October 2010 unless stated otherwise).\(^{48}\)

\(^{40}\) www.skybus.co.uk

\(^{41}\) www.islesofscilly-travel.co.uk/timetable_skybus.asp#ext

\(^{42}\) www.flybe.com/map. We note that Flybe has previously operated flights from Newquay Airport to Southampton Airport and Glasgow Airport but these were cancelled – see document entitled 'Section 2 to the OFT’s Section 26 Notice dated 13 August 2009 – Requests for statements to be set in context and/or explanations of facts contained within documents’, which was supplied with a letter from Flybe’s legal advisers to the OFT dated 7 September 2009, page 53 and news.flightmapping.com/08/06/17/flybe-to-suspend-flights-between-glasgow-and-newquay_1801.html respectively.

\(^{43}\) www.bmibaby.com/bmibaby/flights/home.aspx

\(^{44}\) www.jet2.com/

\(^{45}\) www.lufthansa.com/uk/en/Homepage

\(^{46}\) www.ryanair.com/en

\(^{47}\) www.skybus.co.uk/

\(^{48}\) www.newquaycornwallairport.com/index.cfm?articleid=48607
2.14 ASW and Flybe currently compete directly and indirectly for scheduled airline services to and from Devon and Cornwall, with ASW offering services from Plymouth Airport and Newquay Airport to destinations served by Flybe from Exeter Airport (Manchester, Leeds Bradford, Glasgow, Newcastle, Jersey and Dublin) and from Newquay (London Gatwick). Flybe advertises its Exeter Airport services in the Plymouth Evening Herald, potentially attracting Plymouth residents to its Exeter Airport service.

2.15 On 11 December 2008 Flybe announced that it would be starting operations on the Newquay – London Gatwick route and on 15 February 2009, it began operating three direct flights per day (weekdays). These flights almost exactly mirrored three out of the four ASW flight legs from Newquay – London Gatwick (ASW flights to London Gatwick start at Plymouth Airport).

2.16 Flybe operates 78-seat Bombardier Q400 aircraft on this route. The Winter timetable for Flybe flights on the Newquay – London Gatwick route, available to book at the date of launch in February 2009, was as follows:

<table>
<thead>
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<th>Newquay Airport – London Gatwick</th>
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<tr>
<td>• 07:20 depart, 08:25 arrive (Monday – Saturday)</td>
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<tr>
<td>• 07:45 depart, 08:50 arrive (Sunday)</td>
</tr>
<tr>
<td>• 14.30 depart, 15.35 arrive (Monday – Saturday)</td>
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49 www.thisisplymouth.co.uk

50 Page 4 of ASW briefing note for the OFT received on 9 March 2009

51 See for example www.shephard.co.uk/news/1206/. Emails written by employees of Flybe (provided to the OFT in response to the OFT’s section 26 notice of 18 May 2009) also indicate that the announcement was made on 11 December 2008.


53 Page 4 of ASW briefing note for the OFT received on 9 March 2009
• 18:20 depart, 19:25 arrive (Monday – Friday and Sunday)\textsuperscript{54}

London Gatwick – Newquay Airport

• 09:00 depart, 10:05 arrive (Monday – Saturday)

• 16:05 depart, 17:10 arrive (Monday – Sunday)

• 19:55 depart, 21:00 arrive (Monday – Sunday).\textsuperscript{55}

2.17 Flybe has since made changes to its flight times on the Newquay – London Gatwick route. The latest timetable is set out below:

Newquay Airport – London Gatwick

• 07:20 depart, 08:25 arrive (Monday – Saturday)

• 14:55 depart, 16.00 arrive (Monday – Sunday)

• 18:15 depart, 19:20 arrive (Monday and Friday)

• 18:20 depart, 19:25 arrive (Tuesday, Wednesday, Thursday and Sunday)\textsuperscript{56}

London Gatwick – Newquay Airport

• 09:05 depart, 10:10 arrive (Monday – Saturday)

• 16:35 depart, 17:40 arrive (Tuesday – Sunday)

• 16:40 depart, 17:45 arrive (Monday)

• 20:10 depart, 21:15 arrive (Sunday)

\textsuperscript{54} \url{www.flybe.com/timetable}

\textsuperscript{55} Page 18 of ASW briefing note for the OFT received on 9 March 2009

\textsuperscript{56} \url{www.flybe.com/timetable}
C The complaint

2.18 ASW alerted the OFT to its complaint in February 2009. It subsequently provided the OFT with a briefing note on 9 March 2009 and met with the OFT on 12 March 2009 to discuss the complaint. A further supplementary briefing note was provided to the OFT on 20 March 2009.

2.19 In summary, ASW alleged predatory entry by Flybe on the Newquay – London Gatwick route, which was operated solely by ASW until February 2009, when Flybe began operating its own flights. ASW stated that the route was the major contributor to ASW’s financial viability and alleged that Flybe entered the route with the intention of forcing ASW from it. ASW argued that if Flybe forced it to exit the route it would have to close down altogether, which would have the effect of eliminating all competition for Flybe's services on routes to and from Devon and Cornwall, save for some limited competition at the time from Ryanair on the Newquay – London Stansted route. However, Ryanair has now withdrawn from this route. Its flights ceased on 1 October 2009.

2.20 ASW stated it had evidence of Flybe's intention to eliminate it from the route, including pricing below cost, statements made directly to ASW by Flybe, the introduction of excess capacity on the Newquay – London Gatwick route and the 'shadowing' of

57 Ibid

58 ASW briefing note for the OFT received on 9 March 2009


60 Page 3 of ASW briefing note for the OFT received on 9 March 2009

61 Ibid, page 1

62 Ibid

63 www.thisiswesternmorningnews.co.uk/business/Ryanair-axes-winter-flights-Newquay/article-1302533-detail/article.html
ASW’s services (that is, operating planes with more seats at the same or very similar times to ASW’s flights). ASW believed that Flybe was able to sustain losses on the route by means of cross-subsidisation, relying on the profits it made on other routes.  

ASW also informed the OFT that Flybe had expressed an interest in acquiring ASW at a meeting in 2008.

D The OFT's investigation

Information considered during the investigation

2.21 During the course of the investigation, the OFT sent 10 formal requests for information under section 26 of the Competition Act 1998 (Act) to parties relevant to the investigation (Flybe, ASW, SHH and Exeter Airport). The number of documents provided to the OFT in response to these information requests amounted to over 5,000 pages.

2.22 The OFT has also obtained information and documents from certain parties without using its formal powers as well as using sources of publicly available information such as CAA statistics, various publications and information from the Internet.

2.23 Further, the OFT has met with ASW and Flybe and their respective advisers on several occasions. The OFT has also considered and responded to an application from ASW for an interim measures decision under Section 35 of the Act.

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64 Page 1 of ASW briefing note for the OFT received on 9 March 2009

65 Ibid, page 17
3 THE STORY OF HARM

A The Chapter II prohibition and Article 102 of the Treaty on the Functioning of the European Union

3.1 Section 18(1) of the Act sets out the Chapter II prohibition, which provides that any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the UK or any part of it.66

3.2 Article 102 of the Treaty on the Functioning of the European Union (TFEU) states that 'any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States'.

3.3 To find an infringement of the Chapter II prohibition, the OFT must establish:

- that at the time of the alleged infringement Flybe held a dominant position on a relevant market(s) within the UK or any part of it
- that Flybe abused that dominant position on that market or a related market and
- that such abuse may have affected trade within the UK or any part of it.67

3.4 The OFT’s determination of whether Article 102 of TFEU is applicable will consist of assessing whether the conduct 'may affect trade between Member States'. In practice, where the OFT considers that conduct under investigation may have an effect on trade

66 The Chapter II prohibition does not apply in cases in which it is excluded pursuant to section 19 of the Act. None of the excluded cases are applicable in respect of the conduct which is the subject of this Decision.

67 ‘Communication from the Commission – Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings’, (2009/C 45/02), paragraph 28 also makes provision for an assessment as to whether there is an objective justification for the exclusionary conduct, further to claims put forward by a dominant undertaking that its conduct is justified. In this respect, it is incumbent upon the dominant undertaking to provide all the evidence necessary to demonstrate that the conduct concerned is objectively justified - -see eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF
between Member States, it will, in addition to applying Article 102 of TFEU, usually also apply the Chapter II prohibition.

**Effect on trade**

3.5 Given the findings of the investigation, in particular, given the OFT considers that the other conditions of the Chapter II prohibition and/or Article 102 of TFEU are not all met, it has not been deemed necessary to carry out a full effect on trade assessment in this decision. For the sake of completeness, the OFT considers that the alleged conduct under consideration may be of a type which would otherwise appreciably affect trade between members states, as well as trade within the UK, were it not for the fact that it considers the conditions of the Chapter II prohibition of the Act and/or Article 102 of TFEU not otherwise to be all met. Nothing turns on this consideration for the purposes of the analysis carried out in this decision.

3.6 For the purposes of this decision references to the Chapter II prohibition and/or section 18 of the Act should be deemed to include an appropriate reference to Article 102 of the TFEU unless Article 102 of the TFEU is specifically mentioned.

**The relevant market and the question of dominance**

3.7 The complaint from ASW alleged that Flybe’s decision to enter on to the Newquay – London Gatwick route was predatory and therefore was an abuse of its dominant position and thus infringed the Chapter II prohibition. In examining ASW’s complaint, the OFT considered first whether Flybe could be dominant on the Newquay – London Gatwick route. In this regard, it has concluded that Flybe cannot be considered dominant on a relevant market between Newquay and London. On this basis, the OFT does not consider that Flybe’s conduct may be considered abusive when considered in the context of the Newquay – London Gatwick route alone.

**B Alleged abuse on non-dominated markets**

3.8 However, ASW also asserted that Flybe’s conduct was not simply an attempt to force ASW off the Newquay – London Gatwick route but was an attempt to exclude it more
widely from the airline market. The OFT therefore considered whether there was a plausible story of harm that Flybe’s conduct may have involved deliberately making losses, intended not only to exclude ASW from the Newquay – London Gatwick route but also from wider operations at Plymouth Airport, with the aim of protecting and strengthening Flybe’s alleged position of substantial market power at Exeter Airport.

3.9 In propounding this theory of harm, the OFT was mindful of the case law which found that conduct engaged in by a company which was dominant in one market could amount to the abuse of a dominant position even though the conduct took place on a related market where that company was not dominant, provided the dominated and non-dominated markets were closely associated.

C Characterisation of the potential associative links in this case

3.10 On the basis that the dominated market and the non-dominated market had to be closely associated, the OFT's investigation largely focused on a theory of harm which provided for sufficiently proximate associative links between Flybe’s alleged conduct on the Newquay – London Gatwick route and a potential dominant position it may have on related market(s). In this regard, the OFT has considered whether Flybe could be dominant on certain routes from Exeter Airport and, if so, whether it would be able to employ this market power on to the non-dominated market, that is, the Newquay – London Gatwick route. In this regard, the OFT has examined whether Flybe stood to gain on certain routes it operates from Exeter Airport by virtue of its conduct on the Newquay – London Gatwick route. The routes from Exeter Airport that the OFT has considered in this context are to those destinations which ASW also flies to from Plymouth Airport – namely Dublin, Glasgow, Guernsey, Jersey, Leeds Bradford, Manchester and Newcastle.

3.11 In accordance with such a story of harm, the OFT has carefully assessed the particular facts of this case, having regard to the relevant characteristics of the markets in question to determine whether the associative links between the Exeter Airport Markets and the Newquay – London Gatwick market are sufficiently proximate to support a related-market abuse in this case. In particular, the OFT has considered whether the potential exit of ASW from the Newquay – London Gatwick route would enable Flybe

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68 ASW briefing note for the OFT received on 9 March 2009, page 1
to protect or strengthen its dominant position on the Exeter Airport Markets. In order to understand whether Flybe stood to gain in this way, the OFT has examined whether ASW’s exit from the Newquay – London Gatwick route would:

- result in the wider exit of ASW from operating air services in Devon and Cornwall and, in particular, would lead to the closure of ASW’s services from Plymouth Airport

- result in another airline entering at Plymouth Airport and acting as a competitive constraint on Flybe on the Exeter Airport Markets thus preventing Flybe from enhancing or strengthening its dominant position on the Exeter Airport Markets.

D Consideration of associative links in this case

3.12 The Decision goes on to examine and explain why, in the final analysis, the OFT considers that this story of harm is ultimately open to question in this case. The OFT considers that there is a question that if Air Southwest had to withdraw from the Newquay – London Gatwick route and, if it did exit the wider Devon and Cornwall region, Plymouth Airport's operational limitations as an airport and the underlying viability of air services from Plymouth Airport may be at least a contributing factor to such an exit. The OFT also notes the possibility of new entry at Plymouth Airport. In the OFT's view, these are factors which suggest that the associative links between the Exeter Airport Markets and the Newquay – London Gatwick market may not be sufficiently proximate.

E Consideration of potential abuse

3.13 Separately and notwithstanding the OFT's view on the proximity of the associative links, the Decision also considers that the losses incurred by Flybe are not indicative of predation and are likely to be normal competition as undertaken by a new entrant looking to stimulate traffic for the route. Further, the OFT considers that it has not found sufficient documentary evidence for it to conclude that Flybe's conduct was predation rather than normal, albeit robust, competition.

3.14 Finally, the OFT concludes that it does not consider that the conditions of the prohibition contained in Section 18 of the and/or Article 102 of the TFEU are all met in connection with Flybe's conduct concerning its entrance on to the Newquay – London
Gatwick air route in competition with ASW. A full legal and economic assessment is carried out in Section 6.
4 DEFINING THE RELEVANT MARKETS

A Introduction

4.1 Market definition is not an end in itself. Rather, it is a key process for identifying relevant competitive constraints acting on a supplier of a given product or service, thus facilitating the assessment of dominance. It provides a framework for competition analysis and is usually the first step in an assessment of market power. Although it should be noted that in the case of a no grounds for action decision such as this one, the detail of the OFT’s analysis and the nature of its conclusion may be more circumscribed than in the case of an infringement decision.⁶⁹

4.2 This section considers the relevant market definitions in this case. It sets out the OFT’s approach, taking account of the OFT guidelines⁷⁰ and with reference to relevant precedent which serves as a useful guide when assessing the relevant market definition. The resulting framework for analysis is then applied to produce a definition of the relevant markets in this case.

A framework for establishing the market definition

Hypothetical monopolist test

4.3 In defining the relevant market(s), competition authorities normally use the conceptual framework known as the hypothetical monopolist test.⁷¹ This test forms the starting point for the framework the OFT has used in this case.

4.4 The hypothetical monopolist test, also known as the SSNIP (small but significant non-transitory increase in price) test, supposes that there exists a hypothetical monopolist of

⁶⁹ Freeserve.com plc v Director General of Telecommunications, [2003], CAT 5

⁷⁰ See Market definition (OFT403) at www.of.t.gov.uk/shared_of.t/business_leaflets/ca98_guidelines/of.t403.pdf

⁷¹ The competition law guideline Market Definition (OFT403) sets out in more detail how the OFT applies the test (see paragraphs 2.5 to 2.13). See www.of.t.gov.uk/shared_of.t/business_leaflets/ca98_guidelines/of.t403.pdf
the 'focal' group of products.\textsuperscript{72} The test then asks whether it would be profitable for a hypothetical monopolist to increase the price of the focal product by a small but significant amount (for example five to 10 per cent) above competitive levels for a sustained period of time. If the answer to this is 'yes', the test is complete. The product under the hypothetical monopolist's control is the relevant market.\textsuperscript{73}

4.5 If the answer to this question is 'no', this is typically because a sufficiently large number of customers would either switch some of their purchases to other substitute products (demand side substitution) or decide not to make a purchase. The test then continues, with the hypothetical monopolist assumed to control both the focal product and its closest substitute. The process is repeated, but this time in relation to the larger set of products under the hypothetical monopolist's control.\textsuperscript{74}

4.6 In some situations the price rise would not be profitable because of the responses of other suppliers (supply side substitution). However, the OFT will not take into account supply side substitution in market definition unless 'it is reasonably likely to take place, and already has an impact by constraining the supplier of the product or group of products in question'. In most cases it will take into account constraints from supply side substitution when analysing barriers to entry.\textsuperscript{75} The OFT has followed this approach here.

4.7 As in most cases, the OFT has not undertaken a quantitative analysis of the hypothetical monopolist test in this case, but rather has made an assessment, based on the evidence available to it, of the potential for substitution from the focal product.

\textsuperscript{72} The term 'product' is used for convenience and should be interpreted throughout this Decision to mean good, service or property right

\textsuperscript{73} Market Definition (OFT403), paragraph 2.10. See www.of t.gov.uk/shared_of t/business_leaflets/ca98_guidelines/of t403.pdf

\textsuperscript{74} Ibid, paragraph 2.11

\textsuperscript{76} Ibid, paragraph 3.18
Approach in previous airline cases

4.8 Following previous competition cases, the standard approach to market definition for scheduled passenger air transport services is to start from an origin and destination (O&D) pair, usually a city pair. This is because passengers generally want to travel from a specific origin (a city or region) to a specific destination (another city or region) and would not be prepared to substitute another origin and/or destination when faced with a small but significant increase in price. As a consequence each possible O&D combination is treated as a separate market.

4.9 A market definition typically consists of two dimensions – a product dimension and a geographic area. From the starting point of an O&D city pair, it is usual to then assess the demand substitutability of alternative possibilities for passengers along these two dimensions.

4.10 In terms of the geographic area, alternative possibilities for passengers typically include:

- indirect connecting flights between the O&D pair concerned
- direct flights from other airports which have significant overlaps in their catchment areas with the airport(s) concerned.

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77 See Commission Decision of 27 June 2007, Ryanair/Aer Lingus [2008] OJ C 47/05, paragraph 63, where the Commission considered destination insensitive passengers but argued it was unrealistic to assume that a significant proportion of passengers would not care about to where they flew.


80 Ibid
4.11 Insofar as the product dimension is concerned, alternative possibilities include:

- different types of airlines, such as, business class-only, low-cost and charter
- other modes of transport, such as road, rail and sea.

4.12 Whether these alternatives are substitutes depends on a wide range of factors, such as the overall travel time, frequency of services and price. It may also depend on the type of passenger concerned, as in some cases it may be appropriate to draw a distinction between time-sensitive and non-time-sensitive passengers. As a consequence, whether these alternatives are substitutes can only be determined on a route-by-route basis.

4.13 The OFT sees no reason to deviate here from the approach followed in previous airline cases as set out above. It has therefore considered the scope for demand side substitution on O&D city pairs on a route by route basis. The potential for supply side substitution is considered in the assessment of barriers to entry in Section 5 of this Decision.

B Focal products

4.14 The OFT has considered the relevant market from the starting point of the markets in which Flybe may possess market power and which it may be seeking to protect or strengthen through its conduct.

4.15 The OFT has first considered the question of market definition on the Newquay – London Gatwick route. For the reasons expressed in Section 3, however, the OFT's analysis of the harm from Flybe's conduct concerns principally the protection or strengthening of the Exeter Airport Markets.

4.16 Accordingly, the OFT considers that the relevant routes where Flybe could expect to protect or strengthen its putative dominance as a result of its alleged conduct are those from Exeter Airport that overlap with ASW routes from Plymouth Airport. The focal products (Focal routes) are therefore the series of scheduled flights on routes defined by O&D pairs operated by Flybe from Exeter Airport, which overlap with routes that ASW operates from Plymouth Airport – namely flights to Dublin, Newcastle, Manchester, Leeds Bradford, Glasgow, Jersey and Guernsey. Those Focal routes which are operated by Flybe out of Exeter Airport are termed Flybe Focal routes (Flybe Focal
routes) and the Focal routes operated by ASW out of Plymouth Airport are referred to as ASW Focal routes (ASW Focal routes).

4.17 The OFT has considered the potential for demand substitution along both the product and geographic dimensions, taking the Flybe Focal routes as a starting point. The OFT has identified the following as possible alternatives for passengers travelling on these routes from Exeter Airport:

- flights to the same destination from neighbouring airports (Bristol Airport, Plymouth Airport and Newquay Airport)
- rail and road travel as alternative modes of transport.

4.18 The OFT considers that indirect flights are unlikely to be a constraint to the flights on the focal routes.\(^{81}\) This is due to both the short duration of these flights and to the need to pay more than one set of airport taxes when taking connecting flights. The European Commission has found in previous cases that indirect services do not normally provide a constraint to direct services on short-haul flights, mainly due to the short travelling time as customers are less likely to consider indirect flights when the additional stop could easily double or triple the flight time.\(^{82}\) The OFT therefore considers indirect flights to be outside of any plausible market.

4.19 In accordance with findings in previous competition investigations, the OFT also considers charter flights unlikely to be a constraint to the scheduled services on the focal routes and considers these to lie outside any plausible market.\(^{83}\)

C The alleged target market: the Newquay – London Gatwick route

4.20 The following paragraphs discuss market definition on the Newquay – London Gatwick route. This is the market on which the allegedly abusive conduct has taken place.

\(^{81}\) Indirect flights are not the same as triangulated flights which stop at more than one destination as passengers on triangulated flights are not required to change airplanes and as such do not suffer additional waiting times

\(^{82}\) See for example Commission Decision of 27 June 2007, Ryanair/Aer Lingus [2008] OJ C 47/05, paragraph 289

\(^{83}\) Ibid, paragraph 311
4.21 The market definition considers the closeness of demand substitutes while supply side substitution is considered in the discussion on potential competition in Section 5.

**Geographic market definition**

4.22 The geographic market definition here considers the extent to which flights from other airports may be demand substitutes for flights on the Newquay – London Gatwick route. The OFT considers that demand substitutes at both ends of the route are potentially relevant. At the Newquay Airport end, the other candidate airport is Plymouth Airport (Exeter Airport and Bristol Airport have no air services to London). At the London end, the OFT notes that the other candidate airports aside from London Gatwick are London City Airport and London Stansted. There are flights from Newquay Airport to London Gatwick and until recently to London City Airport\(^{84}\) and flights from Plymouth Airport to London Gatwick and until recently to London City Airport.\(^{85}\) Ryanair previously operated flights from Newquay – London Stansted but stopped operating flights on this route in October 2009.\(^{86}\)

4.23 The geographic market definition is therefore principally concerned with the extent to which the following routes are substitutable to Newquay – London Gatwick:\(^{87}\)

- Newquay – London City
- Newquay – London Stansted
- Plymouth – London Gatwick
- Plymouth – London City.

\(^{84}\) [www.abtn.co.uk/news/0614136-air-southwest-drop-london-city-flights](http://www.abtn.co.uk/news/0614136-air-southwest-drop-london-city-flights)

\(^{85}\) Ibid

\(^{86}\) [www.thisiswesternmorningnews.co.uk/business/Ryanair-axes-winter-flights-Newquay/article-1302533-detail/article.html](http://www.thisiswesternmorningnews.co.uk/business/Ryanair-axes-winter-flights-Newquay/article-1302533-detail/article.html)

\(^{87}\) The OFT understands that scheduled flights between Exeter Airport and London are not considered viable given the length of the train journey between the two cities.
Substitutability of other London airports

4.24 As a starting point, the OFT has considered the Competition Commission's analysis of demand substitution between the London airports in the BAA market investigation.\(^88\) One approach used by the Competition Commission was to look at the 'inter-airport exposure' between the various London airports, that is the proportion of passengers of an airport beginning their journey in districts from which competing airports have a share of total passengers above a certain threshold.\(^89\) For London Gatwick, the inclusion of London Stansted as a potential competitor raised the inter airport exposure considerably,\(^90\) suggesting that there was likely to be significant extent of competition between them.

4.25 In addition, the Competition Commission carried out a survey of passengers leaving from each of the London airports. Just fewer than 15 per cent of the passengers surveyed at London Gatwick considered London Stansted as an alternative airport.

4.26 Flybe has submitted that the opening of its Newquay – London Gatwick route had a greater effect on Ryanair’s route from Newquay – London Stansted.\(^91\) For example, in June 2008 Ryanair carried 14,519 passengers on this route, while in June 2009 this had fallen to 7,134 passengers. Flybe submits that this reflects the stronger marketing in which Ryanair and Flybe engage in the south east of England and the presence of any passengers who are willing to substitute between Stansted and London Gatwick. By contrast, Flybe notes that ASW carries about the same number of passengers as the previous year. However, the OFT notes that the change in the number of passengers carried by Ryanair on the route is to a large extent likely to be a reflection of a


\(^{89}\) See Annex A for a discussion of the inter-airport exposure analysis

\(^{90}\) From less than 10 per cent to 40 per cent, when using a district share threshold of 20 per cent

\(^{91}\) Document provided to the OFT by Flybe at a meeting on 30 July 2009 entitled 'Chart of passengers carryings on Newquay – London, Flybe’s effect on the passenger carryings of Ryanair and Air South West', paragraphs 6a – 6c
reduction in the number of Ryanair services on the route. In this regard, the OFT notes that Flybe has submitted that Ryanair’s number of rotations on the route had a history of volatility\(^{92}\) and the OFT considers that this raises significant doubt that its decision to withdraw services was directly due to Flybe’s entry.

4.27 In the OFT’s view, for passengers originating in London, London Stansted and London Gatwick are likely to exhibit a similar degree of substitutability to that found in the Competition Commission’s analysis.\(^{93}\) The OFT does not consider, however, that there is conclusive evidence to suggest in particular that the Newquay – London Stansted route is in the same market as the Newquay – London Gatwick route.

4.28 With regard to London City Airport, the OFT considers that demand substitutability is likely to differ to that of London Stansted in two contrary ways. First, its location nearer the centre of London may make it a closer demand substitute to London Gatwick than London Stansted, particularly for more time-sensitive business passengers. Second, it does not offer the same range of connecting flights as London Stansted. London Stansted’s greater range of connecting flights may make it a closer substitute to London Gatwick for certain passengers.

4.29 The OFT has not concluded on whether services from other London airports should be considered in the same market as London Gatwick but notes that there is likely to be some degree of demand substitutability between them. However, given that Ryanair has ceased to provide services on the Newquay – London Stansted route, market shares have been calculated in Section 5 below on a conservative basis that excludes Ryanair’s service, though the possibility of entry to replace Ryanair’s service is also considered. Shares are calculated that both include and exclude ASW’s previous services to London City Airport.

\(^{92}\) The operation of Flybe’s business’, Flybe submission to the OFT 24 June 2009, paragraph 71

\(^{93}\) The OFT is also mindful that the EC Commission stated in Ryanair/Aer Lingus [2008] OJ C 47/05: ‘In the light of the foregoing, the Commission takes the view that scheduled point-to-point passenger air transport services between Dublin (as well as Cork and Shannon as there are no indications that the situation would be different) and London Heathrow, Gatwick, Stansted, Luton and City airports belong to the same market.’
Substitutability of Plymouth Airport

4.30 ASW provides flights to London Gatwick from Plymouth Airport via Newquay Airport. Passengers located closer to Plymouth Airport than Newquay Airport may therefore prefer to catch the service at Plymouth Airport. The fact that ASW has made a commercial decision to triangulate the service from Plymouth Airport in itself suggests that flights from the two airports are unlikely to be very close substitutes.

4.31 The OFT has considered the relative geographic location of the two airports. The airports are one hour and 10 minutes apart with no major centres of population in between, suggesting that there is likely to be a significant degree of geographic differentiation between them. Figures 4.1 and 4.2 show the overlap in one hour and two hour isochrones of airports in the south west of England. The one-hour isochrones of Plymouth Airport and Newquay Airport overlap only marginally, whereas the two-hour isochrones overlap significantly. The isochrone overlaps are not conclusive in showing that flights from the two airports do not compete, but do suggest that competition is likely to be limited.

4.32 While it does not conclude on this point, the OFT considers it unlikely that flights from Plymouth – London Gatwick are a significant competitive constraint such that they should be considered in the same market as flights from Newquay – London Gatwick. For the Plymouth – London City route, the degree of demand substitutability would be even less as passengers would have to be willing to substitute both their origin and their destination airport (Newquay for Plymouth and London City for London Gatwick). The OFT has therefore presented evidence concerning market shares on the conservative basis that flights from Plymouth Airport are not in the same market.

Product market definition

4.33 The relative travel times between air journeys and rail journeys are an indicator of the substitutability of rail travel. The flight time from Newquay – London Gatwick is one hour and five minutes. Further, Flybe estimates it will take passengers approximately 50

\[94 \text{ maps.google.co.uk/} \]

\[95 \text{ That is, passengers’ choice of airport is significantly determined by their point of origin} \]
minutes to check in and 30 minutes to travel from London Gatwick to Central London.\textsuperscript{96} In addition, it may take some time for passengers to transfer from the flight to the train and to collect checked-in baggage at London Gatwick. The OFT estimates that this will take approximately 30 minutes. The total journey time by air is therefore approximately two hours and 55 minutes. The rail journey from Newquay to London takes five hours and 10 minutes.\textsuperscript{97}

4.34 The OFT considers that this difference in journey time (two hours and 15 minutes) is likely to mean that rail travel is not an effective constraint. Further, for passengers catching connecting flights at London Gatwick, rail is very unlikely to be a viable substitute.

**Conclusion on market definition for Newquay – London Gatwick**

4.35 The OFT has left open the issue of whether Newquay – London Gatwick flights compete with flights from Newquay to other London airports such that they should be considered in the same market.

4.36 The OFT considers that for the purposes of this Decision it does not need to conclude on the exact market definition. That is because the OFT finds in its assessment of dominance below that Flybe is not dominant even on a narrow market definition where the Newquay – London Gatwick O&D pair constitutes a relevant market in its own right. Therefore, the OFT considers that it is clear that Flybe would not be dominant where the market definition was drawn more broadly to include any of London Stansted, London City, Plymouth Airport and/or rail travel.

**D The putatively dominated markets – Flybe’s routes from Exeter Airport**

4.37 The following paragraphs discuss market definition in respect of routes operated by Flybe from Exeter Airport. According to the OFT’s theory of harm, these are the

\textsuperscript{96} \url{www.gatwickairport.com/parking-transport/}

\textsuperscript{97} \url{www.nationalrail.co.uk/}
markets upon which Flybe may be dominant, and from which market power is allegedly being employed in the Newquay – London Gatwick market.

**Geographic market definition**

4.38 The geographic definition considers the degree to which flights from airports neighbouring Exeter Airport, such as Bristol Airport, Plymouth Airport or Newquay Airport, are substitutable to those from Exeter Airport to the same destination on the Focal routes.

**Drive-time isochrones**

4.39 The OFT notes its previous merger decision in the proposed Macquarie acquisition of Exeter Airport, which stated that third parties suggested that a drive-time of one to two hours typically represents an airport’s catchment areas, though how far consumers are prepared to travel can vary according to factors such as the type of flight, type of passenger and fare levels.

4.40 The maps below show the one hour and two hour drive-time isochrones for Newquay Airport, Plymouth Airport, Exeter Airport and Bristol Airport.

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99 Ibid, paragraph 22
Figure 4.1: One hour drive-time isochrone for south-west Airports

Source: MapInfo with Drivetime version 7.0

Figure 4.2: Two-hour drive-time isochrone for south-west Airports

Source: MapInfo with Drivetime version 7.0
4.41 The one-hour drive-time isochrones of Plymouth Airport and Bristol Airport overlap with that of Exeter Airport. As such, the OFT considers there to be potential for competition between airlines serving the same destinations from these airports and therefore has considered them in more detail in its assessment of demand substitution below.

4.42 When considering the two-hour drive-time isochrones, there is a further overlap between isochrones for Newquay Airport and Exeter Airport. However, the OFT considers that flights from Newquay Airport are unlikely to be a significant competitive constraint on flights from Exeter Airport. The two hour isochrones overlap only marginally and Newquay Airport itself lies outside Exeter Airport's two hour isochrone, whereas Bristol Airport and Plymouth Airport both lie inside it. A report prepared for Plymouth Airport by York Aviation considered the core catchments of Plymouth Airport, Exeter Airport and Newquay Airport to lie within a one hour drive-time isochrone of each respective airport.¹⁰⁰

4.43 Further, data from the CAA passenger survey at Exeter Airport suggest that on the Focal routes only seven per cent of the catchment at Exeter Airport comes from Cornwall, the county in which Newquay Airport is located.¹⁰¹ In addition, while third parties in the investigation of the Macquarie acquisition noted that passengers might be able to travel up to two hours to reach an airport, some also noted that Newquay Airport had inadequate transport links to be a viable competitor to Exeter Airport.¹⁰² Further, the OFT considers that Plymouth Airport's position, situated in between Newquay Airport and Exeter Airport, further reduces Newquay Airport's likelihood of being a viable substitute for passengers wishing to travel from Exeter Airport. As such, the OFT considers that flights from Newquay Airport are outside the geographic frame of reference.

¹⁰⁰ Plymouth City Airport Study, York Aviation, April 2006, paragraph 5.2 – see www.plymouth.gov.uk/kc20_plymouth_airport_final_report.doc.pdf

¹⁰¹ The CAA publishes reports based on its passenger surveys and can provide bespoke information on request. See www.caa.co.uk

Competitor overview

4.44 This subsection provides an overview of competitors at Exeter Airport, Bristol Airport and Plymouth Airport, identifying the airlines that operate at each airport on each of the Focal routes. The situation is slightly complicated, as several of the services provided on these routes are triangulated, that is they stop at an intermediate airport before reaching their final destination.

4.45 The following table summarises the services provided by competitors to Flybe at Exeter Airport, Bristol Airport and Plymouth Airport on each of the Focal routes.
### Table 4.1: Competitors at Exeter Airport, Bristol Airport and Plymouth Airport

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<th>Exeter Airport</th>
<th>Bristol Airport</th>
<th>Plymouth Airport</th>
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<tr>
<td>Dublin</td>
<td>Flybe direct service</td>
<td>Ryanair direct service</td>
<td>ASW service triangulated via Newquay Airport</td>
</tr>
<tr>
<td>Glasgow</td>
<td>Flybe direct service</td>
<td>EasyJet direct service ASW service originating at Plymouth Airport</td>
<td>ASW service triangulated via Bristol Airport</td>
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<td>Guernsey</td>
<td>Flybe direct service</td>
<td>Aurigny 103 direct service</td>
<td>ASW service triangulated via Jersey</td>
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<tr>
<td>Jersey</td>
<td>Flybe direct service</td>
<td>ASW service via Plymouth Airport</td>
<td>ASW service ending at Guernsey Airport</td>
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<tr>
<td>Leeds -Bradford</td>
<td>Flybe direct service</td>
<td>ASW service originating at Plymouth Airport</td>
<td>ASW service triangulated via Bristol Airport</td>
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<tr>
<td>Manchester</td>
<td>Flybe direct service</td>
<td>ASW service originating at Plymouth Airport</td>
<td>ASW service triangulated via Bristol Airport</td>
</tr>
<tr>
<td>Newcastle</td>
<td>Flybe direct service</td>
<td>EasyJet direct service ASW service originating at Plymouth Airport</td>
<td>ASW service triangulated via Bristol Airport</td>
</tr>
</tbody>
</table>

### Frequencies and passenger numbers

4.46 As an indication of the likely competitive constraint exerted by flights from Bristol Airport and Plymouth Airport on flights from Exeter Airport, the OFT has analysed the frequencies and shares of passenger volumes offered for the Flybe Focal routes that overlap with routes operated by competitors at Bristol Airport and the ASW Focal Routes. The OFT has not considered capacity shares (of seats) as many of the services, in particular ASW’s services, are triangulated through more than one airport. On triangulated routes, it is not possible to calculate the capacity attributable to each

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103 Aurigny is a small airline based in the Channel Islands, owned and subsidised by the states of Guernsey – see [www.aurigny.com](http://www.aurigny.com). The states of Guernsey have recently put Aurigny up for sale and propose to sell the airline to Blue Islands see [www.bbc.co.uk/news/world-europe-guernsey-10636450](http://www.bbc.co.uk/news/world-europe-guernsey-10636450). Flybe has expressed its displeasure at the proposed deal – see [www.flybe.com/news/1007/14.htm](http://www.flybe.com/news/1007/14.htm)
particular airport as the airline is able to flexibly reallocate capacity to each airport in response to passenger demand.

4.47 In the OFT's view, relative shares of passenger volumes and flight frequencies are a good indicator of the relative competitive strength of each airline's offering. The OFT considers that if an airline at Bristol Airport is operating a greater frequency service than an airline at Exeter Airport, then all other matters being equal it may exert a stronger competitive constraint. This is because passengers will have greater flexibility in choosing their time of travel from Bristol Airport. Further, if there is a large difference in the respective shares of passenger volumes, the OFT considers that the ability of the smaller airline to respond competitively to changes made by the larger airline (for example an increase in price) is limited, as flight capacities are fixed in the short term. Consequently, in the OFT's view, if passenger volumes from Bristol Airport are large in comparison to those from Exeter Airport, the airline at Bristol Airport is likely to exert more of a competitive constraint.

4.48 While the OFT recognises that it is slightly unusual to consider volume shares before defining a relevant market, it considers that the relative volumes of passengers are key evidence in assessing whether or not Flybe is constrained at Exeter Airport by flights from Bristol Airport and Plymouth Airport such that they should be defined in the same antitrust market, for the reasons expressed above.

4.49 The following table shows the flight frequencies for each destination, leaving from Exeter Airport, Bristol Airport and Plymouth Airport.
### Table 4.2: Flight frequencies (weekly flights)

<table>
<thead>
<tr>
<th>Route</th>
<th>Exeter Airport</th>
<th>Plymouth Airport</th>
<th>Bristol Airport</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dublin</td>
<td>6 flights per week (daily except Wednesday) Flybe</td>
<td>6 flights per week (daily except Saturday) ASW</td>
<td>21 flights per week (three times daily) Ryanair</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Dublin</td>
<td>6 flights per week (daily except Saturday) ASW</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Plymouth</td>
<td>6 flights per week (daily except Saturday) ASW</td>
</tr>
<tr>
<td>Glasgow</td>
<td>7 flights per week (daily) Flybe</td>
<td>7 flights per week (daily) ASW</td>
<td>16 flights per week (three times Monday – Thursday, twice daily Friday, twice Sundays) EasyJet</td>
</tr>
<tr>
<td>Guernsey</td>
<td>12 flights per week (twice daily weekdays; daily weekends) Flybe</td>
<td>6 flights per week (daily except Saturdays) ASW</td>
<td>7 flights a week (daily) Aurigny</td>
</tr>
<tr>
<td>Jersey</td>
<td>12 flights per week (twice daily weekdays; daily weekends) Flybe</td>
<td>7 flights per week (daily) ASW</td>
<td>6 flights per week (daily except Sunday) ASW</td>
</tr>
<tr>
<td>Leeds-Bradford</td>
<td>7 flights per week (daily) Flybe</td>
<td>12 flights per week (twice daily weekdays; daily weekends) ASW</td>
<td>12 flights per week (twice daily weekdays; daily weekends) Flybe</td>
</tr>
<tr>
<td>Manchester</td>
<td>10 flights per week (twice daily Tuesday - Friday, daily Monday and Sunday) Flybe</td>
<td>12 flights per week (twice daily weekdays; daily weekends) ASW</td>
<td>12 flights per week (twice daily weekdays; daily weekends) ASW</td>
</tr>
<tr>
<td>Newcastle</td>
<td>7 flights per week (daily) Flybe</td>
<td>7 flights per week (daily) ASW</td>
<td>17 flights per week (three times daily Monday, Wednesday, Thursday, Friday, twice daily Tuesday and Sunday), daily Saturday EasyJet</td>
</tr>
</tbody>
</table>

Source: Exeter Airport Winter 2009/10 flight schedule, ASW website, Bristol Airport website

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104 [www.exeter-airport.co.uk/scheduled-flights](http://www.exeter-airport.co.uk/scheduled-flights)

105 [www.airsouthwest.com/](http://www.airsouthwest.com/)

Office of Fair Trading
4.50 The OFT notes that there is considerable variation in the relative frequencies offered by competitors at each airport across the Focal routes. On the routes to Dublin, Glasgow and Newcastle, while Flybe only operates a no more than once a day service, flights from Bristol Airport are operated at a higher frequency (two to three times daily) by the large 'low-frills' carriers Ryanair and EasyJet. Flights from Plymouth Airport are offered at a similar frequency to those at Exeter Airport. On the Jersey route, Flybe operates about twice as many flights from Exeter Airport than ASW does from Plymouth Airport. Similarly on the Guernsey route, Flybe operates twice as many flights than ASW at Plymouth Airport and nearly twice as many as Aurigny at Bristol Airport. On the Leeds Bradford route, ASW operates nearly twice the frequency from Plymouth Airport compared with Flybe at Exeter Airport. On the Manchester route, the OFT observes that ASW is operating a similar frequency of flights from Plymouth Airport to Flybe at Exeter Airport.

4.51 The following table shows the passenger shares for airlines at Bristol Airport, Exeter Airport and Plymouth Airport on the Focal routes.

106 [www.bristolairport.co.uk/flight-information/destinations.aspx](http://www.bristolairport.co.uk/flight-information/destinations.aspx)
Table 4.3: Passenger volumes (financial year 2008/09)

<table>
<thead>
<tr>
<th>Route</th>
<th>Exeter Airport</th>
<th>Plymouth Airport</th>
<th>Bristol Airport</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pax**</td>
<td>Share of Pax</td>
<td>Pax</td>
</tr>
<tr>
<td>Dublin</td>
<td>27,370</td>
<td>8%</td>
<td>4,864</td>
</tr>
<tr>
<td></td>
<td>317,672</td>
<td>91%</td>
<td></td>
</tr>
<tr>
<td>Glasgow</td>
<td>39,418</td>
<td>15%</td>
<td>14,685</td>
</tr>
<tr>
<td></td>
<td>213,167</td>
<td>80%</td>
<td></td>
</tr>
<tr>
<td>Guernsey</td>
<td>31,648</td>
<td>51%</td>
<td>3,118*</td>
</tr>
<tr>
<td></td>
<td>26,833</td>
<td>44%</td>
<td></td>
</tr>
<tr>
<td>Jersey</td>
<td>27,039</td>
<td>37%</td>
<td>12,131</td>
</tr>
<tr>
<td></td>
<td>6,573 (ASW)</td>
<td>9%</td>
<td>27,521 (Flybe)</td>
</tr>
<tr>
<td>Leeds-Bradford</td>
<td>26,818</td>
<td>36%</td>
<td>7,306</td>
</tr>
<tr>
<td></td>
<td>41,232</td>
<td>55%</td>
<td></td>
</tr>
<tr>
<td>Manchester</td>
<td>51,345</td>
<td>48%</td>
<td>13,732</td>
</tr>
<tr>
<td></td>
<td>42,203</td>
<td>39%</td>
<td></td>
</tr>
<tr>
<td>Newcastle</td>
<td>43,726</td>
<td>18%</td>
<td>7,306</td>
</tr>
<tr>
<td></td>
<td>194,900</td>
<td>79%</td>
<td></td>
</tr>
</tbody>
</table>

Source: CAA traffic data, Flybe data, ASW data

*This figure is an estimate. ASW has only operated flights to Guernsey since April 2009 and the OFT only has in its possession data for passenger volumes on this route from April 2009 to August 2009. To estimate the figure in the table above the OFT has taken the ratio of the number of passengers on the Guernsey route to those on the Jersey route during the period May to August 2009, and multiplied it by the number of passengers travelling on the Jersey route in 2008/09.

** Pax equals total number of passengers

4.52 In interpreting the passenger volumes in Table 4.3, the OFT notes that these are not shares in a properly defined market. Further, flights from the different airports are likely to be significantly geographically differentiated, that is passenger preferences for each airport will vary depending on their point of origin. Therefore, the shares reported are likely to overstate the competitive constraint imposed on Flybe at Exeter Airport by flights from Bristol Airport and Plymouth Airport.

4.53 That said there is a marked variation across the routes. For Glasgow, Dublin and Newcastle, five to 10 times as many passengers take flights from Bristol Airport than from Exeter Airport. For the other flights, the respective passenger shares at Exeter Airport and Bristol Airport are closer, and Plymouth Airport has a more significant share.
In addition to analysing passenger volumes and flight frequencies, the OFT has considered the competitive constraint imposed by competitors at Bristol Airport in further detail. The OFT has done this by undertaking:

- a detailed analysis of the catchment profiles of passengers travelling on the Focal routes from Exeter Airport and Bristol Airport
- an 'event study' which looks for high level evidence of competitive interaction on the Focal routes by testing the hypothesis that increases in capacity at Bristol Airport will have an effect on competitive parameters, such as passenger numbers and revenue per flight, at Exeter Airport, if the airlines at the two airports are competing.

The methodology and results for the catchment profile analysis and event study are set out in detail in Annexe A. A summary of the main findings is provided below.

### Catchment profiles

The OFT has analysed the overlap in the catchment areas of Bristol Airport and Exeter Airport on the Focal routes following a similar approach to that used by the Competition Commission in the BAA Airports market investigation. In its analysis, the Competition Commission identified the proportion of passengers of a certain airport that were 'exposed' to competition from another airport, as those that came from districts where the other airport had an overall share of passengers above a certain threshold ('the district share threshold'). This proportion gives a measure of the degree of catchment area overlap (termed 'inter-airport exposure' in the Competition Commission BAA Airports market investigation).

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108 Ibid, paragraph 3.43
4.57 The OFT has used the Competition Commission ‘exposure’ methodology with a district share threshold of 20 per cent. The reported ‘catchment exposure’ is therefore the proportion of all passengers travelling from Exeter Airport (on the route in question) who come from districts where the airline at Bristol Airport has a greater than 20 per cent share.

4.58 For major airports, the CAA collects survey data from passengers. The OFT has used some of this data to carry out its subsequent analysis. For the Dublin route, the catchment area exposure is very high (93 per cent) with large numbers of Bristol Airport passengers travelling from Devon. The OFT considers that this suggests that a large proportion of the passengers are likely to be responsive to relative price changes at the two airports. Therefore, the OFT considers that flights from Bristol Airport are extremely likely to constrain flights from Exeter Airport on this route.

4.59 For the Guernsey route, the catchment area exposure is 15 per cent. The OFT considers that, from this figure alone, it would be difficult to infer that flights from Bristol Airport are not a constraint. However, the OFT notes that the vast majority of this exposure arises from a sizeable proportion (10 per cent) of Exeter Airport passengers originating in Avon and Somerset. On the other routes the OFT observes that the proportion of Exeter Airport passengers coming from these counties is negligible. Further, the OFT notes that Bristol Airport has a negligible share of Devon passengers (four per cent). The OFT considers the fact that, on this route, Exeter Airport’s catchment area is larger and encroaches into Avon suggests that flights from Bristol Airport are likely to be a weak constraint.

4.60 For the Glasgow route, the catchment area exposure is 26 per cent, which is higher than for Guernsey. However, apropos the Glasgow route, the OFT notes this is largely because of significant numbers of Bristol Airport passengers originating in Devon. The OFT considers that this evidence suggests that flights from Bristol Airport are likely to be a constraint. However, in the OFT’s view, this evidence, considered alone, is not strong enough to draw a clear-cut conclusion.

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109 The CAA publishes reports based on its passenger surveys and can provide bespoke information on request. See www.caa.co.uk
4.61 In the OFT’s view, the catchment analysis for the Jersey route should be treated with some caution, as both Flybe and ASW operate at Bristol Airport. However, the OFT considers that such analysis still serves to show the level of competition between airlines at the two airports. The catchment area exposure is 13 per cent. As for Guernsey the exposure has arisen from a sizeable proportion of Exeter Airport passengers originating in Avon (eight per cent), although Bristol Airport has a very small share of Somerset passengers travelling to Jersey. In the OFT’s view, Exeter Airport’s larger catchment size suggests, as it did for flights to Guernsey, that flights to Jersey from Bristol Airport are likely to be a weak constraint.

4.62 For the Leeds Bradford route the sample size of the CAA passenger survey is small (only 31 passengers travelling from Bristol Airport and 91 from Exeter Airport). However, the OFT considers that the lack of overlap between the catchment areas of the two airports is striking – the catchment areas only overlap very marginally in Taunton Deane in Somerset. Elsewhere, Bristol Airport serves Avon and Exeter Airport serves Devon and Cornwall. In the OFT’s view, this quite strongly suggests that there is no constraint from flights at Bristol Airport on this route.

4.63 For the Manchester route, the sample size of the CAA passenger survey is similarly small (only 40 passengers travelling from Bristol Airport and 299 from Exeter Airport). As with the Leeds Bradford route, however, the OFT notes there is no overlap between the catchment areas of the two airports. In the OFT’s view, this suggests that flights from Bristol Airport are unlikely to be a competitive constraint.

4.64 For the Newcastle route, the OFT considers that the 26 per cent exposure is fairly significant. It arises from significant numbers of passengers travelling from Bristol Airport originating in Devon. As with the Glasgow route, the OFT interprets this as suggesting that flights from Bristol Airport are likely to be a constraint.

Event study

4.65 The event study\textsuperscript{110} looks for evidence of competitive interaction between the airlines on the routes in question, by looking at the impact of changes in capacity at Bristol Airport.

\textsuperscript{110} Similar types of studies have been used in the context of airline competition investigations:
on competitive parameters such as passenger numbers, yields and revenue per flight at Exeter Airport. An increase in capacity on a route at Bristol Airport leading to lower passenger numbers, yields or revenue per flight at Exeter Airport is an indicator of competitive interaction between the airlines at either airport.\footnote{Updated working paper on analysis of airline yield data (March 2009), paragraph 1.1}

4.66 For the Dublin and Glasgow routes the results are mixed depending on the dependent variable used.\footnote{For the Dublin and Glasgow routes, the results show a significant impact of changes in capacity at Bristol on passenger numbers at Exeter. For the Glasgow route, the results also show a significant impact of changes in capacity at Bristol on revenue per flight at Exeter} In particular, while the regressions show significant effects of capacity changes at Bristol Airport on passenger numbers at Exeter Airport on these routes, there is no significant effect of capacity changes on yield. The OFT is unable to rule out the fact that the lack of effect on yield is not due to the particular nature of the revenue management systems employed by the airlines rather than providing evidence of a lack of competitive interaction, as noted in Annexe A paragraph A.23.

4.67 The OFT considers that these results provide some evidence of competition between Flybe at Exeter Airport and its competitor at Bristol Airport on the Dublin and Glasgow routes. The results show no evidence of competition on the Guernsey, Leeds-Bradford, Manchester and Newcastle routes.

4.68 With the exception of the Newcastle route, these results are consistent with both the relative flight frequencies and passenger volumes at Bristol Airport and Exeter Airport and with the catchment area profile analysis.

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\footnote{Updated working paper on analysis of airline yield data (March 2009), paragraph 1.1}
Conclusion on competition with Bristol Airport

4.69 For the Dublin route, Ryanair’s service from Bristol Airport should be considered in the same geographic market as Flybe at Exeter Airport. In coming to this conclusion, the OFT notes that Ryanair flies more than 10 times as many passengers as Flybe on this route with four times the frequency of flights,\footnote{See Tables 4.2 and 4.3} that the catchment area of the two airlines overlap to a very large extent and that increases in capacity by Ryanair at Bristol Airport have lead to statistically significant reductions in passenger numbers for Flybe travelling from Exeter Airport.

4.70 On the Glasgow and Newcastle routes, the OFT observes that EasyJet carries approximately four times as many passengers and has flights with three times the frequency.\footnote{Ibid} The OFT notes that, on both routes there is a significant degree of overlap in catchment areas. On the Glasgow route there is evidence that increases in capacity by EasyJet have led to reductions in Flybe passenger numbers and in revenue per flight, while on the Newcastle route there is not evidence of a statistically significant effect. On the basis of the evidence overall on both the Newcastle and Glasgow routes, the OFT considers that EasyJet’s services from Bristol Airport should be considered in the same geographic market as Flybe flights to the same destinations at Exeter Airport.

4.71 On the other four Focal Routes, Guernsey, Jersey, Leeds Bradford and Manchester, the OFT considers that the service from Bristol Airport lies outside the geographic market. On all these routes there is a smaller competitor at Bristol Airport offering fewer or a similar number of flights to Flybe’s flights from Exeter Airport, a very limited overlap in catchment areas and no evidence of competition from the event study.

Competition from flights at Plymouth Airport

4.72 The OFT acknowledges that analysis of the degree of competitive constraint imposed by flights from Plymouth Airport is more difficult as there is a lack of available data with which to perform the same tests which the OFT undertook for flights from Bristol Airport. The OFT’s conclusions on whether flights from Plymouth Airport should be
considered inside the geographic market definition as set out below are more tentative, due to the lack of available evidence.

4.73 Plymouth Airport is slightly closer to Exeter Airport than Bristol Airport (one hour drive-time to Plymouth and one hour and fifteen minutes to Bristol). The OFT observes that there is a significant degree of overlap between the one hour drive time isochrone for Plymouth Airport and Exeter Airport, although, Torbay excepted, the overlap does not include major areas of population.

4.74 The CAA does not collect passenger survey data for passengers originating at Plymouth Airport. However, the OFT undertook an analysis of the postcodes of anonymised ASW passengers, obtained from their billing address provided when paying for tickets by credit card. In the OFT’s view, this evidence suggests that passengers are heavily concentrated in the City of Plymouth and the surrounding area. The OFT considers that the small geographic extent of Plymouth Airport’s catchment area suggests that the ASW Focal routes are likely to impose a weak competitive constraint on the Flybe Focal routes.

4.75 For the Dublin, Glasgow and Newcastle routes, the numbers of passengers carried by ASW at Plymouth Airport is three to eight times less than carried by Flybe at Exeter Airport (which are, in turn, five to 10 times smaller than the number carried by Ryanair and EasyJet at Bristol Airport). Therefore, in the OFT’s view, ASW is unlikely to offer a significant competitive constraint on these routes, and so it is unlikely that its Plymouth Airport operations should be considered in the same market as flights from Bristol Airport and Exeter Airport.

4.76 On the other Focal routes, the OFT observes that ASW has also carried significantly fewer passengers than Flybe, suggesting the degree of constraint it imposes is likely to be weak. As such, in the OFT’s view, these routes from Plymouth Airport are likely to lie outside the geographic market.

115 maps.google.co.uk/

116 Tables 4.2 and 4.3

117 A finding that these routes fall outside the geographic market does not conflict with the finding set out at paragraph 6.66 that were Plymouth Airport to close passengers would divert to Flybe’s routes out of Exeter
4.77 Further, the OFT notes internal emails that suggest there is a very limited extent of
competition between ASW at Plymouth Airport and Flybe at Exeter Airport. In an email
exchange about ASW’s entry on to a route to a destination from Plymouth Airport that
Flybe flew to from Exeter Airport, an ex-employee of Flybe wrote:

‘The loads haven’t been particularly good on [...] recently thanks to ours friends
down the road in Plymouth, so hopefully the A class promo will give the pax
numbers a good boost!’

‘Last May when ASW started I was quite aggressive and was significantly cheaper
than them, although this didn’t seem to have any meaningful impact as their
passenger numbers continued to grow and have now become quite consistent.’

4.78 The OFT considers that this evidence is barely sufficient to conclude whether Plymouth
Airport is in the same market as Exeter Airport. However, it notes that whether or not
Plymouth Airport is within the relevant market is not material to any findings on
dominance because of the small passenger volumes carried on the ASW Focal routes
out of Plymouth Airport relative to the volumes carried on Flybe Focal routes out of
Exeter Airport. The volumes carried out of Plymouth Airport are just not sufficient to
impact on the question as to whether Flybe enjoys a dominant position in a market
which includes only flights from Exeter Airport or flights from both Exeter Airport and
Plymouth Airport. To this end, the OFT notes that market definition is no more than a
tool for assessing dominance, and if the inclusion or otherwise of Plymouth Airport does
not impact upon the dominance analysis then the OFT considers that it is not necessary
to reach a firm view on whether or not it is inside the relevant market. However, as a
safeguard, the assessment of dominance in Section 5 is conducted with regard to both
possibilities.

In determining whether the routes from Plymouth Airport are in the same market the OFT is considering
the application of the SSNIP test (that is to say whether passengers would switch from routes flown out of
Plymouth Airport to routes flown out of Exeter Airport in the event of a five to 10 per cent rise in prices). Clearly,
application of the SSNIP test in this way is quite different to a consideration of what passengers would do in the
event of the total closure of Plymouth Airport

118 Emails from an ex-Flybe employee to another Flybe employee dated 30 January 2009

119 See Section 5
Product market definition

4.79 The product market definition assesses whether other modes of transport (such as rail and road travel) represent a sufficient competitive constraint to be included in the market definition on each of the Focal routes. In its assessment of product market definition, the OFT has considered evidence of journey times, frequencies and the purpose of travel for the passengers taking flights from Exeter Airport.

4.80 For Dublin, Jersey and Guernsey the closest substitute mode of transport would involve a sea crossing and as such would involve a considerably longer journey time and the need to use two modes of transport to complete the journey. On the Glasgow and Newcastle routes, road or rail travel is similarly unlikely to be a close substitute for the vast majority of passengers taking flights from Exeter Airport due to the significant difference in journey time. In addition, to travel to Glasgow a passenger would have to change trains. As such, the OFT considers that other modes of transport are likely to lie outside of the relevant market on these routes. Therefore, product market definition is only considered in more detail for the Leeds Bradford and Manchester routes below.

Journey times and frequencies

4.81 The journey time and frequency of service are likely to be significant drivers of passenger preferences in their choice between alternative modes of transport (in addition to price and quality of service). The OFT has therefore considered a direct

120 The rail and ferry journey time from Exeter to Dublin Connolly is 10 hours and 30 minutes to 17 hours depending on time of travel. See www.nationalrail.co.uk

The shortest rail and ferry journey time from Exeter to Jersey (via Weymouth) is approximately six hours and 40 minutes (though the ferry service is dependent on month of departure). See www.condorferries.co.uk and www.nationalrail.co.uk

The shortest rail and ferry journey time from Exeter to Guernsey (via Weymouth) is approximately five hours and 30 minutes (though the ferry service is dependent on month of departure). See www.condorferries.co.uk and www.nationalrail.co.uk

121 The rail journey from Exeter to Glasgow is approximately 7 hours. The rail journey from Exeter to Newcastle is approximately six hours and 10 minutes. See www.nationalrail.co.uk

comparison between the journey times and frequencies for rail and air services to Leeds Bradford and Manchester.

4.82 For Leeds Bradford:

- A rail journey from Exeter St Davids railway station to Leeds railway station takes four hours and 39 minutes.\(^{123}\) There is one direct service per hour.

- A flight from Exeter Airport takes 65 minutes,\(^{124}\) it is 41 minutes to Leeds City Centre from Leeds Bradford Airport by train,\(^{125}\) and Flybe estimates it will take passengers roughly 50 minutes to check-in.\(^{126}\) The total journey time is therefore approximately two hours and 36 minutes. There is one flight per day either at 06:50 (Saturdays) or at 14:50 (Sunday – Friday).\(^{127}\)

- On the above assumptions, the overall difference in journey time between air and rail is two hours and three minutes (the rail journey is 80 per cent longer).

4.83 For Manchester:

- A rail journey takes four hours 15 minutes. There are five direct services per day. There are also more frequent indirect services that take just under five hours. The first train arrives in Manchester at 11:00.\(^{128}\)

- A flight from Exeter Airport takes 65 minutes, it is 20 minutes to Manchester City Centre from Manchester Airport, and Flybe estimates it will take passengers roughly

\(^{123}\) See [www.nationalrail.co.uk](http://www.nationalrail.co.uk)

\(^{124}\) See [www.flybe.com](http://www.flybe.com)

\(^{125}\) See [www.nationalrail.co.uk](http://www.nationalrail.co.uk)

\(^{126}\) ‘Travel time for various modes of transport’ note prepared for Flybe by its economic advisers, 11 November 2009, paragraph 1

\(^{127}\) See [www.flybe.com/timetable/](http://www.flybe.com/timetable/)

\(^{128}\) Ibid
50 minutes to check-in.\textsuperscript{129} The total journey time is therefore approximately two hours and 15 minutes. The first flight arrives at Manchester before 9:00. There are currently two flights a day Tuesday – Friday and one a day on Monday and Sunday.\textsuperscript{130}

- On these assumptions the overall difference in journey time between air and rail is two hours (the rail journey time is 90 per cent longer).

4.84 The journey times by rail from Exeter to Manchester or to Leeds are considerably longer than those by air. For passengers that are sensitive to the journey time, this is likely to mean that rail travel is not a close substitute. However, the difference in journey time alone may not be significant enough to rule out that rail is an effective substitute for some non-time sensitive passengers.

4.85 In this regard, the OFT notes the European Commission’s finding in Air France/KLM\textsuperscript{131} that a high speed rail link between Amsterdam and Paris, operated by Thalys, was a competitive constraint for passengers travelling with restricted tickets\textsuperscript{132} to air services provided by the parties on the same route.\textsuperscript{133} In that case the journey time for an air journey was three hours compared to the time of a rail journey of four hours and nine minutes. In Lufthansa/Swissair,\textsuperscript{134} the European Commission found that Deutsche Bahn’s train service between Zurich and Frankfurt was a competitive constraint for passengers travelling with restricted tickets to the air services by the parties.\textsuperscript{135} In that

\textsuperscript{129} ’Travel time for various modes of transport’ note prepared for Flybe by its economic advisers, 11 November 2009, paragraph 1

\textsuperscript{130} See www.flybe.com/timetable/


\textsuperscript{132} Restricted tickets are tickets offered for a particular flight, as opposed to an 'unrestricted' ticket, which offers the customer flexibility to choose a flight after purchasing the ticket. Flybe only offers restricted tickets

\textsuperscript{133} Commission Decision of 11 February 2004, Air France /KLM, OJ [2004] C 60/06, paragraph 71


\textsuperscript{135} Ibid, paragraph 56
case the journey time for an air journey was two hours and 45 minutes compared to a train journey of two hours and 55 minutes.

4.86 The difference in journey times between air and rail in this case is significantly greater than in either of these cases previously investigated by the European Commission, suggesting it may be a lesser competitive constraint. However, the OFT cannot rule out that on this evidence alone that it may be a constraint on the Leeds Bradford and Manchester routes such that it should be considered in the same market.

4.87 To assess the likely sensitivity of passengers to journey time, the OFT has also considered the flight purpose of passengers travelling from Exeter Airport. The constraint from rail or road travel on air travel is likely to be strongly dependent on passenger time sensitivity as air travel is considerably faster than other modes of transport, particularly over larger distances. Time sensitivity may relate to both the overall journey time and to the frequency of the service (as some passengers may have to arrive at a specific time).\(^{136}\) Whether the purpose of travel is business or leisure is likely to give a good indication of passengers’ likely time sensitivity. The CAA survey data has information on the flight purposes of passengers travelling from Exeter Airport to Leeds Bradford and Manchester.

**Table 4.4: Flight purpose**

<table>
<thead>
<tr>
<th></th>
<th>LBA</th>
<th></th>
<th>MAN</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business</strong></td>
<td>5950</td>
<td>31%</td>
<td>30137</td>
<td>57%</td>
</tr>
<tr>
<td><strong>Leisure</strong></td>
<td>13512</td>
<td>69%</td>
<td>22289</td>
<td>43%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>19462</td>
<td>100%</td>
<td>52426</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: CAA passenger survey 2008

4.88 On services to both destinations there are a large proportion of leisure passengers. Although, approximately one third of Leeds Bradford passengers and one half of Manchester passengers are business passengers.

4.89 The OFT has also considered the proportions of passengers travelling to Leeds Bradford and Manchester for connecting flights. For these passengers, the OFT considers that alternative modes of transport are unlikely to be a constraint both because of the

\(^{136}\) Ibid, paragraph 58
convenience of travelling on only one mode of transport that uses the same connecting hub and because air travel tickets on an indirect flight are likely to be sold in a bundle including both journey legs. From the CAA passenger survey, almost no passengers travel to Leeds Bradford for a connecting flight and only 10 per cent of passengers travel to Manchester for a connecting flight.

Arrival times

4.90 Arrival times may be important for passengers that have to arrive at a particular time of day, such as passengers that have to attend business meetings. For non-time sensitive passengers they are likely to be less important. For Leeds Bradford, business passengers wishing to travel on the same day to a meeting are unlikely to be able to travel by air unless they arrange the meeting in the late afternoon. For Manchester, the air service is more suited for business passengers as the first service arrives at 9:00 am, and passengers will be able to catch a flight back the same evening. This difference is reflected in the relative proportions of business and leisure passengers detailed in Table 4.4 above.

Conclusion on product market definition

4.91 For the routes from Exeter Airport to Dublin, Glasgow, Guernsey, Jersey and Newcastle, the OFT considers that alternative modes of transport are not close enough substitutes to be considered in the same product market.

4.92 For Leeds Bradford and Manchester rail journeys take approximately two hours longer than air journeys. The OFT considers that for time-sensitive passengers this difference in journey time is likely to mean that rail travel is not a constraint. However, for non-time sensitive passengers, the difference in journey time alone is not significant enough to confidently rule out that rail is an effective substitute. The OFT has not analysed

137 The OFT is also mindful of a report entitled ‘Air and Rail Competition and Complementarity’ prepared for the European Commission (DG TREN) in 2006 by Steer Davies Gleave – see ec.europa.eu/transport/rail/studies/doc/2006_08_study_air_rail_competition_en.pdf. The report looked at a selection of European routes to examine the relationship between rail and air journey times and rail and air market shares. It found at paragraph 2.5 that rail passenger shares ranged from 18 per cent to 40 per cent for a three hour difference in journey time and from 44 per cent to over 85 per cent for a one and a half hour difference in journey time.
the relevant rail use figures which may have shed further light in this regard. As a result, the OFT has not concluded on this aspect of the product market definition on these routes but has considered the potential constraint offered by alternative modes of transport directly in its assessment of dominance.

E Conclusion on the relevant markets

4.93 In defining the relevant markets, the OFT has considered both Flybe's services on the Newquay – London Gatwick route and on a number of routes from Exeter Airport as focal products.

4.94 With respect to the Newquay – London Gatwick route, the OFT has not concluded on whether flights from Plymouth Airport or from other London airports are in the same geographic market. It has assessed market shares in the section on actual competition below on the conservative basis that they are not in the same market, although, it notes that there is evidence which suggests there is some degree of demand substitutability between London airports. However, the OFT considers that nothing turns on whether it concludes that flights from Plymouth Airport and other London airports are in the same geographic market. In this regard, the OFT notes that Flybe does not have a presence at any of Plymouth Airport, London Heathrow, London City or London Stansted. Therefore, as the OFT concludes below, if Flybe is not dominant on the narrowly drawn Newquay – London Gatwick market, it follows that it also will not be dominant on a broader market including any of Plymouth Airport and the other London airports.

4.95 The OFT has also considered demand substitutability on the routes that Flybe operates out of Exeter Airport to the same destination as flights ASW operates from Plymouth Airport. As noted in paragraph 4.78, the OFT has not concluded on whether ASW's flights from Plymouth Airport to the same destinations are part of the same market, but has assessed Flybe's putative dominance with regards to both possibilities. Similarly, the OFT has not formally reached a conclusion on whether rail journeys from Exeter to Leeds and Exeter to Manchester should be considered as part of the relevant market and has consequently considered the constraint imposed by rail travel directly in its assessment of dominance.

4.96 For the reasons set out in this section, the OFT therefore concludes the relevant markets on which to consider Flybe's dominance are:
• The series of flights operated by Flybe and ASW from Newquay to London Gatwick and potentially the series of flights operated by ASW from Newquay to London City.

• The series of flights operated by Flybe from Exeter Airport to Dublin, the series of flights operated by Ryanair from Bristol Airport to Dublin and potentially the series of flights operated by ASW from Plymouth Airport to Dublin.

• The series of flights operated by Flybe from Exeter Airport to Glasgow, the series of flights operated by EasyJet from Bristol Airport to Glasgow and potentially the series of flights operated by ASW from Plymouth Airport to Glasgow.

• The series of flights operated by Flybe from Exeter Airport to Guernsey and potentially the series of flights operated by ASW from Plymouth Airport to Guernsey.

• The series of flights operated by Flybe from Exeter Airport to Jersey and potentially the series of flights operated by ASW from Plymouth Airport to Jersey.

• The series of flights operated by Flybe from Exeter Airport to Leeds Bradford, potentially the series of flights operated by ASW from Plymouth Airport to Leeds Bradford and potentially rail journeys from Exeter to Leeds.

• The series of flights operated by Flybe from Exeter Airport to Manchester, potentially the series of flights operated by ASW from Plymouth Airport to Manchester and potentially rail journeys from Exeter to Manchester.
5 DOMINANCE

A Introduction

5.1 As explained in Section 4, in assessing whether an undertaking has substantial market power, it is helpful to consider market shares and the extent to which the undertaking faces competitive constraints. The most important constraints are actual competition and potential competition. Other factors such as strong buyer power from the undertaking’s customers can also be relevant. Available evidence from all indicators will be considered in the round before coming to an assessment of market power.

B Assessment of market power

5.2 The Court of Justice has defined a dominant market position as:

‘...a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers’.  

5.3 The Court of Justice has also held that:

‘...such a position does not preclude some competition...but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which competition will develop, and in any case to act largely in disregard of it so long as such conduct does not act to its detriment’.  

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140 Case 85/76 Hoffmann-La Roche v Commission [1979] ECR 461, paragraph 39
5.4 The OFT considers that an undertaking will not be dominant unless it has substantial market power.\(^{141}\) Market power is not an absolute term but a matter of degree, and the degree of market power that an undertaking possesses will depend on the circumstances of each case.\(^{142}\) It can be described as the ability profitably to sustain prices above competitive levels or to restrict output, innovation, or quality below competitive levels.\(^{143}\) The assessment of whether an undertaking is dominant is an assessment of market power so, while there are no bright lines in assessing dominance and while the OFT is obliged to answer the question of whether or not an undertaking is dominant, it may also be thought of as a matter of degree.

5.5 It is not necessary for a finding of dominance that an undertaking has eliminated all opportunity for competition in the market.\(^{144}\) For the Chapter II prohibition to apply therefore it is not a condition that competition has been eliminated.

5.6 While an undertaking's market share is an important factor in assessing whether it has market power it does not, in itself, determine whether an undertaking holds a dominant position. In this case, where the services are significantly differentiated and market definition has not been conclusive, sales or revenue volumes are not equivalent to market shares but are a good indicator of the competitive constraint imposed by the airlines on one another. This point is discussed in more detail below.

5.7 The existence of a dominant position may derive from several factors which, taken separately, are not necessarily determinative. In assessing whether an undertaking has substantial market power, the OFT considers whether and to what extent an


\(^{143}\) Ibid, paragraph 1.4

undertaking will face constraints on its ability to behave independently in the relevant market.\footnote{Assessment of Market Power (OFT415), paragraph 2.10 – see www.of.t.gov.uk/shared_of/ business_leaflets/ca98_guidelines/oft415.pdf} These constraints might be:

- **actual competitors** – according to their strength in the market. This may be indicated by market shares, amongst other factors

- **potential competitors** – this may be shown by a lack of significant entry barriers and the existence of other undertakings which might easily enter the market

- **other constraints** – such as significant countervailing buyer power exercised by the undertaking's customers and regulatory constraints.

5.8 The OFT deals first with these 'other constraints' (buyer power and regulatory constraints) below, before focusing in the rest of this section on the assessment of actual competition, on the basis of the market definition and framework for analysis described above. The OFT assesses potential competition in the latter part of this section below.

C **Assessment of other constraints**

5.9 In this case, the buyer power of individual passengers will be limited. Flybe offers corporate discounts to a few clients on some of the Focal Routes but these discounts make a very small proportion of the total revenues (less than one per cent) for each of the Focal routes.\footnote{Letter from Flybe's legal advisers to the OFT dated 11 January 2010} The OFT therefore considers that buyer power will be limited in this case.

5.10 With regard to regulatory constraints, there appears to be little in the way of regulatory barriers that would prevent entry at Newquay Airport, Exeter Airport, Plymouth Airport or Bristol Airport as concerns the possibility of launching/providing competing scheduled flights to the O&D pairs/UK domestic destinations outlined above in the defined frame of reference.
5.11 The evidence indicates that buyer power and regulatory constraints are unlikely to be strong in this case. The assessment of other constraints is therefore not considered any further.

D The Newquay – London Gatwick route

5.12 The OFT has first considered the question of whether Flybe is dominant on the Newquay – London Gatwick route.

Market shares

5.13 As noted in paragraphs 4.35 and 4.36 above, the OFT has not concluded on whether other London Airports are substitutable such that they should be considered in the same market as Flybe’s service on the Newquay – London Gatwick route. The OFT has considered market shares including and excluding ASW’s previous service to London City and Ryanair’s previous service from Newquay to London Stansted, based on passenger numbers carried in 2009. Ryanair’s service from Newquay to Stansted airport has now withdrawn from this route (its flights ceased on 1 October 2009).\textsuperscript{147} The passenger numbers for Flybe’s service are prorated from the CAA statistics for March to December, the full months it has been in service in 2009. Similarly, the passenger numbers for ASW’s London City service are prorated from the CAA statistics for May to December, and the Ryanair service prorated from the CAA statistics from March to September 2009.

\textsuperscript{147} \url{www.thisiswesternmorningnews.co.uk/business/Ryanair-axes-winter-flights-Newquay/article-1302533-detail/article.html}
### Table 5.1: Newquay London airports market shares 2009

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Flights</td>
<td>1980</td>
<td>1767</td>
<td>1103</td>
<td>717</td>
</tr>
<tr>
<td>Passengers</td>
<td>75,241</td>
<td>58,045</td>
<td>18,518</td>
<td>78,048</td>
</tr>
<tr>
<td>Share of passengers (excluding London City and Stansted)</td>
<td>56%</td>
<td>44%</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Share of passengers (including London City)</td>
<td>50%</td>
<td>38%</td>
<td>12%</td>
<td>N/A</td>
</tr>
<tr>
<td>Share of passengers (including London Stansted)</td>
<td>36%</td>
<td>27%</td>
<td>N/A</td>
<td>37%</td>
</tr>
<tr>
<td>Share of passengers (including London City and Stansted)</td>
<td>33%</td>
<td>25%</td>
<td>8%</td>
<td>34%</td>
</tr>
</tbody>
</table>

Source: CAA monthly passenger statistics and OFT calculations

5.14 Under the most conservative market definition that excludes both ASW's London City service and Ryanair’s London Stansted service, Flybe has acquired a market share of 56 per cent since entering the market in March 2009. The OFT notes that the other 44 per cent of the market is served by only one operator, ASW, which has historically been a monopolist incumbent on this market and is also the largest operator at Newquay Airport. The OFT notes also that Flybe has only recently entered the Newquay - London Gatwick route in competition with ASW.

5.15 Given these circumstances, the OFT considers that Flybe is constrained by actual competition from ASW and is not dominant on the route.

**Potential competition**

5.16 The OFT considers previous examples of entry on to the Newquay – London Gatwick route, including Flybe’s entry itself, is an indication that potential competition may possibly be a constraint on Flybe’s ability to exercise market power.

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5.17 However, slot constraints at London Gatwick are likely to be a significant barrier to entry. Historically, slot capacity has been a significant constraint for airlines wishing to establish routes at London Gatwick, notwithstanding the recent movement of some of the providers of intercontinental services from London Gatwick to London Heathrow. In explaining its rationale for acquiring the slots at London Gatwick necessary to launch the Newquay – London Gatwick route, Flybe has submitted to the OFT that the availability of slots, which had arisen because providers of intercontinental services were moving their operations to London Heathrow, represented a 'once-in-a-generation chance to establish a major position at London Gatwick'.

5.18 A new entrant may find it difficult to acquire slots to use on the Newquay – London Gatwick route. On the other hand, an airline with a large number of existing slots at London Gatwick such as EasyJet would be able use these slots to serve the Newquay – London Gatwick route without difficulty. However, the OFT considers that, in the event that slots at London Gatwick were to become available, it is possible that entry on to the Newquay – London Gatwick route, against a strong competitor such as Flybe, would not be as attractive as other potential opportunities.

5.19 In addition, while the OFT has not concluded on whether flights from London airports are a constraint such that they should be considered in the same market, entry on to routes from Newquay to other London Airports (such as Ryanair’s service to London Stansted and ASW’s service to London City that have now both been withdrawn) may act as a constraint on Flybe.

Conclusions on Flybe’s putative dominance in the target market

5.20 The OFT considers that Flybe is not dominant on the Newquay – London Gatwick route. Flybe has recently entered into competition with ASW and currently has an approximately equal share of passengers. Therefore, the OFT considers that Flybe does not possess sufficient market power to be considered dominant on the route.

149 ‘The operation of Flybe’s business’, Flybe submission to the OFT 24 June 2009, paragraph 74
E Flybe’s routes from Exeter Airport

Assessment of actual competition

Market shares

5.21 As noted in paragraph 5.7, the strength of actual competition can be indicated by market shares, amongst other factors. The tables below show the passenger shares of airlines defined in the same market as Flybe’s Focal routes.

Dublin, Glasgow and Newcastle

Table 5.2: passenger shares for Dublin, Glasgow and Newcastle (financial year 2008 – 2009)

<table>
<thead>
<tr>
<th>Route</th>
<th>Flybe (Exeter Airport)</th>
<th>ASW (Plymouth Airport)</th>
<th>Ryanair (Bristol Airport)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pax</td>
<td>Share of Pax</td>
<td>Pax</td>
</tr>
<tr>
<td>Dublin</td>
<td>27,370</td>
<td>8%</td>
<td>4,864</td>
</tr>
<tr>
<td>Glasgow</td>
<td>39,418</td>
<td>15%</td>
<td>14,685</td>
</tr>
<tr>
<td>Newcastle</td>
<td>43,726</td>
<td>18%</td>
<td>7,306</td>
</tr>
</tbody>
</table>

Source: CAA traffic data and ASW data

5.22 For Dublin, Glasgow and Newcastle, the OFT has not concluded on whether ASW flights from Plymouth Airport should be considered inside or outside the market definition. However, given the very small volume of passengers transported by ASW in comparison to Flybe and competitors at Bristol Airport, this is largely irrelevant. Ryanair has over 90 per cent share of passenger volumes on the Bristol – Dublin route and Flybe only eight per cent. For the Glasgow route, Flybe’s share of passenger volumes is 15 per cent. For the Newcastle route, Flybe’s share of passengers is 18 per cent. Even if these routes from Plymouth Airport were in the same market, they would not be sufficiently large to exercise a competitive constraint on either Flybe or Ryanair, and would not affect the dominance analysis.
Guernsey, Jersey, Leeds Bradford and Manchester

5.23 For the Guernsey, Jersey, Leeds Bradford and Manchester routes, the relevant market does not include competitors at Bristol airport. As for the Dublin, Glasgow and Newcastle routes, the OFT has not concluded on whether ASW flights from Plymouth Airport should be considered inside or outside the market definition. However, the following table presents shares on the conservative basis that flights from Plymouth Airport are in the same market. If this was not the case, Flybe’s market share on each of these routes would be 100 per cent.

Table 5.3: passenger shares for Guernsey, Jersey, Leeds-Bradford and Manchester (financial year 2008 – 2009)

<table>
<thead>
<tr>
<th>Route</th>
<th>Flybe (Exeter Airport)</th>
<th>ASW (Plymouth Airport)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pax</td>
<td>Share of Pax</td>
</tr>
<tr>
<td>Guernsey</td>
<td>31,648</td>
<td>91%</td>
</tr>
<tr>
<td>Jersey</td>
<td>27,039</td>
<td>69%</td>
</tr>
<tr>
<td>Leeds-Bradford</td>
<td>26,818</td>
<td>79%</td>
</tr>
<tr>
<td>Manchester</td>
<td>51,345</td>
<td>79%</td>
</tr>
</tbody>
</table>

Source: CAA traffic data and ASW data

*This figure is an estimate. ASW has only operated flights to Guernsey since April 2009 and the OFT only has in its possession data for passenger volumes on this route from April 2009 to August 2009. To estimate the figure in the table above the OFT has taken the ratio of the number of passengers on the Guernsey route to those on the Jersey route during the period May to August 2009, and multiplied it by the number of passengers travelling on the Jersey route in 2008/09

5.24 Even when ASW’s flights from Plymouth Airport are included in the relevant market, the OFT considers that Flybe has a market share ranging from just under 70 per cent to above 90 per cent on these four routes. In the absence of competitive constraints from potential competition (considered at paragraphs 5.29 – 5.80 below), these market shares give an indication that Flybe may be dominant on these routes.

5.25 However, for the Leeds Bradford and Manchester routes, the OFT has not formally concluded on whether the product market definition should be extended to include rail travel and has not analysed the relevant rail travel figures. If rail passenger volumes
from Exeter to each of these respective destinations are included in the calculation of market shares,\textsuperscript{150} Flybe’s shares on these routes are highly unlikely to be at a level where dominance would be presumed. Nonetheless, the OFT considers that it does not need to conclude in this regard given its findings set out in paragraphs 5.79 – 5.80 in respect of the Guernsey and Jersey routes allow it to conduct a full analysis under section 18 of the Act in this case.

Conclusion on actual competition

5.26 Flybe’s flights out of Exeter Airport have a less than 20 per cent market share on the Dublin, Newcastle and Glasgow routes. Flybe faces significant actual competition from the high frequency services operated by Ryanair and EasyJet from Bristol Airport. As such, the OFT concludes that it is not dominant on these routes.

5.27 On the Leeds Bradford and Manchester routes, the OFT has not concluded on whether or not Flybe is constrained by actual competition from rail services.

5.28 On the Jersey and Guernsey routes, Flybe’s flights out of Exeter Airport are not constrained by actual competition. Flybe’s share on these routes is 69 per cent for Jersey and 90 per cent for Guernsey, even on the conservative basis that ASW’s flights from Plymouth Airport are in the same market.

F Assessment of potential competition

5.29 The preceding paragraphs set out the evidence concerning the nature of the actual competitive constraints on Flybe’s conduct. However, as noted in paragraph 5.7, in assessing whether an undertaking has substantial market power, the OFT also considers whether and to what extent an undertaking will face constraints from potential competitors on its ability to behave independently in the relevant market. In

\textsuperscript{150} The OFT is also mindful of a report entitled 'Air and Rail Competition and Complementarity' prepared for the European Commission (DG TREN) in 2006 by Steer Davies Gleave – see ec.europa.eu/transport/rail/studies/doc/2006_08_study_air_rail_competition_en.pdf. The report looked at a selection of European routes to examine the relationship between rail and air journey times and rail and air market shares. It found at paragraph 2.5 that rail passenger shares ranged from 18 per cent to 40 per cent for a three hour difference in journey time and from 44 per cent to over 85per cent for a one and a half hour difference in journey time.
this context, potential competition refers to either the scope for new entry or for expansion by existing competitors.

5.30 The strength of potential competition will depend on the extent of barriers to entry. Even an undertaking with a large market share may not have market power if there are low entry barriers.\(^{151}\) Entry barriers might allow an undertaking to exert its dominance and thus profitably earn and sustain supra-competitive profits in the long term, without being more efficient than its potential rivals. Entry barriers include not only those factors that prevent entry but also those that impede expansion.

5.31 In its assessment of potential competition, the OFT has therefore considered structural barriers to entry (such as the availability of suitable slots) and the resulting incentives for an airline to enter the Focal routes in competition with Flybe.

**Structural barriers to entry**

5.32 In its review of the *Lufthansa/Swiss* merger,\(^ {152}\) the European Commission found five categories of barriers to entry – (i) access to airports (slot constraints), (ii) regulatory barriers to entry, (iii) economies of scope at base airport, (iv) marketing costs of entry and (v) network economies and frequency advantages.\(^ {153}\)

5.33 The OFT, in considering these categories and other possible barriers specific to this case, has assessed the significance of possible structural barriers to entry from sunk costs,\(^ {154}\) slot availability, runway length and economies of scale and scope.\(^ {155}\) These

\(^{151}\) See *Assessment of Market Power* (OFT415), paragraph 5.4 – see www.of.t.gov.uk/shared_of.t/business_leaflets/ca98_guidelines/of.t415.pdf


\(^{153}\) Ibid, pages 7 – 10

\(^{154}\) Sunk costs refer to those costs which must be incurred to compete in a market, but which are not recoverable on exiting the market. Entry and expansion will only occur if the expected profit from being in the market exceeds any sunk cost of entry/expansion. The expected profit from being in a market would also account for the possibility that exit occurs and that any associated 'exit costs' are incurred

\(^{155}\) There are no regulatory barriers to entry as all the Focal Routes are to UK or European destinations
are considered in turn below for entry on to the Focal routes from Exeter Airport, Bristol Airport and Plymouth Airport.

Sunk costs of entry

5.34 Costs incurred on entry that are not subsequently recoverable should the entrant decide to exit may be a barrier to entry. Entry on to a new route requires aircraft, landing slots as well as facilities to park the aircrafts overnight and maintain them. ASW has submitted that for an existing airline it is relatively easy to enter routes, as aircraft can be switched from existing routes at short notice.\(^{156}\) Such entry costs are not sunk as aircraft can be removed from a route easily as well. For an existing airline, therefore, these costs of entry appear relatively low. Further, these entry costs suggest that entry on to the Focal routes by an existing airline in possession of a fleet of aircraft is more likely than by an entrant that has not previously provided air services, particularly considering that it would enter into direct competition with Flybe.

5.35 However, an entrant may need to incur marketing costs to generate demand on the route. The need for airlines to incur marketing costs in the local catchment area to raise consumer awareness and generate demand has been recognised in previous competition cases.\(^{157}\) In this case, Flybe has submitted that, when airlines enter on to a route in competition with an incumbent, it is necessary to stimulate the market as well as to schedule flights to attract consumer switching.\(^{158}\)

5.36 The OFT considers that marketing costs are likely to be a significant factor in the decision for a new airline to enter a route and that this is likely to apply to a new airline wishing to enter onto the Focal routes at Exeter Airport, Bristol Airport or Plymouth Airport. However, the OFT considers that there does not appear to be any reason to suspect that marketing costs for these routes are atypical. Further, the OFT considers that marketing costs are unlikely to be high based on its analysis of costs and revenues

\(^{156}\) ASW briefing note for the OFT received on 9 March 2009, paragraph 4.10


\(^{158}\) ‘Flybe Limited Submission to the OFT’, dated 28 July 2009, paragraph 1.13.2
on the Newquay – London Gatwick route, which shows that Flybe’s media and
advertising costs are [...] per cent of total costs.159

Slot availability

5.37 Landing and take-off slots are crucial inputs for an entrant wishing to start a new
service. At certain airports, where there is limited capacity of available slots, slot
capacity can form a barrier to entry. This barrier to entry has previously been
recognised in various airline competition cases.160

5.38 The OFT has considered possible barriers to entry arising from limited slot capacity for
the Focal routes, departing from Bristol Airport, Exeter Airport or Plymouth Airport.

5.39 Both Flybe and ASW have submitted to the OFT that procurement of slots at regional
airports is easy. Flybe has submitted that slot availability ‘will not pose a barrier at
Newquay, Plymouth or Exeter airports’.161 ASW has submitted that there are unlikely to
be slot issues at regional airports that would prevent airlines from entering on to new
routes.162

5.40 The International Air Transport Association163 (IATA) classifies airports with excess
demand for slots and, as a consequence, requires systems for coordinating airline
schedules. The IATA classification has three levels:

- A (Level 1) non-coordinated airport is one where the capacities of all the systems at
  the airport are adequate to meet the demands of users.

- A schedules facilitated airport (Level 2) is one where there is potential for
  congestion at some periods of the day, week or scheduling period, which is

159 See paragraph B.19, Annex B


161 ‘Flybe Limited Submission to the OFT’, dated 28 July 2009, paragraph 3.53.4

162 Page 11 of ASW briefing note for the OFT received on 9 March 2009

163 www.iata.org
amenable to resolution by voluntary cooperation between airlines and where a
schedules facilitator has been appointed to facilitate the operations of airlines
conducting services or intending to conduct services at that airport.

- A 'Level 3 coordinated' airport is one where demand exceeds capacity for sufficient
  periods to the extent that formal procedures for the allocation of available capacity
  (take off and landing 'slots') are needed.

5.41 In its analysis of the Flybe/BA Connect\textsuperscript{164} merger, the OFT considered that scarcity of
slots was unlikely to be a barrier to entry at airports of level 2 or less. Of Plymouth
Airport, Exeter Airport and Bristol Airport only Bristol Airport is a 'schedules facilitated
(level 2)' airport. As such, the OFT considers that limited slot capacity is unlikely to be
a barrier to entry at any of these three airports.

5.42 Of the destination airports, Dublin and Manchester are level 3 'coordinated' and
Glasgow and Newcastle are level 2 'schedules facilitated'.\textsuperscript{165} Scarce slot capacity on
any of the Focal routes is therefore unlikely to be a barrier to entry, with the possible
exceptions of Manchester and Dublin. Given Flybe is constrained by actual competition
on its routes to Dublin and Manchester from Exeter Airport, the OFT has not considered
slot capacity at these airports further.

**Plymouth Airport’s short runway**

5.43 The OFT has been informed during the course of its investigation that Plymouth Airport
has a short runway, which precludes its use by the vast majority of current civil
transport aircraft.\textsuperscript{166} The length of the runway may form a barrier to entry at Plymouth
Airport for airlines that do not currently own the requisite aircraft as they would be
required to either purchase or lease them and their availability may be limited.

\textsuperscript{164} Anticipated acquisition by Flybe Group Limited of the BA Connect business of British Airways plc – The OFT’s
decision on reference under section 33(1) given on 7 February 2007. Full text of decision published on 15
February 2007 – see \url{www.oft.gov.uk/shared_oft/mergers_ea02/361227/Flybe.pdf}

\textsuperscript{165} IATA Worldwide Scheduling Guidelines, 19\textsuperscript{th} Edition, effective January 2010, – see

\textsuperscript{166} Letter from Plymouth City Council to the OFT dated 24 July 2009, page 1
5.44 ASW submitted to the OFT that the restricted runway length at Plymouth Airport and market size of Plymouth significantly limit the aircraft options for services to and from Plymouth Airport. ASW consider that only certain types of aircraft afford the prospect of offering a commercially viable operation from Plymouth Airport’s runway. These are the Dash 8 – 300 (ASW’s aircraft), the ATR 42, the ATR 72, the Dornier 328 and the DHC 6 – Twin Otter, and ASW informed the OFT that these aircraft are now out of production.\textsuperscript{167} The OFT consulted the CAA on this point. The CAA advised that the majority of the suitable aircraft types are no longer in production. Some aircraft types could be used if the payload was restricted on the operations concerned, but these restrictions could lessen the commercial viability of the service. The OFT also notes a study prepared by York Aviation LLP considering development options for Plymouth Airport,\textsuperscript{168} which indicates that the key issue for Plymouth Airport is the restrictions imposed by its length of runway, and anticipates that the current types of aircraft in service at Plymouth Airport will become obsolete.

5.45 ASW identified four current UK airlines in possession of suitable aircraft, namely Aurigny, Blue Islands, Manx2 and Scott Airways.\textsuperscript{169} ASW has submitted that these airlines would be unlikely to be willing to operate at Plymouth Airport as they already utilise all their aircraft on existing routes.\textsuperscript{170}

5.46 It appears that the airlines noted above would be able to switch aircraft on to routes leaving from Plymouth Airport were a profitable opportunity to present itself, for instance were Flybe to restrict its frequency of service at Exeter Airport. In addition,

\textsuperscript{167} Paper produced by an aviation consultant provided to the OFT by ASW’s legal advisers at a meeting on 29 September 2009

\textsuperscript{168} Plymouth City Airport Study, York Aviation, April 2006, paragraph 5.2 – see www.plymouth.gov.uk/kc20_plymouth_airport_final_report.doc.pdf

\textsuperscript{169} Supplementary paper (discussing runway restrictions posed by Plymouth Airport) received from ASW at a meeting on 29 Sept 2009 at OFT

\textsuperscript{170} In a letter from ASW’s legal advisers dated 29 April 2010, ASW also submitted that whilst other UK airlines may have the capability to operate at Plymouth Airport, in ASW’s opinion the likelihood of any of these airlines doing so is remote
the OFT notes that ASW’s fleet of aircraft would become available to an entrant were ASW to cease operations. This is discussed further in paragraphs 6.88 – 6.93.

5.47 The OFT considers that Aurigny, Blue Islands, Manx 2 or Scott Airways could only enter at Plymouth Airport on a scale capable of replacing the same level of constraint that ASW has imposed on Flybe’s services at Exeter Airport. They would not be able to impose a greater level of constraint on Flybe's operations at Exeter Airport due to the restricted size of the aircraft that they could fly from Plymouth Airport. While the OFT has not concluded on whether the ASW Focal routes are in the same market as the Flybe Focal routes, it considers that the relatively small passenger volumes recorded by ASW at Plymouth Airport are not sufficient to prevent a finding that Flybe is dominant on the two Exeter Airport Markets. Therefore, the OFT considers that entry at Plymouth Airport of the scale the OFT envisages is unlikely to prevent Flybe from maintaining its dominance on the two Exeter Airport Markets.

Economies of scope and scale

5.48 Another barrier to entry identified by the European Commission in the Lufthansa/Swiss and the Ryanair/Aer Lingus mergers is the existence of economies of scope at an airline’s airport base. These economies arise from the flexibility of airlines to spread various costs including crew costs, ground handling and maintenance costs over several different routes, and from airlines' ability to reallocate their aircraft fleet across different routes, for example in order to minimise disruption costs. Consequently, an incumbent with an airport base may have a significant cost advantage over potential entrants. For example, in Ryanair/Aer Lingus, the European Commission found that Ryanair and Aer Lingus were likely to have an advantage over competitors in being able to switch between routes out of Dublin airport.173


173 Ibid, paragraph 59
5.49 Flybe’s base at Exeter Airport, from which it currently operates on 25 routes,\(^{174}\) is likely to endow it with such cost advantages against another airline wishing to enter at Exeter Airport on to any of the Focal routes. In addition, there are no current operators with a base at Plymouth Airport, with the exception of ASW. At Bristol Airport, however, Ryanair (33 routes) and EasyJet (41 routes)\(^{176}\) have a sufficient number of routes to neutralise Flybe’s cost advantage at Exeter Airport.

5.50 The OFT has also considered whether airlines may also have cost advantages arising from economies of scope at the destination airports on the Focal routes.

- At Dublin, there are a number of airlines with several routes that would benefit from such advantages, including Ryanair, Aer Lingus and EasyJet. Ryanair already operates a route to Bristol Airport from its base in Dublin which we have found to exert a significant competitive constraint on Flybe at Exeter Airport.\(^{176}\)

- At Glasgow, EasyJet serves 13 routes.\(^{177}\)

- At Guernsey, Aurigny serves eight routes and Blue Islands serves six routes.\(^{178}\)

- At Jersey, Flybe serves the most routes (24 direct services) and Blue Islands serves six routes.\(^{179}\)

- At Leeds Bradford, Ryanair serves 13 routes and Jet2 serves 18 routes.\(^{180}\)

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\(^{174}\) [www.flybe.com/map](http://www.flybe.com/map)

\(^{175}\) [www.bristolairport.co.uk/flight-information/airline-and-tour-operators.aspx](http://www.bristolairport.co.uk/flight-information/airline-and-tour-operators.aspx)

\(^{176}\) [www.dublinairport.com/flight-information/destinations-and-airlines](http://www.dublinairport.com/flight-information/destinations-and-airlines)

\(^{177}\) [www.glasgowairport.com/portal/page/Glasgow^General^Flight + information^Destinations + and + airlines/](http://www.glasgowairport.com/portal/page/Glasgow^General^Flight + information^Destinations + and + airlines/)

\(^{178}\) [www.guernsey-airport.gov.gg/routes.html](http://www.guernsey-airport.gov.gg/routes.html)


\(^{180}\) Information taken from the winter 2009/10 timetable available at [www.leedsbradfordairport.co.uk/flightsandholidays-allflights.php](http://www.leedsbradfordairport.co.uk/flightsandholidays-allflights.php)
• At Manchester, there are a number of operators with several scheduled routes including BMI (12 routes), BmiBaby (17 routes), EasyJet (19 routes) and Jet2 (28 routes).\textsuperscript{181}

• At Newcastle, EasyJet serves 16 routes, Jet2 20 routes and Eastern five routes.\textsuperscript{182}

5.51 At most of the airports identified above there are competitors that operate a number of routes and so would be likely to benefit from similar economies of scope to Flybe. The notable differences are those airports in the Channel Islands where Flybe operates the most routes and the other airlines only operate a small number.

5.52 In addition to the economies of scope arising from its base at Exeter Airport, the OFT considers that Flybe’s absolute scale may give it a cost advantage in competing against smaller rivals. The question arises as to whether this may act as a deterrent for smaller rivals considering entering the Focal routes. Scale is important in airline competition for a number of reasons. First, the absolute scale of an airline may produce cost efficiencies in marketing, in the acquisition and maintenance of aircraft and as centralised overheads are spread over a larger base. Second, a large airline will benefit from the ability to spread route-specific risk, for example from competition or uncertain demand, across a number of routes. Third, airlines which operate on a large number of routes are able to reallocate aircraft across their routes in response to shifts in demand.\textsuperscript{183}

5.53 Flybe is one of the largest airlines in the UK,\textsuperscript{184} operating on 203 routes\textsuperscript{185} and carrying approximately five million passengers on domestic flights in 2009, as illustrated in the

\textsuperscript{181} www.manchesterairport.co.uk/MANInfo/Destinations

\textsuperscript{182} www.newcastleairport.com/FlightInformation/DestinationsandAirlines.htm


\textsuperscript{184} For instance see www.anna.aero/2009/12/04/flybe-1-uk-domestic-airline/

\textsuperscript{185} www.flybe.com/company_information/default.htm
The relative scale of potential entrants to Flybe is considered further when assessing likelihood of entry below.

### Table 5.4: UK domestic passenger numbers and shares 2009

<table>
<thead>
<tr>
<th>Airline</th>
<th>Terminal</th>
<th>Passengers</th>
<th>Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Easyjet Airline Company Limited</td>
<td>5,170,079</td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>Flybe Limited</td>
<td>4,983,099</td>
<td>22%</td>
<td></td>
</tr>
<tr>
<td>British Airways Plc</td>
<td>4,160,141</td>
<td>19%</td>
<td></td>
</tr>
<tr>
<td>BMI British Midland</td>
<td>1,986,840</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Ryanair</td>
<td>1,593,717</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>Bmibaby Limited</td>
<td>1,116,839</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>Loganair</td>
<td>521,473</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Eastern Airways</td>
<td>457,756</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Aurigny Air Services</td>
<td>430,675</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>BA Cityflyer Limited</td>
<td>345,012</td>
<td>2%</td>
<td></td>
</tr>
</tbody>
</table>

Source: CAA traffic data

### Conclusion on structural barriers to entry

5.54 For the reasons set out above, the OFT considers that there are unlikely to be significant barriers to entry from slot availability or excessive sunk costs of entry on any of the Focal routes.

5.55 However, entry sufficient to constrain Flybe is unlikely at Plymouth Airport given the length of the runway and the type of aircraft required to use it. Flybe’s cost advantages from its absolute scale and economies of scope at Exeter Airport may constitute barriers to entry against smaller potential entrants, particularly for the Jersey and Guernsey routes, where no other airline currently operates a number of routes at these airports likely to be sufficient to neutralise Flybe’s advantages from economies of scope at its base at Exeter Airport.

### History of entry, exit and expansion plans

5.56 Since the inception of Flybe’s routes at Exeter Airport there has been no other entry onto the Focal routes at Exeter Airport by scheduled airlines. ASW has entered onto routes to the same destinations at Plymouth Airport, but as argued in paragraphs 5.21 – 5.28 discussing actual competition, this has not acted as a significant competitive constraint on Flybe.
5.57 In order to determine the likelihood of entry at Exeter Airport, the OFT sent a section 26 notice to Exeter Airport, requesting details of discussions it had held with airlines over the last three years with regards to the operation of new scheduled routes from Exeter Airport. Exeter Airport’s response of 19 October 2009, confirmed that while other airlines had held discussions with Exeter Airport (most significantly [...] ), no discussions appear to have taken place or reached an advanced stage with regards to the operation of domestic UK routes to compete with those Flybe operates from Exeter Airport.\[166\] Further, none of the route discussions Exeter Airport has held with airlines previously are currently ongoing and Exeter Airport has informed the OFT that due to the current economic climate, route development is scarce and so it does not envisage any new routes from Exeter Airport in either winter 2009 or 2010.\[167\]

5.58 The OFT is not aware of any airline with current plans to enter on to the Focal routes from either Bristol Airport or Plymouth Airport.

Incentives and likelihood of entry

Entry by 'regional' airlines

5.59 As noted above, smaller regional airlines are likely to suffer cost disadvantages both from absolute scale and from economies of scope due to Flybe’s base in Exeter Airport. This is particularly the case for the routes to Jersey and Guernsey where there is no incumbent airline with a large number of routes that could enter into competition with Flybe.

5.60 On the other hand, the OFT notes the large number of routes provided by BMI at Manchester, and by Jet2 at Leeds Bradford, and considers that these are likely to neutralise the advantages arising from economies of scope due to Flybe’s base in Exeter Airport. As such, the OFT considers that entry on to the Exeter – Leeds Bradford and Exeter – Manchester routes is more likely than entry on to the Exeter – Jersey and Exeter – Guernsey routes.

\[166\] Spreadsheet provided by Exeter Airport as an annex to a letter from Exeter Airport’s legal advisers to the OFT dated 19 October 2009

\[167\] Letter from Exeter Airport’s legal advisers to the OFT dated 19 October 2009, page 2
5.61 The incentive of airlines to enter will also depend on their perception of Flybe's likely response to entry. If a potential entrant anticipates a robust response by Flybe then it is less likely to enter. Further, small regional airlines that suffer from cost disadvantages relative to Flybe will be less capable of dealing with short term losses arising from a robust response, and less likely to be able to obtain market share from Flybe on a route.

5.62 In this regard, the OFT has noted a complaint made by Manx2 concerning Flybe’s allegedly aggressive behaviour, following the loss of Flybe’s contract to supply chartered services on behalf of the Department of Health and Social Security (DHSS) in the Isle of Man, flying patients to hospitals in the UK (mainly in north-west of England). Flybe is alleged to have issued stories that it would retaliate against Manx2 by targeting two of their most profitable routes to Belfast and Blackpool.

5.63 Other anecdotal evidence could also indicate allegations of aggressive conduct by Flybe against competitors on other routes, and give rise to a perception in the market that Flybe responds to competitive threats in this way. For example, a press statement regarding a third party airline’s decision to stop flights on a specific route claimed that the decision was as a result of Flybe’s entry to the route, which was allegedly not able to sustain two carriers, although the press statement expressed disappointment that one of the airports in question had attracted Flybe, rather than blaming Flybe directly. An internal Flybe email, which was sent with a copy of the press statement, stated:

'...it's clear from the last few days announcements that [...] will cede [...] but will make their last stand in [...].'

188 Aggressive response to entry has been considered as a possible barrier to entry in Ryanair/Aer Lingus (Commission Decision of 27 June 2007, Ryanair/Aer Lingus [2008] OJ C 47/05, paragraph 407 see – ec.europa.eu/competition/mergers/cases/index/m88.html#m_4439) where the European Commission argued that Ryanair may be prone to compete aggressively on specific routes where these routes were to its Dublin base, since it may expect competitors to leave the route for good and not to enter other Dublin markets.

189 www.manx2blog.com/2009/02/call-for-oft-to-investigate-flybeloganair-plan

190 Email from senior Flybe executive to a senior employee of Flybe dated 4 February 2008
5.64 In addition, the OFT notes a press report on a third party website which details comments made by a senior executive of Flybe in response to comments made by a senior executive of a competitor airline. Flybe maintains\(^{191}\) that the comments were made in response to the senior executive of the competitor airline claiming that it would 'run Flybe out of Cardiff'. This exchange of comments followed Flybe's decision to launch routes from Cardiff to Edinburgh, Glasgow and Newcastle. The senior executive of Flybe is reported to have said:

'It's not sustainable for there to be 2 low-cost airlines on domestic (routes). Ultimately we will come out on top, it's just a matter of time.' He said in the long-term Flybe would focus on business routes and he expected bmibaby to concentrate on leisure weekends in European cities, rather than UK flights.'\(^{192}\)

5.65 The OFT has also considered some previous examples of entry against Flybe. While there is no history of entry on to the Focal routes, there are a few examples where competitors have entered in direct competition with Flybe on other routes. Using traffic data from the CAA, the OFT has looked for examples of previous entry since 2004/05 on the routes that Flybe served with more than 300 flights in 2008/09.\(^{193}\)

5.66 BA Connect entered on to the route from Belfast City to Birmingham in direct competition with Flybe in April 2006 but exited again in August 2006.

5.67 Bmibaby entered on to the Birmingham – Edinburgh route on its launch in 2005. At the time both BA Connect and Flybe were operating on the route though BA Connect was acquired by Flybe in 2007. Bmibaby also entered the Birmingham – Glasgow route in 2007 following the BA Connect acquisition. Bmibaby appears to have discontinued its

\(^{191}\) Letter from Flybe’s legal advisers to the OFT dated 27 September 2010. In that letter Flybe’s legal advisers state that the comments in this report were made at a media event where Flybe had been given the right to reply to the comments from its competitor

\(^{192}\) www.airport-hotels-guide.co.uk/cardiffairporthotels170308.htm

\(^{193}\) The OFT has only considered entry examples where the entrant has provided more than 300 flights in a year
Birmingham – Edinburgh route as of 27 March 2010,\(^{194}\) although Flybe continues to operate this route.\(^{195}\)

5.68 Eastern Airways entered into direct competition with Flybe on the Birmingham – Isle of Man route in 2005, taking over from BA Citiexpress, which had previously competed with Flybe on the route.

5.69 Blue Islands entered in direct competition with Flybe on the Guernsey to Southampton route with a twice daily service in July 2007. In July 2008 it subsequently increased its service rotation to three times a day and now carries a similar number of passengers to Flybe on this route.

5.70 Overall, the OFT considers that most airlines are unlikely to be willing to enter into direct competition with Flybe at Exeter Airport due to Flybe’s scale and scope advantages and the possibility of a robust response. There are few examples of airlines entering into direct competition with Flybe.

5.71 The OFT notes in particular the entry by […] on the […] route as an example where a small regional airline has successfully entered into direct competition with Flybe. This is particularly relevant to this case, as, in the OFT’s view, […] is well-placed to enter on the Jersey and Guernsey routes in direct competition with Flybe at Exeter Airport as it already provides flights on an albeit small number of routes from these airports. However, with regard to the potential threat of entry by a third party airline, the OFT notes evidence from Flybe’s internal emails which suggest that Flybe considered that the competitor would have to buy larger aircraft to grow its business and that it did not have sufficient aircraft to generate enough revenue to cover its overheads.\(^{196}\)

‘I believe the options facing […] are:

\(^{194}\) Flight search on [www.bmibaby.com](http://www.bmibaby.com)


\(^{196}\) An extract from an email from a senior Flybe executive to other senior Flybe executives dated 4 December 2008
(1) Stay at the same size and accept long term losses. Not in [...] I suggest.

(2) Close the airline and lose [...] – not there yet

(3) Replace the current fleet with [...] Very high risk and a major change of gear.

(4) Keep fighting [...] (or persuade us to join [...] in achieving this goal).

(5) Buy [...] and use this as the vehicle to give [...] which [...] will then use to compete against us [...] on a better platform. (It’s what we did [...] to take [...] out of [...]’)

Entry by large low cost carriers

5.72 Ryanair and EasyJet are well placed to enter in terms of scale and scope advantages at destination airports on most of the routes. In particular, both airlines have a large number of routes at Bristol Airport. Entry at Bristol Airport on a similar scale to EasyJet’s current routes to Newcastle and Glasgow or Ryanair’s route to Dublin would be likely to act a significant constraint on Flybe at Exeter Airport. Further, the OFT considers that larger carriers are likely to be less deterred by the prospect of a robust response from Flybe as their greater scale means they are more able to withstand a sustained period of losses on an individual route.

5.73 However, the OFT considers that the ‘thin’ nature of the routes means that large low cost carriers such as Ryanair or EasyJet would be unlikely to consider them viable.

5.74 Low cost carriers would need to carry a certain number of passengers to make it worthwhile for them to operate a service given the size of aircraft and desired load factor and frequency. Flybe’s passenger numbers on the Focal routes range from 25,000 to 50,000. On either of the Jersey and Guernsey routes, where Flybe faces limited constraints from actual competition, it flies approximately 30,000 passengers

197 ‘Thin’ refers to the overall demand for travel on a particular route (in terms of passenger numbers)

198 See table 4.3
from Exeter Airport. In addition, similar numbers are currently flown from Bristol Airport (by Aurigny to Guernsey, and by Flybe and ASW to Jersey).

5.75 Looking at EasyJet’s services from Bristol Airport and Flybe’s services from Exeter Airport in 2008, for EasyJet’s 24 mature routes, \(^{199}\) only 2 (Valencia with 60,000 passengers and Pisa with 58,000 passengers) carry fewer than 70,000 passengers.\(^{200}\) The average number of passengers across all 24 of EasyJet’s routes in the sample is 120,000. In order for Ryanair or EasyJet to achieve similar numbers of passengers on routes to Jersey and Guernsey, they would therefore have to be confident of either displacing the incumbent operators or causing the market to double its current size.

**Conclusion on potential competition**

5.76 In theory, the larger low cost airlines, such as Ryanair and EasyJet, may be able to enter at Bristol Airport and are less likely to be affected by Flybe’s scale advantages and potentially robust response. However, currently, they are unlikely to consider entry to be viable. This is because their potential routes from Bristol Airport, designed to compete with the Flybe Focal routes, are likely to be too ‘thin’ to be viable proposition for them. As such, the OFT considers that there is currently no constraint on Flybe from such entry on its Focal routes at Exeter. However, the OFT considers that such entry may be a constraint in the future were the routes to grow in terms of passenger numbers and revenues. Consequently, the OFT considers that this may place an upper limit on the degree of market power afforded to Flybe.

5.77 The OFT considers that the potential for entry and expansion by small regional airlines is limited by Flybe’s scale and scope advantages, arising from its absolute size and base at Exeter Airport. In the OFT’s view, it is also limited by the likelihood (or at least, the perceived likelihood) of a robust response to entry from Flybe.

5.78 The OFT considers that while Bmibaby and Jet2 appear well-placed to enter at Manchester and Leeds Bradford respectively, due to the large number of routes they currently operate from these airports, there are no such operators with a similar number

\(^{199}\) A mature route is defined as having had a 120 flights per year over the last three years (2007 – 2009)

\(^{200}\) CAA traffic data
of routes at Jersey or Guernsey airports. The OFT notes the previous relevant example of successful entry by [...] onto the [...] route, but considers that evidence from Flybe’s internal emails suggests that the likelihood of entry by [...] onto the Jersey and Guernsey routes in the future is low.\textsuperscript{201}

5.79 As such, the OFT considers that Flybe may be constrained by potential competition on the Leeds Bradford and Manchester routes but that potential competition on the Jersey and Guernsey routes is likely to be limited.

G Conclusion on dominance

5.80 Overall, taking the evidence in the round, the OFT considers that Flybe is not dominant on the Newquay – London Gatwick route. Flybe has recently entered on to the route in competition with the incumbent ASW and currently has a 56 per cent share of passengers compared with ASW’s 44 per cent share. Therefore, the OFT considers that Flybe faces sufficient constraint from actual competition from ASW that it is not dominant on that route.

5.81 The OFT considers that Flybe is dominant on the Exeter – Jersey and Exeter – Guernsey routes for the reasons set out in paragraphs 5.28 to 5.30 and paragraphs 5.79 to 5.82 above.

5.82 The OFT considers that Flybe is constrained by actual competition on the routes to Newcastle, Dublin and Glasgow. With regard to the routes between Exeter Airport and Manchester and Leeds Bradford, the OFT has not concluded whether Flybe is constrained by rail travel.\textsuperscript{202} However, the OFT considers that Flybe may be constrained by potential competition. The OFT does not consider it necessary to

\textsuperscript{201} An extract from an email from a senior Flybe executive to other senior Flybe executives dated 4 December 2008

\textsuperscript{202} The OFT is also mindful of a report entitled ’Air and Rail Competition and Complementarity’ prepared for the European Commission (DG TREN) in 2006 by Steer Davies Gleave – see ec.europa.eu/transport/rail/studies/doc/2006_08_study_air_rail_competition_en.pdf. The report looked at a selection of European routes to examine the relationship between rail and air journey times and rail and air market shares. It found at paragraph 2.5 that rail passenger shares ranged from 18 per cent to 40 per cent for a three hour difference in journey time and from 44 per cent to over 85 per cent for a 1.5 hour difference in journey time
conclude on whether Flybe is dominant on these routes as in any event it has found Flybe to be dominant on the routes to Jersey and Guernsey and therefore can conduct a full analysis under section 18 of the Act for the purposes of its investigation.
6 LEGAL AND ECONOMIC ASSESSMENT

A Associated markets

6.1 The Court of Justice has held that conduct on markets other than the market on which the undertaking is dominant can be abusive.\(^{203}\) The leading authority is *Tetra Pak II*,\(^{204}\) in which the Court distinguished three different scenarios:

- abusive conduct on dominated markets which has effects on markets other than the dominated markets\(^ {205}\)
- abusive conduct on a separate non-dominated market which is intended to strengthen the undertaking’s position on the dominated market\(^ {206}\)
- abusive conduct on a separate non-dominated market where the anti-competitive effects are experienced in that non-dominated market

6.2 In respect of the second situation, the Court reaffirmed its conclusion in *BPB Industries and British Gypsum*,\(^ {207}\) in which it had found certain conduct on markets other than the dominated markets and which had effects on the dominated markets to be abusive. In that case the two markets concerned were not vertically related, neither being


\(^{204}\) Case C-333/94P *Tetra Pak International v Commission* [1996] ECRI-5951

\(^{205}\) Joined Cases 6/73 and 7/73 *Commercial Solvents v Commission* [1974] ECR 223 and Case 311/84 *CBEM v CLT and IPB* [1985] ECR 3261. In Commercial Solvents for example, Commercial Solvents held a dominant position on the market for the raw materials necessary for producing the drug in question, and its refusal to supply constituted an abuse of its dominant position within the dominated market, but whose effects extended to the market for anti-tuberculosis drugs, which Commercial Solvents wished to penetrate


\(^{207}\) CFI, Case T-65/89 – *BPB Industries and British Gypsum v Commission* [1993] ECR II-389
downstream to the other, but were 'neighbouring' and the dominant undertaking's motive was to protect its dominant position. 208

6.3 In his Opinion in *BPB and British Gypsum*, 209 Léger A.G. considered whether it is permissible to take account of conduct on a market other than that on which the dominant position was identified, and, on the basis of previous case law, he considered that the Court should answer the question in the affirmative whenever there is a connecting link between the two markets:

'. . .That question is a familiar one for this Court. It has been answered in the affirmative whenever there is a connecting link between the two markets.[..] In the present case, the close links between the markets for plasterboard and for plaster enabled BG, through an abuse (in the form of extended delivery times) committed on the plaster market, to strengthen its dominant position on the market for plasterboard.' 210

6.4 The OFT notes therefore that it is well-established that conduct on a related market may be abusive where it is intended to strengthen an undertaking's dominant position.

6.5 In *Tetra Pak II*, the Court of Justice expanded the concept of related-market abuse further by concluding that Article 86 [now Article 102] can apply to conduct found on an associated, non-dominated market and having effects on that associated market, provided, however, that sufficiently 'special circumstances' apply to engage Article 102:

208 In that case, the Court of First Instance accepted that Article 86 [now 102] was applicable to an advantage which the undertaking in question, which held a dominant position on the market for plasterboard, provided on a separate market, the market for plaster, only to 'loyal' customers who purchased plasterboard exclusively from it. The undertaking gave preferential treatment in the supply of plaster to customers who purchased their plasterboard from it, with the aim of preventing or hindering imports of plasterboard from other Member States. The commercial conduct on the plaster market was therefore intended to strengthen the undertaking's dominant position on the plasterboard market.

209 See the Opinion of Advocate General Léger in Case C-310/93 P *BPB Industries and British Gypsum v Commission* [1995] ECR I-865

210 Case C-310/93 P *BPB Industries and British Gypsum v Commission* [1995] ECR I-865, paragraph 83
...It is true that application of Article 86 [now Article 102] presupposes a link between the dominant position and the alleged abusive conduct, which is normally not present where conduct on a market distinct from the dominated market produces effects on that distinct market. In the case of distinct, but associated, markets, as in the present case, application of Article 86 [now Article 102] to conduct found on the associated, non-dominated, market and having effects on that associated market can only be justified by special circumstances.\textsuperscript{211} Such special circumstances, taken together, place the undertaking in a situation comparable to that of holding a dominant position on the markets in question as a whole.'

6.6 \textit{Tetra Pak II} made it clear that it is not possible to define with complete accuracy what constitutes closely related or linked markets. In this context, the Opinion of Ruiz-Jarabo Colomer A.G.\textsuperscript{212} is instructive:

'It is a question which must be decided on a case-by-case basis by the authorities responsible for applying Community competition law. In reaching that decision, account must be taken of, inter alia, the following circumstances: supply and demand structure on the markets, characteristics of the products, use by the dominant undertaking of its power on the dominated market in order to penetrate the linked market, market share of the dominant undertaking on the non-dominated market and degree of control on the dominated market by the dominant undertaking. [ ] the link between the dominated market and the market affected by the abuse must be a close one, since this new application of Article 86 [now Article 102] must be applied strictly...'

\textsuperscript{211} In \textit{Tetra Pak II} the Court of Justice identified some of these special characteristics as being the fact that Tetra Pak held a high overall market share encompassing both markets (78 per cent), as well as the fact that it held a position of strength compared to its competitors on the non-dominated non-aseptic market due to its portfolio power and high entry barriers. Furthermore, the Court of Justice took into account the relevance of the associative links, in this case, mainly, the fact that the various materials involved were used for packaging the same basic liquid products, which showed that Tetra Pak's customers in one sector were also potential customers in the other. Thanks to its position on the dominated market, Tetra Pak could concentrate its efforts on the non-dominated market by acting independently of the other economic operators.

Associated markets in UK case law

6.7 As to a consideration of the 'related-market abuse' case law by the UK Competition Appeal Tribunal (CAT), the CAT noted in *Genzyme*\(^{213}\) that:

'Cases such as *Commercial Solvents*, *Télémarketing* and *Tetra Pak II* demonstrate that it may well be an abuse for an undertaking which is dominant in one market to act without objective justification in a way which tends to monopolise a downstream, neighbouring or associated market. That is confirmed by the decision of the Court of Justice in Case C-18/88 *GB Inno* [1991] ECR I-5941, where the court referred to *Télémarketing* with approval in a case where the monopoly operator of a telecommunications system effectively reserved to itself the supply and maintenance of equipment for the network. As the OFT points out at paragraphs 296 and 304 of the decision, the abuses found in the case law essentially involve a company which is dominant in one market extending its monopoly into a separate or related market to the exclusion of competitors who would otherwise be able to compete in that separate market. If the elimination of competition in the related market is not the result of competition on the merits, then an abuse may be found.'\(^{214}\)

6.8 In *First Edinburgh/Lothian*,\(^{215}\) the OFT examined this linked markets point with reference to *Tetra Pak II*\(^{216}\) and concluded:

'The OFT does not consider that the associative links need to be as strong as was found in *Tetra Pak* in order for a firm with a dominant position in one market to abuse that position in another market.'\(^{217}\)

\(^{213}\) *Genzyme Limited and the Office of Fair Trading*, [2004], CAT 4

\(^{214}\) Ibid, paragraph 489

\(^{215}\) Decision of the Office of Fair Trading, No CA98/05/2004, *First Edinburgh/Lothian*, 29 April 2004


\(^{217}\) Decision of the Office of Fair Trading, No CA98/05/2004, *First Edinburgh/Lothian*, 29 April 2004, paragraphs 42 and 43
6.9 In *First Edinburgh/Lothian*,\(^{218}\) the OFT considered various factors as possible associative links between the markets. First, it noted the fact that First Edinburgh had a high market share in the area surrounding Edinburgh which it considered may have given it an advantage in attracting passengers who also wished to travel on connecting services within Greater Edinburgh (where the alleged predation took place by First Edinburgh), for example by allowing First Edinburgh to offer integrated services or tickets. Second, the OFT noted that First Edinburgh and Lothian were each possible entrants in markets where the other was present. In this regard, Lothian (dominant operator in Greater Edinburgh) was the most obvious entrant in the area surrounding Edinburgh where First Edinburgh was potentially dominant. Third, the OFT considered the impact of First Edinburgh’s position in the surrounding area on the ability of First Edinburgh to deter further entry, should Lothian be forced to exit the Greater Edinburgh market. Fourth, the OFT noted there was no ready supply of entrants or no other large operators within the region surrounding Edinburgh which could easily establish significant operations in Edinburgh by expanding from an existing base.

6.10 In the BT 118500 directory enquiries case,\(^{219}\) OFTEL stated:

>'When considering whether leveraging could be a breach of the Chapter II prohibition in this case, the Director considers that it is necessary to show:

(a) that there is dominance in a market;
(b) that there has been a leveraging of this dominance into another market;
(c) that there is a close relationship between the two markets in question; and
(d) the leveraging took place by means of abusive conduct which has had a material adverse effect on competition.

The Director considers there to be a close inter-relationship among points (a) to (d) above. The ability to leverage from one market to another requires that the markets be *closely related*. Similarly, markets will be considered to be *closely*

\(^{218}\) Decision of the Office of Fair Trading, No CA98/05/2004, *First Edinburgh/Lothian*, 29 April 2004

\(^{219}\) Decision of the Director General of Telecommunications – *BT publishing its 118500 directory enquiries number on the front of the BT phonebook*, 23 December 2003
related where behaviour in one market is capable of materially affecting competition in another market. Unless there is dominance in the market(s) from which the leveraging takes place, there will be no materially anti-competitive effect in the closely related market.

On this basis, the Director has developed a three step test under which to analyse BT's conduct:

(i) Is there dominance?
(ii) Is there the ability to leverage from the dominant market into a closely related second market?
(iii) Has leveraging occurred (ie if point (ii) is satisfied, has BT’s conduct actually had a material adverse effect on competition in the closely related, second market)’

6.11 In considering the linkage between markets, OFTEL referred to Tetra Pak II and the need for a 'sufficient link' between the market on which BT was dominant (in this case the phone books market) and the market which it was allegedly engaged in leveraging conduct (in this case the telephone directory enquiries market).

6.12 OFTEL considered that the markets were sufficiently proximate and that it was feasible for action on the former to have an anti-competitive effect in the latter. In this case, OFTEL noted in particular BT's high market share on the legacy telephone directory enquiries market and its likely dominance in the primary phonebooks market, indicating that 'there is likely to be a strong connection in the mind of the consumer between the supply of number information services and directory products and BT'.

220 Ibid, paragraphs 27 – 29


222 Decision of the Director General of Telecommunications – BT publishing its 118500 directory enquiries number on the front of the BT phonebook, 23 December 2003, paragraph 96
6.13 In the OFT's non-infringement decision in Consignia,
 after identifying the 'special circumstances' requirement in Tetra Pak II, the OFT accepted that 'sufficiently close associative links' between the markets in question existed. These sufficiently close associative links were Consignia’s monopoly of the ordinary mail market and the vertical links between the ordinary mail market and the consumer lifestyle data market.

6.14 In conclusion and in the light of the relevant case law, the OFT considers that abusive conduct can be found on distinct but closely associated markets, where the conduct in question is likely to protect or strengthen the position on the dominated market. Further, there is precedent for the proposition that there can be an abuse of a dominant position where conduct on a market distinct from the dominated market produces effects on that distinct market, provided special circumstances, in particular, the existence of sufficiently proximate associative links between the markets in question, can be established.

6.15 The OFT considers that the case law is not particularly well-developed in respect of how closely linked the markets should be in order to underpin a finding of related market abuse. However, in the OFT's view, the associative links need not be as strong as those found in Tetra Pak II. The OFT notes that Tetra Pak II was an unusual case in which the anti-competitive effects occurred on the related market, rather than on the dominated market by strengthening the dominant position, and that in that scenario the links between the markets had to be stronger in order to warrant a finding of abuse.

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227 Ibid
B Alleged abuse – analysis of costs and revenues

6.16 The Court of Justice has defined the concept of an abuse as:

‘an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market, or the growth of that competition.’\(^{228}\)

Case law on predation

6.17 One of the ways in which an undertaking that holds a dominant position can abuse that dominance in such a way as to infringe UK or EU competition law is by engaging in predatory pricing behaviour.

6.18 The seminal case on predation is *AKZO*.\(^ {229}\) *AKZO*\(^ {230}\) states:

‘Prices below average variable costs (that is to say, those which vary depending on the quantities produced) by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive. A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss, namely the total amount of the fixed costs (that is to say, those which remain constant regardless of the quantities produced) and, at least, part of the variable costs relating to the unit produced.

\(^{228}\) Case 85/76, *Hoffmann-La Roche v Commission* [1979] ECR 461


\(^{230}\) Ibid
72. Moreover, prices below average total costs, that is to say, fixed costs plus variable costs, but above average variable costs, must be regarded as abusive if they are determined as part of a plan for eliminating a competitor. Such prices can drive from the market undertakings which are perhaps as efficient as the dominant undertaking but which, because of their smaller financial resources, are incapable of withstanding the competition waged against them.'

6.19 The ECJ in that case quotes extensively from the European Commission's decision itself (upheld on appeal by the Court), which made it clear that Article 86 [now 102] does not make costs the decisive criterion for determining whether price reductions by a dominant undertaking are abusive. A detailed analysis of the costs of the dominant undertaking might, however, according to the Commission in AKZO, be of considerable importance in establishing the reasonableness or otherwise of its pricing conduct. The Court quotes point 80 of the decision:

'The exclusionary consequences of a price-cutting campaign by a dominant producer might be so self-evident that no evidence of intention to eliminate a competitor is necessary. On the other hand, where the low pricing could be susceptible of several explanations, evidence of intention to eliminate a competitor or restrict competition might also be required to prove an infringement.'

6.20 The AKZO test has been followed in Tetra Pak II and most recently in the judgment of the Court of Justice in France Telecom. In France Telecom, the Court of Justice stated that:

\[\text{\textsuperscript{231}}\text{Ibid}\]

\[\text{\textsuperscript{232}}\text{In this respect, it is worth noting that the ECJ expressly indicated that the presumption that prices below AVC are predatory could be rebutted, or 'susceptible of [another] explanation'. The ECJ in AKZO did not discuss the period of time over which the AVC should be calculated}\]

\[\text{\textsuperscript{233}}\text{Case C-333/94P Tetra Pak International v Commission [1996] ECRI-5951. The Commission in Tetra Pak II had based its decision on the AKZO presumption that prices below AVC are predatory, and gathered further evidence to conclude that sales at a loss were the result of a deliberate policy aimed at eliminating competition; the Commission Decision also considered whether exceptional circumstances independent of Tetra Pak's will had forced it to make losses, but it had found none. Note that in Tetra Pak II the Court of Justice considered that}\]
'In order to assess the lawfulness of the pricing policy applied by a dominant undertaking, the Court, in paragraph 74 of *AKZO v Commission*, relied on pricing criteria based on the costs incurred by the dominant undertaking and on its strategy.

Thus, the Court of Justice has held, first, that prices below average variable costs must be considered prima facie abusive inasmuch as, in applying such prices, an undertaking in a dominant position is presumed to pursue no other economic objective save that of eliminating its competitors. Secondly, prices below average total costs but above average variable costs are to be considered abusive only where they are fixed in the context of a plan having the purpose of eliminating a competitor (see *AKZO v Commission*, paragraphs 70 and 71, and *Tetra Pak v Commission*, paragraph 41).’

6.21 However, the OFT also notes that, while the above quote from *France Telecom* (relying heavily on *AKZO* and *Tetra Pak II*) may suggest that a 'bright-line' cost test can be applied in the case of predation, the CAT judgment in *Aberdeen Journals* indicates that predation is an issue which must be looked at 'in the round', in particular taking account of whether the conduct has 'the effect of weakening or distorting competition in the relevant market.' The judgment notes:

>'Even where prices are below average variable costs, and despite the apparently peremptory wording of the judgments of the Court of Justice in *AKZO*, at paragraph 71 and *Tetra Pak II*, at paragraph 41, we do not exclude the possibility that, exceptionally, a dominant firm may be able to rebut the presumption of abuse.'

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prices below AVC must ‘always’ be considered abusive. At para 41 of the judgment the Court of Justice: ’Prices below AVC must always be considered abusive. In such a case, there is no conceivable economic purpose other than the elimination of a competitor, since each item and produced and sold at entails a loss for the undertaking.’

234 Case C-202/07 P, *France Télécom v Commission*, not yet reported

235 Ibid, paragraphs 108 – 109

236 Ibid, paragraphs 357 – 358. The OFT notes that the recent *Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings*) notes that
6.22 The OFT further notes that the presumption of predation arising as a result of pricing below AVC has been said to be rebuttable in the OFT’s *First Edinburgh/Lothian* case.\(^\text{237}\) In that case, the OFT concluded on the balance of the evidence that First Edinburgh was deliberately incurring losses in the short-run in an attempt to establish a more secure commercial basis for its Edinburgh operations and so compete more effectively with Lothian (the incumbent) in that market in the longer term. First Edinburgh was thus said not to have infringed section 18 of the Act.

6.23 The OFT notes that the European case law set out above, solely involves incumbents looking to eliminate competitors from the dominated market. However, ASW’s complaint is very different in that the complaint of predation is made against a new entrant by an incumbent, and not against the incumbent. ASW, the incumbent on the Newquay – London Gatwick route, is complaining about Flybe’s entry on to that route, alleging it is incurring losses in order to force ASW out of the market. Flybe states that such losses have been incurred in order to stimulate demand for a new service.

6.24 The OFT considers that that the case law as embodied in *AKZO*,\(^\text{238}\) *Tetra Pak II*\(^\text{239}\) and *France Telecom*\(^\text{240}\) provides a basis for assessing the conduct of dominant incumbents. The dominant undertakings involved in these cases were already active on the relevant market where the abuse took place. This can be distinguished from the situation in the present case where Flybe is clearly a new entrant on to the Newquay – London Gatwick route.

6.25 The OFT notes that there is little case law which deals squarely with the question of what constitutes predation when launching a new product or service in a new market.

\(^{237}\) Decision of the Office of Fair Trading No CA98/05/2004, *First Edinburgh/Lothian*, 29 April 2004


\(^{240}\) Case C-202/07 P, *France Télécom v Commission*, not yet reported
In this regard, the OFT notes the decision of the CAT in the Freeserve case, where the CAT stated that:

'There are as yet no decided cases as to whether a dominant undertaking may price below LRIC or AVC for a period on the grounds that it is launching a new product, and if so what that period might be.'

6.26 Further, the CAT commented that:

'We can see that, in the early stages of the introduction of a new technology such as broadband, it may take some time for the service to reach full profitability. At what point, however, the scale or duration of any initial losses in one market is to be judged to be an abuse of a dominant position held in an upstream or neighbouring market, or even in the market concerned, and on what criteria, is a matter of general importance which would need to be fully argued.'

6.27 The OFT is further mindful of a large array of academic and economic literature supporting the proposition that there are many pro-competitive justifications for below-cost pricing, and that a firm may price below its cost not only to predate, but also to promote a new product or enter a new market, reduce costs through learning-by-doing, or increase the value of its product through network externalities. Such dynamic efficiencies explain how the higher sales resulting from lower prices might increase future profits even with no exclusionary or disciplining effect.

6.28 In the OFT's view, it is clear from Freeserve that there may well be an important distinction to be made between pricing below cost when entering a new market and

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241 Freeserve.com plc v Director General of Telecommunications supported by BT Group plc [2003] CAT 5, paragraph 220

242 Ibid, paragraph 224

243 See, by way of example, for a fuller discussion 'A Three-Step Structured Rule of Reason to Assess Predation under Article 82'; Miguel de la Mano and Benoit Durand, December 2005 at ec.europa.eu/dgs/competition/economist/pred_art82.pdf

244 Freeserve.com plc v Director General of Telecommunications supported by BT Group plc [2003] CAT 5, paragraph 220
launching a new service and pricing below cost as the incumbent in order to deter a competitor. This distinction may be required in order not to prevent dominant companies from entering new markets.\textsuperscript{245} For this reason the OFT considers that the case law as embodied in \textit{AKZO},\textsuperscript{246} \textit{Tetra Pak II}\textsuperscript{247} and \textit{France Telecom}\textsuperscript{248} which deals with predation by incumbents may be of limited assistance in the particular circumstances of this case.

**Economic context in which to consider predation in this case**

6.29 External evidence and evidence from Flybe's route specific management accounts suggest that airlines often incur initial losses on entering routes, even in certain cases where there is no incumbent competitor, as it may take some time to stimulate demand.\textsuperscript{249}

\textsuperscript{245} See, for instance, Temple Lang and O’Donoghue in their joint article entitled 'Defining legitimate competition: How to clarify pricing abuses under Article 82 EC' published in the Fordham International law Journal 2002, Volume 82


\textsuperscript{248} Case C-202/07 P, \textit{France Télécom v Commission}, not yet reported

\textsuperscript{249} The OFT notes Temple Lang and O’Donoghue in their joint article entitled \textit{Defining legitimate competition: How to clarify pricing abuses under Article 82 EC}, published in the Fordham International law Journal 2002, Volume 82 have argued in connection with otherwise predatory conduct that there should be a defence available to a dominant company which:

'...is launching a product or service in a new market, and so inevitably the first sales, whatever the price charged, will not cover the average variable costs that are being incurred or have already been incurred. A defence on these lines must be permissible; otherwise dominant companies would be unable to enter new markets'

The OFT also notes Pozdnakova \textit{Liner shipping and EU competition law} (Kluwer Law International, 2008), page 370 where the author states:

'Supply of a shipping service at a decreased rate or below cost can be explained by the need of the dominant carrier to enter a new market. Therefore, prices below cost can be seen pro-competitively where a dominant liner shipping company is entering a new market and needs to set its rates below cost with a view to achieving the
6.30 The OFT notes the following views independently expressed by third parties, regarding initial losses made by airlines on entering routes. In *Aer Lingus v British Midland*, The European Commission commented that airlines would expect to incur some losses during an initial period, although they do not give an idea of how long the initial period would be: 250

‘When an airline commences a new service, it will normally expect to incur some losses during an initial period, during which it will have to organize economic operation of its service and to attract sufficient interest from the travel trade and from travellers. It cannot expe[ct] to attain the load factors and the revenue necessary to ensure profitable operations from the beginning of the service. Therefore new entry will always be difficult.’

6.31 Further, certain low cost carriers in Australia have been prepared to enter onto routes expecting losses for the first year or two after entry. 251

6.32 The OFT notes a presentation by Simat, Helliesen & Eichner (an aviation consultancy firm) which states that airlines often lose money when starting up new routes and that airlines' expectations on starting new routes is that they will make losses in year one, breakeven in year two and become profitable in year three. 252

necessary volume of sales, which will allow future costs to be reduced. In line with the discussion above, such campaign cannot be objectively justified if its objective is to eliminate a competitor operating on the new market. Therefore, it is unlikely that rates below average variable cost of the dominant carrier could be justifiable unless such low rates are indispensable for filling capacity employed on a new market'  


252 The OFT refers to slide 3 of a presentation by Eliot Lees of Simat, Helliesen & Eichner (an aviation consultancy firm) dated 16 March 2010 (available at www.sh-e.com/presentations/lees_2_031610.pdf), which states that airlines often lose money when starting up new routes and that airlines' expectations on starting new routes are that they will make losses in year one, breakeven in year two and become profitable in year three. The OFT also notes slide 2 in a presentation entitled ‘Route Planning and Evaluation’ prepared by Dr Peter P Belobaba, dated 15 March 2006 (which can be found at http://ocw.mit.edu/courses/aeronautics-and-astronautics/16-75j-airline-management-spring-2006/lecture-notes/) which states: ‘Strategic considerations can overlook lack of route profit: Longer term competitive and market presence benefits of entering a new route even if it is expected to be unprofitable in short run’
6.33 Therefore, the OFT regards that in considering entry on to a new route in the economic context of the airlines market, caution should be exercised when drawing conclusions based on the analysis of revenues and costs in the initial period after entry. Incurring a loss on entry may evidence normal competition in this context, rather than abuse.

6.34 In traditional predation cases involving incumbents attempting to deter new entrants, the case law\(^{253}\) considers, amongst other things, whether revenues exceed average variable costs (AVC). In this case the OFT has taken average avoidable costs (AAC) as the appropriate measure. Following the EC Commission’s Guidance,\(^{254}\) the OFT considers that AAC is the average of the costs that could have been avoided if the company had not produced a discrete amount of (extra) output, in this case the amount allegedly the subject of abusive conduct. In most cases, AAC and the AVC will be the same, as it is often only variable costs that can be avoided.\(^{255}\)

6.35 The OFT considers that the time period over which a route might build up to profitability will vary across routes hence the relevant time period over which to assess whether cumulative AAC have exceeded revenues on the Newquay – London Gatwick route where Flybe is a new entrant rather than an incumbent is unclear.\(^{256}\)


\(^{255}\) Ibid, at paragraph 64, footnote 3 states:

‘In most cases the AVC and AAC will be the same, as often only variable costs can be avoided. However, in circumstances where AVC and AAC differ, the latter better reflects possible sacrifice: for example, if the dominant undertaking had to expand capacity in order to be able to predate, then the sunk costs of that extra capacity should be taken into account in looking at the dominant undertaking’s losses. Those costs would be reflected in the AAC, but not the AVC’

\(^{256}\) The OFT notes Freeserve.com plc v Director General of Telecommunications supported by BT Group plc [2003] CAT 5 at paragraph 220 where the CAT stated that:

‘There are as yet no decided cases as to whether a dominant undertaking may price below LRIC or AVC for a period on the grounds that it is launching a new product, and if so what that period might be.’
does not consider it necessary, in this case, to reach a concluded view on the exact period over which AAC must be recovered following entry in order to avoid a finding of abuse. It has focused on the length of time over which Flybe anticipates recovering AAC, and whether in the economic context of this market, that is a reasonable period in which to establish market presence on this route.

The analysis of costs and revenues

Flybe's costs and revenues on the Newquay – Gatwick route

6.36 Taking into account the European Commission’s Guidance\(^\text{257}\) the OFT has considered whether Flybe’s AAC from entering the Newquay – London Gatwick route have exceeded its revenues.

6.37 The OFT considers that, as Flybe is an entrant on the Newquay – London Gatwick route, it is also relevant to consider the pattern of Flybe’s returns that may be expected from entry on to a new route.\(^\text{258}\)

6.38 In undertaking its assessment of whether AAC are in excess of revenue, the OFT has assessed Flybe’s actual and forecast data. Flybe has provided the OFT with actual


\(^{258}\) The OFT notes that in Wanadoo UK plc (formerly Freeserve.com plc) and Office of Communications supported by BT Group plc [2005] CAT 7, the CAT stated:

‘Although there is some overlap between the two matters, that is to say the present appeal and the ongoing investigation, in our view the present Appeal does raise a discrete issue, namely, what is the proper approach by a dominant firm to pricing of a new product in a new market by what may be called loosely ‘penetration pricing’? Behind that question is an issue of real public importance, which is the extent to which the Regulator can intervene on an ex ante basis in a case of alleged predation and, if the Regulator does so, on what basis should predation be judged in the very early stages of development of a new market? In particular, should any alleged predatory conduct be assessed on the basis of business or economic projections of what the business may reasonably have known of foreseen at that time, or should the matter be judged on the basis of such historical cost information that is then available, or subsequently becomes available to the Regulator in the course of investigating the complaint, and the decision is taken?’
financial information for the first 18 months of operations (February 2009 – July 2010). In addition, Flybe has provided the OFT with forecast data for the first three years of operation. The financial evidence suggests that Flybe’s revenue was insufficient to cover AAC in its first year after entry and that it only forecast revenue to catch up with AAC in the second year of operation. On a cumulative basis, revenue was only forecast to exceed AAC in year four.

6.39 The European Commission Guidance notes that failure to cover LRAIC in a market indicates that an equally efficient competitor could be foreclosed from that market. The OFT considers that there is no distinction between LRAIC and AAC in this case, as AAC should also include fixed costs involved in setting up the route, as these would have been avoided had Flybe not decided to enter.

6.40 The OFT considers that, as its cost analysis shows that Flybe’s AAC have exceeded its revenues on the Newquay – London Gatwick route in its first 18 months of operation, this also implies that Flybe’s LRAIC have exceeded revenues in this period.

6.41 Flybe has submitted its view that ASW is an inefficient competitor and has been able to continue operation on the Newquay – London Gatwick route. As such, it cannot be said that its conduct would exclude an as efficient competitor when even an inefficient competitor is not excluded.

6.42 The OFT disagrees with this analysis. The OFT considers that the as-efficient competitor test should not take into account the efficiency or otherwise of ASW but rather should focus on Flybe’s costs and revenues. In addition, the as-efficient competitor analysis is not a tool for determining whether conduct will exclude competitors, but whether it is capable of doing so. The OFT’s view is the fact that an actual competitor manages to hold its market presence in the face of abusive conduct does not prevent the conduct being abusive.


260 Flybe submission of 28 July 2009, pages 49 and 50

261 In this regard, the OFT notes paragraphs 196 – 204 of the Court of Justice’s judgment of 14 October 2010 in Case C-280/08 P, Deutsche Telekom AG v Commission
6.43 In addition to Flybe’s forecast data, internal documentation shows that it was aware that it would make losses on the Newquay – London Gatwick route. For example, a paper from a senior Flybe executive to other senior Flybe executives stated:

‘unless ASW pull or seek to sell out to us the NQY [Newquay]-LGW [London Gatwick] will be loss making for at least 18 month. Our best chance of reducing investment losses would be with a summer launch; this would also give ASW plenty of time to think of the consequences, perhaps leading Sutton Harbour to review its commitment to the Airline sector’ 262

Flybe’s costs and revenues when entering other routes

6.44 The OFT has considered Flybe’s conduct on other routes as a benchmark for Flybe’s conduct in this case. The OFT notes that the extent of losses projected by Flybe on the Newquay – London Gatwick route in its first year of operation are large, but are on a similar scale to those incurred on other routes. The OFT does not have evidence to suggest that Flybe possesses a dominant position on any of these comparator routes such as to indicate that predatory abuse may be behind the losses incurred on those routes.263 As such, the OFT does not consider the extent of losses below AAC projected by Flybe on the Newquay – London Gatwick route for the first year of operation alone is conclusive evidence of sacrifice. It appears simply to be an inherent part of what is required to enter a new route, in the economic context of the airlines market.

6.45 A more detailed analysis of the revenues and costs incurred by Flybe on the Newquay – London Gatwick route and the results of the analysis benchmarking Flybe’s performance against other routes are contained in Annexe B.

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262 A paper written by a senior Flybe executive for the attention of other senior Flybe executives dated 15 September 2008

263 The OFT has not investigated in detail the market position of Flybe in each of the comparator routes it has entered. However Exeter Airport is the only airport in the UK from which Flybe is the only significant scheduled airline
Flybe's explanation for entering Newquay – London Gatwick

6.46 This section looks at Flybe’s explanation of the commercial reasoning behind its decision to enter the route to ascertain whether the evidence supports predatory intention on Flybe’s part or whether its decision to enter the Newquay – London Gatwick route was underpinned by a plausible commercial rationale.

6.47 The OFT notes that the European Commission’s guidance on Article 102 states:

‘However, the concept of sacrifice does not only include pricing below AAC. In order to show a predatory strategy, the Commission may also investigate whether the allegedly predatory conduct led in the short term to net revenues lower than could have been expected from a reasonable alternative conduct, that is to say, whether the dominant undertaking incurred a loss that it could have avoided.’

6.48 Flybe’s explanation for launching the Newquay – London Gatwick route, which was projected to lose £2.4m in the first year of operation, was that it decided to focus its limited new capacity deployment on the 'once in a generation' chance to establish a major position at London Gatwick, which led to Flybe launching new lines of flight from London Gatwick to Newquay, Dusseldorf and Leeds Bradford. Further, Flybe was able to acquire peak time slots at London Gatwick [...]. Flybe has also stated that it wanted to develop a London base as it would establish credibility for the airline.

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265 Ibid, paragraph 64 – 66

266 ‘The operation of Flybe’s business’, Submission to the OFT of 24 June 2009, paragraph 74

267 ‘Responses to OFT request for information under section 26 Competition Act 1998’, Flybe submission to the OFT of 12 June 2009, annex 1, page 6

268 Document entitled ‘Section 2 to the OFT’s Section 26 Notice dated 13 August 2009 – Requests for statements to be set in context and/or explanations of facts contained within documents’, which was supplied with a letter from Flybe’s legal advisers to the OFT dated 7 September 2009, page 12
Flybe submits that its reasons for launching the Newquay – London Gatwick route in particular were that it believed it would be profitable for the following reasons:  

- It saw an opportunity to provide a hub/interline connection at London Gatwick which was not being served because ASW and Ryanair did not participate in the Global Distribution System (GDS). As Newquay Airport had no other hub links, Flybe expected this to be a significant market opportunity.

- The potential market was under stimulated owing to ASW’s high pricing and its need to split traffic from Plymouth Airport, which pushed up yields and suppressed demand from Newquay Airport.

- The Ryanair service on the Newquay – London Stansted route had a history of volatility in the number of rotations deployed which suggested Ryanair may not be strategically committed to the route.

- Flybe had optimal economic aircraft for the sector length and market size.

- ASW had little or no marketing brand profile in the London/south east area and was therefore failing to stimulate the market. Flybe’s national brand meant it could successfully compete with Ryanair and bring more air passengers from the south east to the route.

- Flybe believed that ASW was an inefficient operator (high cost/high pricing/no national brand) and that Flybe would be able to stimulate the market by more effectively competing with other forms of transport.

- Other possible UK domestic destinations from London Gatwick were already served by multiple carriers.

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269 ‘The operation of Flybe’s business’, Submission to the OFT of 24 June 2009, paragraph 69-71


271 Sector refers to a single journey leg of a flight
6.50 The OFT notes that there is little contemporaneous documentary evidence which directly supports or contradicts Flybe’s assertions in this regard.

6.51 That said, evidence obtained from Flybe indicates that, originally, it planned to launch the Newquay – London Gatwick route at the start of the summer 2009 season. However, Flybe has informed the OFT that it decided to launch the Newquay – London Gatwick route earlier in order to retain grandfather rights to slots at London Gatwick. As Flybe had to launch the Newquay – London Gatwick route earlier than would have been ideal, the OFT notes that this may have had a negative impact on the first year profitability of the route.

6.52 The OFT notes that Flybe’s internal documentation supports the conclusion that the acquisition of slots at London Gatwick was a high commercial priority. It also considers that Flybe’s explanation that slots at London Gatwick are typically very scarce, and as such, that their availability represented a valuable opportunity to establish a major position at the airport is credible, particularly as London Gatwick’s runway capacity limitations are well-documented.

6.53 Further, the OFT considers that Flybe’s explanation of its strategic reasons for entering on to the Newquay – London Gatwick route in particular have a plausible commercial rationale. From the evidence the OFT has seen, Flybe viewed the Newquay – London Gatwick route as one that would be profitable over time, rather than one it thought was likely to fail. This would suggest that Flybe’s decision to enter on to the Newquay —

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272 Internal Flybe paper provided to the OFT on 24 June 2009 in response to the OFT’s section 26 notice to Flybe dated 18 May 2009, paragraph 5(a)

273 A system whereby slots are granted to airlines that have used them historically

274 ‘The Operation of Flybe’s business – Action taken to comply with OFT Section 26 letter’, Flybe submission to the OFT of 24 June 2009, paragraph 79

275 ‘Responses to OFT request for information under section 26 Competition Act 1998’, Flybe submission to the OFT of 12 June 2009, annex 1, page 2

– London Gatwick route was underpinned by a normal commercial rationale rather than a predatory one.

C Assessment of evidence regarding the alleged related market abuse and the strength of any associative links

6.54 In Section 3 above the OFT explained that in order to understand whether Flybe stood to protect or strengthen any dominant position on the Exeter Airport Markets, the OFT has examined whether ASW's exit from the Newquay – London Gatwick route would:

- result in the wider exit of ASW from operating air services in Devon and Cornwall and, in particular, would lead to the closure of ASW's services from Plymouth Airport
- result in another airline entering at Plymouth Airport and acting as a competitive constraint on Flybe on the Exeter Airport Markets thus preventing Flybe from enhancing or strengthening its dominant position on the Exeter Airport Markets.

6.55 In the paragraphs which follow, we examine whether there is sufficient evidence that the associative links are sufficiently proximate in this case.

ASW’s exit would protect or strengthen Flybe’s dominant position at Exeter Airport

6.56 In the OFT’s view the first question to consider is whether Flybe stood to gain at Exeter Airport (and particularly on the Exeter Airport Markets) from the demise of ASW at Plymouth Airport in order to understand whether Flybe had a possible rationale for allegedly employing the dominant position that it holds on the Exeter Airport Markets in the Newquay – London Gatwick market with a view to excluding ASW.

6.57 For Flybe's entry on to the Newquay – London Gatwick route to foreclose competition from ASW routes out of Plymouth Airport and benefit Flybe's routes at Exeter Airport, the OFT considers that ASW must exert a degree of actual or potential competition on Flybe's routes at Exeter Airport, such that this competition would be lost in the event that ASW were to cease operations.
As noted in paragraphs 5.22 and 5.23 above, the OFT has not concluded on whether ASW's flights on routes from Plymouth Airport are a constraint on Flybe's routes from Exeter Airport such that they should be considered in the same market. The OFT also considers that, due to the relatively small number of passengers carried by ASW on routes from Plymouth Airport in comparison to the number of passengers carried on routes operated by Flybe from Exeter Airport, the actual constraint imposed by ASW at Plymouth Airport is likely to be weak. Further, the OFT has noted in paragraph 4.76 that internal Flybe emails suggest that the degree of actual competition is limited.

With regard to potential competition, the OFT notes the documentary evidence which shows Flybe wanted to prevent a third party airline acquiring ASW in order to prevent the development of significant competition for Flybe in particular regions were Flybe operates flights.\(^{277}\)

In this regard, a senior Flybe executive offered his thoughts on what Flybe should do:

'I strongly believe that given our strategic objectives, we should enter the market with force and announce this very soon. It must be very a very determined and high profile move to bring ASW to the table and to stop [...] buying it. A combination of [...] and an airline covering [...] is a dangerous and potentially costly combination for us.'\(^{278}\)

In fact, Flybe has told the OFT that a combined entity consisting of [...] would represent a significant competitive threat to be addressed.\(^{279}\) This evidence suggests that Flybe believed there to be a significant threat of competition, or potential competition, from the existence of ASW's operations at Plymouth Airport.

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\(^{277}\) This evidence includes emails from senior executives or senior employees of Flybe to other senior executives, senior employees and/or non-executive directors of Flybe

\(^{278}\) Email from senior Flybe executive to other senior Flybe executives dated 4 December 2008

\(^{279}\) See document entitled 'Section 2 to the OFT’s Section 26 Notice dated 13 August 2009 – Requests for statements to be set in context and/or explanations of facts contained within documents', which was supplied with a letter from Flybe’s legal advisers to the OFT dated 7 September 2009, page 20
6.62 On this basis, the OFT considers that in undermining ASW's viability overall, Flybe would be expected to strengthen and/or protect its dominant positions on the Exeter Airport Markets. In this regard, it would benefit particularly from the diversion of passengers travelling to Jersey and Guernsey from Plymouth Airport. It would also be able to profitably raise prices on the Exeter Airport Markets.

6.63 The OFT's above view is based on documentary evidence provided by Flybe in relation to its interest in acquiring ASW. This documentation indicates that Flybe believed it would gain former Plymouth Airport passengers at Exeter Airport in the event of the closure of Plymouth Airport. In this regard, on 4 December 2008, a senior executive at Flybe emailed a non-executive director setting out his thoughts on a potential scenario if Plymouth Airport were to close:

'Another thought is for us to seek a meeting with ASW just before we announce and make an offer for the company with a guarantee that we will continue to operate the PLH [Plymouth]-NQY [Newquay] service for 12 months which gives them time to organise a timely closure of PLH [Plymouth] airport. We would benefit from the cessation of all other ASW routes which would benefit our network from EXT [Exeter Airport] and potentially increase interline traffic on lgw [London Gatwick] route...'

6.64 Flybe, however, has submitted that the small potential increase in the number of passengers that would use Exeter Airport as a result of ASW's operations at Plymouth Airport closing would not support an argument that Flybe had the incentive to predate. The OFT has considered whether the likely revenue from diversion and from raising prices on the Exeter Airport Markets would, in fact, support such an incentive.

6.65 The OFT notes that not all of the passenger diversion from Plymouth Airport, in the event of ASW ceasing operations, would go to Exeter Airport. In the OFT's view, some passengers may switch to Bristol Airport, switch to rail or may not travel at all. Flybe has submitted that it believes, based on its previous experience, the passenger

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280 Email from senior Flybe executive to non-executive director of Flybe dated 4 December 2008

281 Letter from Flybe's legal advisers to the OFT dated 4 December 2009

282 Ibid
diversion ratio from Plymouth Airport, in the event of ASW’s closure, would be in the region of 25 per cent to 33 per cent.\textsuperscript{283}

6.66 The OFT considers this assumption to be conservative. The OFT has made this assessment on the basis of data contained in the CAA passenger survey, which shows the proportion of passengers originating in the Plymouth district, from where Plymouth Airport draws the majority of its catchment,\textsuperscript{284} who currently travel to Bristol Airport or Exeter Airport. More than four times as many passengers in the Plymouth district travel to Exeter Airport than to Bristol Airport in respect of all the routes apart from the Dublin route. This suggests that more than 80 per cent of passenger diversion to the two airports would go to Exeter Airport. As Flybe has noted,\textsuperscript{285} a certain proportion of passengers may divert to other modes of transport or not travel. The OFT, however, considers that this proportion is likely to be considerably smaller than implied by Flybe’s estimate of passenger diversion to Exeter Airport of 25 to 33 per cent.

6.67 In any event, the revenues diverted are considerable based on Flybe’s assumption. The following table illustrates estimates of the possible revenue diversion from ASW routes at Plymouth Airport to Flybe routes at Exeter Airport, were Plymouth to close. This is based on Flybe’s assumption.

\begin{table}
\centering
\begin{tabular}{|c|c|}
\hline
\textbf{ASW Route} & \textbf{Flybe Route} \\
\hline
\textbf{Dublin} & \textbf{London} \\
\textbf{Edinburgh} & \textbf{Manchester} \\
\textbf{Birmingham} & \textbf{Sheffield} \\
\hline
\end{tabular}
\caption{Revenue Diversion Estimates}
\end{table}

\textsuperscript{283} In the table below assume revenue diversion is assumed to be proportional to passenger diversion

\textsuperscript{284} See paragraph 4.74

\textsuperscript{285} Letter from Flybe’s legal advisers to the OFT dated 4 December 2009
Table 6.1: Recoupment from diversion of passengers from Plymouth to Exeter

<table>
<thead>
<tr>
<th></th>
<th>ASW revenue 2008/09</th>
<th>25% diversion</th>
<th>33% diversion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manchester</td>
<td>£1,048,250</td>
<td>£262,063</td>
<td>£345,923</td>
</tr>
<tr>
<td>Leeds – Bradford</td>
<td>£601,415</td>
<td>£150,354</td>
<td>£198,467</td>
</tr>
<tr>
<td>Jersey</td>
<td>£694,348</td>
<td>£173,587</td>
<td>£229,135</td>
</tr>
<tr>
<td>Newcastle</td>
<td>£652,802</td>
<td>£163,201</td>
<td>£215,425</td>
</tr>
<tr>
<td>Glasgow</td>
<td>£1,101,099</td>
<td>£275,275</td>
<td>£363,363</td>
</tr>
<tr>
<td>Dublin</td>
<td>£304,107</td>
<td>£76,027</td>
<td>£100,355</td>
</tr>
<tr>
<td>Guernsey</td>
<td>£231,449</td>
<td>£57,864</td>
<td>£76,378</td>
</tr>
<tr>
<td><strong>TOTAL DIVERSION</strong></td>
<td><strong>£1,158,368</strong></td>
<td><strong>£1,529,046</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: ASW data, Flybe submission

6.68 As set out in paragraph 5.82, the OFT considers that Flybe is dominant on the Exeter – Jersey and Exeter – Guernsey routes, and as such may be able to raise prices in the event of ASW ceasing operations. Assuming a five per cent price rise, Flybe’s total revenue gain at Exeter Airport from raising prices on these routes would be approximately £200,000 per annum. Flybe would also be able to raise its prices on other routes to a lesser extent where there is a diversion of passengers from Plymouth but it is not dominant, but would be constrained by competition with Bristol Airport in doing so.

6.69 Both the estimates for Flybe’s gain from diversion and from raising its prices on the routes on the Exeter Airport Markets have been assessed in terms of revenue. Flybe may face additional costs if it has to change its capacity to meet the additional demand, but the relatively low load factors on these routes (approximately 60 per cent) suggest that this effect would be minimal. Based on the estimates above, Flybe would gain at least £1.3 million per year from the closure of Plymouth Airport, and potentially considerably more. Further, it would considerably protect and strengthen its dominant position on the Exeter Airport Markets.

6.70 Flybe's projected first year losses on the Newquay – London Gatwick route were approximately £2.4 million, after which it was predicted to become significantly more profitable. The analysis of Flybe’s profitability on other routes suggests that Flybe may currently be incurring losses because of need to stimulate demand on the route, and will be able to recoup them in time. However, from the evidence on the likely diversion
from Plymouth Airport, it also appears that Flybe would be able to recoup these losses in a relatively short length of time were Plymouth Airport to close.

6.71 Were Flybe to successfully exclude ASW from all operations and no replacement airline were to enter Plymouth, the OFT believes on relatively conservative calculations that Flybe could expect to benefit at Exeter Airport by at least £1m per year and significantly strengthen its dominant position on the Exeter Airport Markets. To this end, the OFT considers that there was a plausible rationale for Flybe to look to eliminate ASW.

**Conduct capable of excluding ASW and closure of its services at Plymouth Airport**

6.72 Given that the OFT considers that there is a plausible rationale for Flybe to look to eliminate ASW, the question arises as to whether it was capable of so doing.

6.73 With regard to whether Flybe's entry was capable of undermining the viability of ASW as an airline, the OFT considers that airlines typically have a number of routes, which would normally be expected to cover incremental costs.\(^\text{286}\) In order for the airline to be profitable in the long run, its routes would collectively contribute enough above incremental costs to cover the overheads of the airline. A larger airline is able to spread its overheads over a large number of routes, whereas a smaller airline will have to rely on only a small number of routes to do so. As a consequence, airlines with a smaller number of routes may be more exposed to risks from negative demand shocks, competition or exclusionary behaviour on particular routes, to the extent that they are unable to cross subsidise these losses with gains from other routes.

6.74 The OFT notes that Flybe operates 203 routes across 13 countries. Its turnover in 2008/09 was £572.4m and it made a profit of £4.1m after tax.\(^\text{287}\) This is in stark contrast with ASW, which is a relatively small airline, only operating 26 routes.\(^\text{288}\)

\(^{286}\) Costs which would be incurred by operating the route, compared to those that would have obtained if it did not operate the route


\(^{288}\) [www.airsouthwest.com/](http://www.airsouthwest.com/)
ASW’s turnover in 2008/09 was £22m, and it made a profit of £350,000. ASW is a subsidiary of SHH which had a turnover in 2009 of £29.3m and made a loss of £3.4m. The OFT considers that this difference in scale will make a significant contribution to Flybe’s ability to withstand losses on an individual route.

6.75 ASW has submitted to the OFT that the Plymouth – Newquay – London Gatwick route is the only mature route on its network, that it represented the majority of ASW’s profitability and that it was widely understood externally to be ASW’s core route. Further, documentary evidence from Flybe, described below, suggests that Flybe believed ASW to be reliant on profits from the Newquay – London Gatwick route.

6.76 However, the OFT considers that evidence from ASW finances casts some doubt as to the extent to which profits on Newquay – London Gatwick cross-subsidised losses on other routes in reality. To this end, the OFT notes that ASW’s response of 18 August 2009 indicates that while the loss on this route for 2009/10 is now projected to be approximately £1.7m, the route in fact only made a modest profit of £157,000 for 2008/9. As Flybe’s entry on this route only took place halfway through February 2009, it appears unlikely that this was a significant factor in the performance in 2008/9. In comparison, the OFT notes that the aggregate performance of all non-London connected routes is projected by ASW to be profit neutral for 2009/10. As such, some of these routes will be projected to make a significant positive contribution to ASW’s overheads, and might be viewed as supporting ASW’s overall operations.

6.77 The OFT also notes that ASW’s operations are heavily focused on Plymouth Airport. Certain commentators have questioned the capacity of Plymouth Airport to support further expansion given the restricted length of its runway and the consequent limited number of aircraft which can operate on such short runways. The OFT considers that the restrictions imposed by the constraints at Plymouth Airport may prevent ASW from operating the most efficient aircraft on the routes it serves and as a result make ASW a little more vulnerable to fierce competition on such routes.

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289 ASW submission to the OFT, 9 March 2009, para 2.11

6.78 Some of the documentary evidence provided by Flybe shows that it believed ASW to be in a financially vulnerable position, such that by entering on to the Newquay – London Gatwick route, it would cause ASW to shut down its operations at Plymouth Airport. However, the OFT notes that there is a danger that statements simply indicating legitimate strong rivalry between competitors may be incorrectly interpreted as evidencing a clear and unlawful intention to eliminate a competitor. Nonetheless, the OFT sees benefit in setting out the relevant documentary evidence to allow it to be considered and weighed in the balance in making its Decision.

6.79 In early December 2008, a senior Flybe executive emailed other senior Flybe executives, setting out the details of his conversation with an individual that had worked in the airline industry. The email contained the following statements amongst others:

'It is a one route airline in terms of profitability. The LGW [London Gatwick] route is a rich route which is the cornerstone of the airline. The other routes are not making money with their other good route, Plymouth-Bristol-Manchester falling into losses. They are in a very vulnerable position... [...] said no way could ASW survive without the LGW [London Gatwick]-NQY [Newquay] operation. [...] suggested that the Group is at its most vulnerable with the share price in the low £0.40's and their core business in decline at the moment...[...] agreed that there is

291 In the OFT’s view it is important to consider the assertions of executives carefully. For instance, Temple Lang and O’Donoghue in their joint article entitled 'Defining legitimate competition: How to clarify pricing abuses under Article 82 EC' published in the Fordham International law Journal 2002, Volume 82 state at page 140:

'... all profit-maximising companies 'intend' to eliminate their rivals and the most obvious way of doing this is through price competition. It is almost impossible to distinguish between the 'intent' that the antitrust laws should prohibit and the 'intent' they encourage. One U.S. Circuit Court vividly described the problems with penalizing intent as follows:

[F]irms 'intend' to do all the business they can, to crush their rivals if they can...Rivalry is harsh, and consumers gain the most when firms slash costs to the bone and pare price down to cost, all in pursuit of more business. Few firms cut price unaware of what they are doing; price reductions are carried out in pursuit of sales at others’ expense. Entrepreneurs who work hardest to cut their prices will do the most damage to their rivals, and they will see good in it. You cannot be a sensible business executive without understanding the link among prices, your firm’s success, and other firms' distress. If courts use the vigorous, nasty pursuit of sales as evidence of a forbidden ‘intent’, they run the risk of penalizing the motive forces of competition.'
a possibility that a sustained battle could pull the Group down in the current climate.'

'ASW and Sutton Harbour Group. Very vulnerable at the moment with the possibility of the group going into a loss situation. In no state to withstand a long term battle.'

6.80 Following Flybe’s decision, in principle, to launch the Newquay – London Gatwick route, a senior executive of Flybe sent an email to other senior Flybe executives in early December, expressing his view on ASW and Sutton Harbour Holdings:

'You will see from the Executive Summary that my overall impression is SHH could not sensibly withstand a £2m+ loss of revenue on ASW’s only profitable route for any period of time, nor would its financiers and shareholders allow it to. Risks to this assumption include:

- SHH decides to continue to fight on LGW [London Gatwick]-NQY [Newquay] – this has been factored into our forecast loss on the route in 09/10.
- SHH finds a buyer for ASW – […] may have a view on this following recent meetings.
- SHH successfully realises significant value on regeneration projects – a possibility, but unlikely in the current environment'.

6.81 The OFT considers that the documents are evidence that Flybe believed that it would be able to withstand significant losses on the Newquay – London Gatwick route, and by doing so would also force ASW to also incur negative returns on the route. This evidence also suggests that in so doing, Flybe believed that it could potentially undermine the overall viability of ASW including its operations from Plymouth Airport.

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292 Email from senior Flybe executive to other senior Flybe executives dated 4 December 2008

293 Email from senior Flybe executive to other senior Flybe executives dated 8 December 2008

294 In this context, the OFT also notes a paper written by a senior Flybe executive for the attention of other senior Flybe executives dated 15 September 2008 which stated:
6.82 However, the OFT also notes, with particular reference to the email described at paragraph 6.80 above, that Flybe believed that SHH might continue to fight on the Newquay – London Gatwick route or that SHH might find a buyer for ASW. The OFT therefore considers that, while Flybe executives may have believed that the exit of ASW from Plymouth Airport was a potential consequence of Flybe’s entry, there may have been a considerable element of uncertainty in this belief. Further, this apparent belief needs to be weighed in the balance with more concrete facts and, in this regard, as noted in paragraphs 6.52 – 6.53 above, the OFT considers that Flybe’s explanation of its strategic reasons for entering on to the Newquay – London Gatwick route has a plausible commercial rationale, and therefore that Flybe may well have launched the route irrespective of any effect on ASW.

6.83 Flybe contends that ASW has not been harmed by Flybe’s entry on to the Newquay – London Gatwick route. In support of its contention, Flybe has submitted the following points:

- Flybe’s entry onto the route has had a far greater impact on Ryanair’s route from Newquay to Stansted than on ASW.

- ASW has expanded its customer offering since Flybe entered the route by opening two new routes, from Plymouth to London City Airport via Newquay, and from Plymouth to Guernsey.

- ASW has entered the Global Distribution System (GDS).

'unless ASW pull or seek to sell out to us the NQY [Newquay]-LGW [London Gatwick] will be loss making for at least 18 month. Our best chance of reducing investment losses would be with a summer launch; this would also give ASW plenty of time to think of the consequences, perhaps leading Sutton Harbour to review its commitment to the Airline sector.'

Further, to the extent that ASW’s routes cover incremental costs it is not necessarily an inefficient airline. Most airlines tend to have this feature that they cover their overheads from a subset of routes. ASW is particularly vulnerable because such a high proportion of its overheads appear to be covered on the one route

295 Letter from Flybe’s legal advisers to the OFT dated 4 December 2009
With respect to ASW’s performance on the Newquay – London Gatwick route, Flybe has provided evidence of passenger carryings from CAA data. This shows that for the period April to September 2009 ASW’s passenger numbers fell by five per cent in comparison to the same months in 2008, while Ryanair’s fell by 52 per cent in the same period. Flybe has submitted that the reason that it has managed to take a large share of passengers from Ryanair and not from ASW is that it entered with a low fare model similar to Ryanair, but that for most passengers London Gatwick was a preferred alternative to London Stansted.

The OFT considers that this evidence is consistent with Flybe’s entry on to the Newquay – London Gatwick route having an impact on Ryanair as well as on ASW. It notes, however, that Flybe’s entry may have had an impact on ASW’s prices as well as on its passenger carryings, in that ASW is likely to have lowered prices in a competitive response to Flybe’s entry. In this regard, ASW has submitted that Flybe’s entry has resulted in a reduction in yields of […] per cent.

With respect to Flybe’s other contentions, the OFT notes that ASW did launch a twice daily service on the Plymouth – Newquay – London City route (which has recently been withdrawn) and another new route between Plymouth Airport and Guernsey subsequent to Flybe’s entry on to the Newquay – London Gatwick route. The OFT is also aware of ASW’s entry into the GDS system, which may also have significant costs associated with it. The OFT considers that these various actions, risks and expansions appear to be at odds with the cost-cutting behaviour and retrenchment normally to be expected of a company in financial difficulties. Further, the OFT considers that were ASW to exit the airline market in Devon and Cornwall, the restrictions imposed on the types of aircraft which can operate out of Plymouth Airport may be a contributing factor in any such exit by making ASW more vulnerable to fierce competition on the routes it serves because it cannot operate the most efficient aircraft.

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296 Document provided to the OFT by Flybe at a meeting on 30 July 2009 entitled ‘Chart of passengers carryings on Newquay – London, Flybe’s effect on the passenger carryings of Ryanair and Air South West’, page 9

297 Ibid

298 Letter from ASW to the OFT dated 14 August 2009

6.87 However, the OFT notes that SHH decided to put ASW up for sale in May 2010, citing significant losses and the negative impact of difficult economic, trading and environmental factors. That said, press reports at the time SHH made this announcement indicated that there were parties interested in acquiring ASW. Further, SHH announced in September 2010 that it had reached agreement to sell ASW to Eastern Airways, subject to regulatory approval. The proposed deal appears to envisage the continuation of ASW’s services under the ASW brand which may suggest that Eastern Airways is likely to take on some or all of ASW’s routes and potentially act as a constraint on Flybe. This, in turn, casts some doubt as to whether Flybe has the ability to exclude ASW or its successor. The likelihood, during the OFT’s investigation, of another airline replacing ASW at Plymouth Airport is dealt with in the following paragraphs.

Replacement airline at Plymouth Airport

6.88 As detailed above, while the OFT is now aware that SHH reached agreement to sell ASW to Eastern Airways, subject to regulatory approval in September 2010, during the course of its investigation the OFT considered, whether, were ASW to cease operation, another airline would be likely to replace the competitive constraint ASW imposed on the Flybe Focal routes.

6.89 As set out in paragraph 5.55 above, the OFT considers the only barrier to entry at Plymouth Airport is the short runway. Further, it considers that airlines noted by ASW as possessing aircraft suitable for use on Plymouth Airport’s short runway would be

301 www.thisisplymouth.co.uk/news/Airline-sale/article-2219264-detail/article.html
304 Ibid
able to switch aircraft on to routes leaving from Plymouth Airport were a profitable opportunity to present itself.

6.90 In addition, the OFT considers that were ASW to be forced to cease operations, its aircraft may become available to a third party airline that would be able to operate from Plymouth Airport.

6.91 The OFT considers that the proposed sale of ASW to Eastern Airways and the apparent proposed continuation of services under the ASW brand gives some credence to the prospect of another airline replacing ASW at Plymouth Airport. In addition, the OFT notes that Flybe’s internal documentation\(^{305}\) and explanation\(^{306}\) of the same cites a potential threat from a third party airline purchasing ASW. It is clear to the OFT that Flybe considered this potential threat to be a real and present danger to its business. As such, it determined to minimise this potential threat by entering on to the Newquay – London Gatwick route in a forceful manner and sooner than it wanted to.

6.92 The OFT notes that market developments concerning the third party airline which Flybe feared would purchase ASW mean that Flybe is unlikely to have succeeded in entirely neutralising this third party airline as a threat to Flybe’s business.

6.93 Taking the evidence in the round, the OFT considers that there are unlikely to be significant barriers to entry save for perhaps Flybe’s reputation as a fierce competitor for another airline to replace ASW at Plymouth Airport on a scale sufficient to replace the constraint imposed by ASW. The OFT considers that its view in this regard appears to be being borne out by events.

\(^{305}\) Email from senior Flybe executive to other senior Flybe executives dated 4 December 2008

\(^{306}\) See document entitled 'Section 2 to the OFT’s Section 26 Notice dated 13 August 2009 – Requests for statements to be set in context and/or explanations of facts contained within documents', which was supplied with a letter from Flybe’s legal advisers to the OFT dated 7 September 2009, page 20
Conclusion of the OFT's assessment of the strength of any associative links in respect of any alleged market abuse

6.94 As set out above and according to the relevant case law, the OFT considers that for Flybe to use its dominance on the Exeter – Jersey and Exeter – Guernsey routes to enable it to foreclose ASW by its conduct on the Newquay – London Gatwick route requires associative links to be in place. The OFT believes that in the event that ASW ceased operations at Plymouth Airport and was not replaced then Flybe stood to gain at Exeter Airport and would have protected or strengthened its dominant position on the Exeter Airport Markets. Further, the OFT notes that the documentary evidence suggests that Flybe believed that its actions on the Newquay – London Gatwick route might lead to ASW ceasing operations at Plymouth Airport, and on this basis considers there to be a plausible story of foreclosure.

6.95 However, the OFT notes that this evidence alone does not support all the associative links required and that there are possible extraneous factors and certain weaknesses in the chain, which cast doubt over the premise that Flybe’s conduct would lead to the foreclosure of ASW.

6.96 The OFT questions whether ASW would necessarily go out of business if it had to withdraw from the Newquay – London Gatwick route and, if it did exit the airline market, whether Plymouth’s operational limitations as an airport may be at least a contributing factor to such an exit. The OFT also considers that in the event that ASW ceased operations at Plymouth Airport, it is possible that another airline is likely to take its place. This is because the OFT does not consider there to be particularly strong barriers to entry which would prevent the constraint on Flybe represented by ASW from being replaced by another airline. The OFT considers that the proposed sale of ASW to Eastern Airways and the apparent proposed continuation of ASW’s services support the OFT’s conclusion in this regard.

D Objective justification

6.97 Notwithstanding the fact that the OFT does not consider that there is sufficient evidence to demonstrate that Flybe has abused any dominant position it may benefit from on the Exeter Airport Markets, the OFT has nevertheless gone further and considered whether Flybe's conduct on the Newquay – London Gatwick route was either (a) objectively necessary and justified, or (b) whether the conduct produces substantive efficiencies which outweigh any-anti-competitive effects on consumers.

Objective necessity and justification

6.98 The evidence set out above indicates that the Newquay – London Gatwick route is not exceptional amongst Flybe’s routes in actually experiencing losses in its first year of operation and projecting losses for its first two years of operation. An analysis of Flybe’s route specific management accounts shows that Flybe makes losses in the first two years on entering a route on average. Further, the OFT has identified several specific routes where Flybe has made losses similar to those it sustained on Newquay – London Gatwick.

6.99 The OFT considers that this evidence supports Flybe’s claims that initial losses experienced on entering a route are a result of normal commercial practice for an airline and that they are due to the need to stimulate market demand for the route. For certain routes, where there is a need to stimulate demand, the OFT considers there may be an objective necessity for an airline to experience and project initial losses on entry. Therefore, based on the evidence presented, the OFT considers that there is an objective justification for Flybe’s decision to enter the Newquay – London Gatwick route despite projecting and experiencing initial losses.

Efficiencies

6.100 In addition to the need to stimulate demand on a route, the OFT has considered whether efficiencies generated as a result of Flybe’s entry on to the route may also be regarded as an objective justification.
6.101 In examining any claims that the conduct is justified by efficiencies, the European Commission's guidance\textsuperscript{308} sets out the cumulative conditions that a dominant undertaking will generally be expected to demonstrate, with a sufficient degree of probability, and on the basis of verifiable evidence, that it has met:

'The efficiencies have been, or are likely to be, realised as a result of the conduct. They may, for example, include technical improvements in the quality of the goods, or a reduction in the cost of production or distribution,

The conduct is indispensable to the realisation of those efficiencies: there must be no less anti-competitive alternatives to the conduct that are capable of producing the same efficiencies,

The likely efficiencies brought about by the conduct outweigh any likely negative effects on competition and consumer welfare in the affected markets,

The conduct does not eliminate effective competition, by removing all or most existing sources of actual or potential competition. Rivalry between undertakings is an essential driver of economic efficiency, including dynamic efficiencies in the form of innovation. In its absence the dominant undertaking will lack adequate incentives to continue to create and pass on efficiency gains. Where there is no residual competition and no foreseeable threat of entry, the protection of rivalry and the competitive process outweighs possible efficiency gains. In the Commission's view, exclusionary conduct which maintains, creates or strengthens a market position approaching that of a monopoly can normally not be justified on the grounds that it also creates efficiency gains.'\textsuperscript{309}


\textsuperscript{309} Ibid, paragraph 30
6.102 Flybe has made representations to the OFT about the benefits realised following its entry to the Newquay – London Gatwick route.\textsuperscript{310} In summary, these were:

- An estimated quantifiable consumer benefit of £4.48 million. Flybe calculated this by multiplying the annual number of passengers on the Newquay – London Gatwick route (160,000) by the difference between the average fare before it entered the Newquay – London Gatwick route (£76) and the average fare since it entered the route (£48).\textsuperscript{311}

- Flybe stated it has increased the frequency of flights on the Newquay – London Gatwick route, meaning consumers now have more choice.\textsuperscript{312}

- Flybe operates direct flights from London Gatwick – Newquay\textsuperscript{313} whereas three out of four ASW flights from London Gatwick to Newquay are indirect, travelling via Plymouth.

- Flybe flights are available for sale via the Global Distribution Systems (GDS),\textsuperscript{314} which enables them to be sold as part of a journey comprising of several flights (for example a consumer can fly from Newquay to a long haul destination using a Flybe flight on the Newquay – London Gatwick leg of the journey). Since Flybe’s entry on to the Newquay – London Gatwick route, ASW has also made its flights available on the GDS, although it is unclear whether this can be directly attributed to Flybe’s entry.

- Flybe stated it has one of the most environmentally sensitive fleets of planes in the world\textsuperscript{315} and that it has introduced more efficient aircraft to the Newquay – London

\begin{footnotesize}
\textsuperscript{310} See ‘Flybe Limited Submission to the OFT’ dated 28 July 2009, pages 1 – 2 and 31 – 32 and letter from Flybe’s legal advisers to the OFT dated 4 December 2009, page 7

\textsuperscript{311} Ibid

\textsuperscript{312} ‘Flybe Limited Submission to the OFT’ dated 28 July 2009, page 31

\textsuperscript{313} ‘Flybe Limited Submission to the OFT’ dated 28 July 2009, pages 1 and 31

\textsuperscript{314} ‘Flybe Limited Submission to the OFT’ dated 28 July 2009, page 31

\textsuperscript{315} www.flybe.com/en/company_information/
\end{footnotesize}
Gatwick route.\textsuperscript{316} The OFT notes that several airlines including Flybe have made public statements about the efficiency of the aircraft used by Flybe on the Newquay – London Gatwick route.\textsuperscript{317}

- Flybe stated that it has stimulated the market in the south east of England by increasing advertising spending in the area.\textsuperscript{318} Further, Flybe stated that both ASW and Flybe are now advertising their flights making consumers more aware of what is available to them.\textsuperscript{319}

6.103 The OFT notes that several of these possible benefits have been realised, these being the increase in frequency of flights on the Newquay – London Gatwick route and more consumer choice, new direct flights operated by Flybe from London Gatwick – Newquay and Flybe’s flights being available on the GDS.

6.104 It is important to note that while some of the potential benefits identified could be realised as a result of increased efficiency on the Newquay – London Gatwick route, they could also be the result of predatory behaviour. In respect of lower fares on the route, although this will be a benefit while both Flybe and ASW operate the Newquay – London Gatwick route, there is no guarantee that these lower fares would continue if Flybe were to become the sole operator on the Newquay – London Gatwick route. Indeed, Flybe claims that its entry to the Newquay – London Gatwick route caused the average fare to decrease. The OFT cannot be certain that prices would not rise again if Flybe became the sole operator on the Newquay – London Gatwick route.

6.105 In respect of Flybe’s claims about stimulating the market, while the once-off stimulation of the market may bring about longer term benefits, it is not guaranteed that this would continue should Flybe become the sole operator on the Newquay – London Gatwick route.

\textsuperscript{316} ‘Flybe Limited Submission to the OFT’ dated 28 July 2009, page 2

\textsuperscript{317} \url{http://www2.bombardier.com/q400/en/testimonials.jsp}

\textsuperscript{318} ‘Flybe Limited Submission to the OFT’ dated 28 July 2009, page 1

\textsuperscript{319} Letter from Flybe’s legal advisers to the OFT dated 4 December 2009, page 7
6.106 The OFT notes that some possible benefits, such as Flybe's presence on the GDS, might continue to be passed on to consumers in the longer term, even if Flybe became the sole operator on the Newquay – London Gatwick route. Further, the OFT notes Flybe’s claims that its entry to the Newquay – London Gatwick route has forced ASW to take certain steps to compete, notably ASW’s entry to the GDS. However, the OFT cannot be certain that the potential benefits realised in the short term would continue to be passed on to consumers if Flybe became the sole operator on the Newquay – London Gatwick route. Further, it is not certain that Flybe’s entry to the Newquay – London Gatwick route was directly responsible for the actions taken by ASW since.

6.107 Overall the OFT considers that there is an objective justification for Flybe’s decision to enter the Newquay – London Gatwick despite projecting and experiencing initial losses.

6.108 However, with regard to Flybe’s other representations, the OFT considers that there is insufficient evidence to conclude that any efficiencies realised as a result of Flybe's entry to the Newquay – London Gatwick route are (a) fully attributable to Flybe's conduct and (b) would be sufficient to offset the long term impact of any potential predatory strategy on consumer welfare. As a result, the OFT does not consider that Flybe’s entry to the Newquay – London Gatwick route can be objectively justified by the potential efficiencies set out above.

E The OFT’s conclusions on Flybe's conduct

6.109 In conclusion, the OFT has found that Flybe is not dominant on the Newquay – London Gatwick market.

6.110 The OFT has found that Flybe is dominant on the Exeter – Jersey and Exeter – Guernsey routes.

6.111 The OFT has examined at paragraphs 6.54 – 6.96 whether there exist associative links in place as required by the relevant case law, for Flybe’s conduct on the non-dominated Newquay – London Gatwick market to be capable of infringing the Chapter II prohibition and/or Article 102 of the TFEU.

6.112 In examining whether there is sufficient evidence to support these associative links, the OFT considers that, there was evidence that Flybe’s dominant position on the two Exeter Airport Markets could be protected or strengthened if ASW ceased to operate and thus there would be a plausible rationale for Flybe seeking to eliminate ASW.
6.113 The OFT concludes that some of the evidence may indicate that Flybe believed that ASW was financially vulnerable when it took the decision to launch the Newquay – London Gatwick route, believing that one of the consequences of Flybe’s entry might be that ASW would go out of business. However, the OFT questions whether ASW would necessarily go out of business if it had to withdraw from the Newquay – London Gatwick route and, if it did exit the wider Devon and Cornwall region, whether Plymouth’s operational limitations as an airport may be at least a contributing factor to such an exit.

6.114 Further, the OFT considered that there are no barriers to entry preventing another airline taking over from ASW save for perhaps Flybe’s reputation as a fierce competitor. In this regard, the OFT notes SHH’s agreement to sell ASW to Eastern Airways, which is subject to regulatory approval, and the apparent proposed continuation of ASW’s services under the ASW brand. In the OFT’s view, this suggests that it is possible that another airline will take on ASW’s routes and perhaps act as a similar level of constraint on Flybe as ASW.

6.115 Therefore, in the final analysis, the OFT questions whether Flybe has the ability to exclude ASW or any successor to it. The OFT considers that there are possible extraneous factors which weaken the chain of associative links, such that the evidence may be ultimately insufficient to support the proposition that Flybe’s conduct would be capable of excluding ASW or any successor from operating services in Devon and Cornwall.

6.116 Separately and notwithstanding the OFT’s view on the proximity of the associative links and the OFT’s consequent doubts as to whether Flybe has the ability to exclude ASW or its successor, the OFT has examined the losses incurred by Flybe on entering the Newquay – London Gatwick route to see if they are predatory in nature. The OFT concludes that such losses are not predatory and may constitute normal, albeit robust, competition, even if the entry ultimately results in the new entrant displacing an incumbent operator.

6.117 The OFT has also examined all the internal documentation provided to it by Flybe. It considers that such documentary evidence does not provide sufficient evidence that Flybe's principal intention when entering on to the Newquay –London Gatwick route was to eliminate ASW nor does it demonstrate that Flybe’s conduct in so doing was commercially irrational.

6.118 For these reasons, the OFT does not consider that the conditions of the Chapter II prohibition of the Act and/or Article 102 of TFEU are all met in connection with Flybe’s conduct concerning its entrance on to the Newquay – London Gatwick air route in competition with ASW.

6.119 Finally, in the event, for the avoidance of doubt, the OFT further concludes that, even if the conditions of the Chapter II prohibition and/or Article 102 TFEU were to be met, which the OFT does not consider to be the case on the evidence before it, there is an objective justification for Flybe’s decision to enter the Newquay – London Gatwick despite projecting and experiencing initial losses.

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