Terms of reference and conduct of the inquiry

Terms of reference

1. On 15 June 2012, the OFT sent the following reference to the CC:

    1. In exercise of its duty under section 22(1) of the Enterprise Act 2002 ('the Act') to make a reference to the Competition Commission ('the CC') in relation to a completed merger, the Office of Fair Trading ('the OFT') believes that it is or may be the case that:

        (a) a relevant merger situation has been created in that:

            (i) enterprises carried on by or under the control of Ryanair Holdings plc (Ryanair) have ceased to be distinct from enterprises previously carried on by or under the control of Aer Lingus Group plc (Aer Lingus); and

            (ii) as a result, the conditions specified in section 23(4) of the Act will prevail, or will prevail to a greater extent, with respect to the supply of scheduled airline services between the UK and the Republic of Ireland measured by number of passengers;

        (b) the creation of that situation has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services, including the provision of scheduled airline services on a number of direct routes between cities in the UK and cities in Ireland where either:

            (i) Ryanair and Aer Lingus overlap in the provision of services (these routes being: Manchester (Liverpool)- Dublin; Birmingham (East Midlands)-Dublin; London-Cork; London-Shannon; London-Knock; and London-Dublin); or

            (ii) Ryanair operates on the route and Aer Lingus is a potential entrant onto the route (these routes being: Dublin-Newcastle and Knock-Bristol).

    2. Therefore, in exercise of its duty under section 22(1) of the Act, the OFT hereby refers to the CC, for investigation and report within a period ending on 29 November 2012, on the following questions in accordance with section 35(1) of the Act:

        (a) Whether a relevant merger situation has been created; and

        (b) If so, whether the creation of that situation has resulted or may be expected to result, in a substantial lessening of competition within any market or markets in the UK for goods or services.

    (signed) **AMELIA FLETCHER**
    Chief Economist, Office of Fair Trading
    15 June 2012

Conduct of the inquiry

2. We conducted our inquiry according to our usual procedures.[1]

3. On 18 June 2012, we published on our website an invitation to express views about the completed acquisition by Ryanair of a minority interest in Aer Lingus.

4. On 18 July 2012, we posted on our website a notice of an extension of the inquiry period, made pursuant to section 39(4) of the Act. The extension was terminated on 28 February 2013 and a notice was posted on our website on 1 March 2013. As a result of this extension, we were required to publish our final report by 11 July 2013. On 26 June 2013 we posted on our website a notice of a further extension of the inquiry period, made pursuant to section 107(2)(c) of the Act. This resulted in a revised date of 5 September 2013 for publication of our final report.

5. On 5 March 2013, we published an administrative timetable for the inquiry. This was updated on 26 June 2013.

6. On 6 March 2013, we published an issues statement on our website.

7. We collected evidence from Ryanair, Aer Lingus and a range of third parties and sought verification of the evidence received. During our inquiry, the main parties drew our attention to numerous press articles mentioning Ryanair, Aer Lingus, the Irish Government or other third parties. In general we sought parties' views and relevant documents directly on matters of relevance to our inquiry rather than relying on the information contained in press articles. We gathered oral evidence through hearings with selected third parties. Summaries of third party hearings are on our website.

8. Non-confidential versions of Aer Lingus's initial submission and submissions made by Ryanair to the OFT on material influence and the SLC question were posted on our website. We visited Aer Lingus and Ryanair in Dublin. We also held hearings with Aer Lingus and Ryanair.

9. During the course of our inquiry, we sent Ryanair, Aer Lingus and certain third parties extracts from working papers and draft reports for comment, and considered a number of submissions from those parties.

10. On 30 May 2013, we published on our website the notice of provisional findings, a summary of our provisional findings and the notice of possible remedies. Our full provisional findings were published on our website on 3 June 2013.

11. Following publication of our provisional findings, we received submissions from the main parties, non-confidential versions of which were published on our website. We held response hearings with Ryanair and Aer Lingus and gathered further evidence and views from third parties.

12. A non-confidential version of the final report has been placed on our website.

Interim measures

13. On 27 September 2012, we accepted undertakings given by Aer Lingus and these have been published on our website.

[1] See in particular, *CC18, Merger Procedural Guidelines*; and *CC7, Chairman's Guidance on Disclosure of Information in Merger Inquiries, Market Investigations and Reviews of Undertakings and Orders accepted or made under the Enterprise Act 2002 and Fair Trading Act 1973*.

14. On 27 September 2012, we imposed an interim order on Ryanair. This is published on our website.

Background information on Aer Lingus and Ryanair

Introduction

1. In this appendix, we provide background information on Aer Lingus and Ryanair.

2. The Aer Lingus background information is as follows:

   (a) Aer Lingus's board structure;

   (b) Aer Lingus's shareholders;

   (c) Aer Lingus's Employee Share Ownership Trust (ESOT);

   (d) Aer Lingus's pension scheme; and

   (e) the franchise agreement between Aer Arann and Aer Lingus concerning Aer Lingus Regional.

3. Paragraphs 21 to 25 set out some relevant background information on Ryanair's business.

Aer Lingus

Aer Lingus's board structure

4. Aer Lingus's board structure and membership is set out in Table 1.

TABLE 1 **Aer Lingus's Board of Directors**

Name	*Position*	*Date appointed*	*Details*
Colm Barrington	Chairman	19 September 2008	CEO of Fly Leasing Limited. Formerly MD of Babcock & Brown Dublin
Christoph Mueller	Chief Executive Officer	14 September 2009	Prior role: Aviation Director at TUI Travel plc
Andrew Macfarlane	Chief Financial Officer	3 October 2010 (appointed interim CFO 21 December 2009)	Prior role: CFO of Rentokil Initial
David Begg	Non Executive Director	28 January 2011	General Secretary of the Irish Congress of Trade Unions since 2001. For five years prior to that he was Chief Executive of Concern Worldwide, an international humanitarian organization
Montie Brewer	Non Executive	25 January 2010	Former President and CEO of Air Canada
Laurence Crowley	Senior independent director	9 January 2009	Former Governor of Bank of Ireland (until 2005)
Mella Frewen	Non Executive	1 January 2011	Director General of the Confederation of the Food and Drink Industries of the EU (CIAA) based in Brussels
Danuta Gray	Non Executive	25 August 2006	Chairman of Telefonica O2 and Former Chief Executive of O2 Ireland
Francis Hackett	Non Executive	9 February 2006	Solicitor
Colin Hunt	Non Executive	31 January 2008	Managing Director at Macquarie Capital
Thomas Moran	Non Executive	25 August 2006	Chairman of the Board of Mutual of America Life Insurance Company
Nicola Shaw	Non Executive	25 January 2010	Chief Executive of High Speed 1, the railway between St Pancras in London and the Channel Tunnel

Source: Aer Lingus annual report 2012.

Notes:
1. Shading indicates nominations by the Irish Minister of Transport.
2. Mr Colm Barrington, Mr David Begg, Mr Montie Brewer, Mr Laurence Crowley, Ms Mella Frewen, Ms Danuta Gray, Mr Andrew Macfarlane, Mr Christoph Mueller, Mr Thomas Moran and Ms Nicola Shaw were re-elected as Directors at the Company's Annual General Meeting (AGM) held on 26 April 2013.

Aer Lingus's shareholders

5. Aer Lingus's shareholders at 28 March 2013 are set out in Table 2.

TABLE 2 **Summary of Aer Lingus's shareholders at 28 March 2013**

Name	*Description*	*Shares held in Aer Lingus*	*Ownership of Aer Lingus %*
Ryanair Holdings	Competitor	159,231,025	29.82
Minister for Finance of Ireland	Irish Government	134,109,026	25.11
'Other strategic investors'			
Mr Denis O'Brien	Private investor	20,308,822	3.80
Etihad	Airline	15,950,000	2.99
Irish Airlines Pilots Pensions Limited	Employee-related	12,024,980	2.25
Tailwinds Nominees (Aer Lingus Pilots)	Employee-related	6,480,156	1.21
Sub-total		54,763,958	10.25
'Financial investors'			
Commerzbank Securities	Financial institution	11,230,030	2.10
Wellington Mgt Company	Financial institution	9,876,203	1.85
Goodbody Stockbrokers	Financial institution	7,418,978	1.39
Norges Bank Investment Mgt	Financial institution	6,552,527	1.23
Investec Asset Mgt	Financial institution	5,627,907	1.05
Baring Asset Mgt	Financial institution	5,144,486	0.96
F&C Asset Mgt	Financial institution	3,994,235	0.75
HSBC Securities	Financial institution	3,986,786	0.75
Merrion Investment Mgrs	Financial institution	3,823,724	0.72
Dimensional Fund Advisors	Financial institution	3,729,344	0.70
Davy Stockbrokers	Financial institution	3,324,925	0.62
Dolmen Stockbrokers	Financial institution	3,135,605	0.59
BlackRock Investment Mgt (BGI)	Financial institution	2,459,209	0.46
Allianz Global Investors	Financial institution	2,305,000	0.43
Sub-total		64,709,150	12.12
Unidentified	Not known	121,226,931	22.70
Total		**534,040,090**	**100.00**

Source: Aer Lingus.

Note: Tailwind Nominees was established by Aer Lingus pilots to acquire shares in the company.

Employee Share Ownership Trust

6. At the time of the IPO in 2006, a block of Aer Lingus shares amounting to 12.5 per cent was purchased by the Aer Lingus ESOT on behalf of current and former employees. Under the company's Articles of Association, the ESOT was given the right to nominate up to two directors to the board for so long as its shareholding exceeded 5 per cent.

7. A significant part of this shareholding was acquired with borrowed funds. These borrowed funds, and applicable interest, were to be repaid out of a profit-share arrangement under which Aer Lingus was required to pay up to 7.5 per cent of its annual profit before tax and exceptional items until the earlier of 2023 or such time as the loan and all interest were fully repaid. As a result of the turmoil in financial markets in 2008/09 and the fact that no profit share had been paid in 2008 and 2009, the interest rate on the ESOT loan would have increased significantly (and to a multiple of Aer Lingus's then current deposit rates), thus increasing Aer Lingus's liability to pay profit share out of future profits.

8. In December 2010 the ESOT shares were distributed to the underlying beneficiaries (about 4,000 individuals) and a one-off payment of €25.3 million was made by Aer Lingus to ESOT to extinguish all future profit-share liabilities. This one-off payment was less than the expected total future profit-share payments and other associated costs had the profit-share arrangements continued in place.

Aer Lingus's pension scheme

9. Aer Lingus is engaged in ongoing discussions with its trade unions and pension trustees under the auspices of the Labour Relations Commission (LRC) about the future of the pension scheme to which most of its employees belong. This is the Irish Airlines (General Employees) Superannuation Scheme (IASS) and covers present and former employees of Aer Lingus (approximately 75 per cent of scheme members) and of DAA (approximately 25 per cent).

10. Although IASS member benefits are described in final salary terms under the terms of the scheme (ie 'defined benefit' from a member's point of view), Aer Lingus stated in its 2006 IPO prospectus that, from its point of view, the IASS was a 'defined contribution' scheme as it was under no obligation to increase the regular contributions it was then making (and continues to make) into the scheme. This is because, under the terms of the scheme, no increase in employer contributions can become effective without the agreement of all the employers affected, and Aer Lingus is not prepared to agree to any such increase.

11. According to Aer Lingus, the IASS funding shortfall as at 31 December 2012 was estimated to be €779 million on a minimum funding standard (MFS) basis. Mathematically, approximately 65 per cent of the scheme's liabilities are associated with current or former members of Aer Lingus staff. In order to achieve a fair outcome for IASS members and for its own shareholders, and to minimize the likelihood of industrial action by disaffected employees, Aer Lingus entered negotiations under the auspices of the LRC in 2010. Aer Lingus engaged with the trade unions and the Labour Court. In May 2013, the Labour Court issued its recommendation, which was broadly welcomed by Aer Lingus and the trade unions.

12. The proposal recommended by the Labour Court involves:

(a) the closure of the IASS to new members and cessation of benefit accrual for existing members;

(b) the creation of a new defined contribution scheme in respect of future service of Aer Lingus employees; and

(c) the payment by Aer Lingus of a one-off initial contribution of €110 million into the new scheme (plus cost stabilization payments up to 2017 to replace existing annual increments) to improve the likely future pensions of affected IASS members. Aer Lingus would also pay €30 million into the new scheme in respect of former employees who are deferred members of the IASS.

13. Although the IASS Trustee has not yet made a formal submission to the Irish Pensions Board (the pensions regulator) on the basis of this proposal, it held discussions with the regulator. Following these discussions, in July 2013 the Irish Pensions Board wrote to the IASS Trustee indicating that the outline proposal would not be an acceptable basis for a funding proposal. Aer Lingus continues to believe that the proposal represents a viable solution and expects the IASS Trustee to make a formal submission to the Irish Pensions Board.

14. Ryanair had vigorously opposed the payment by Aer Lingus of any initial contribution into the new scheme, and had threatened legal action against the company and its directors for misrepresentation in the IPO prospectus if any such payment is made. Ryanair supports Aer Lingus's previous policy, as set out in the IPO prospectus and subsequent annual reports, that no further contribution should be made to the Aer Lingus pension funds. Ryanair stated that these pension funds received €104 million

of shareholder funds at the time of the Aer Lingus IPO in 2006, at which time both the unions and Aer Lingus employees agreed that Aer Lingus's pension contributions would be fixed thereafter. Aer Lingus has stated that it intends to submit any deal on the pension schemes to a shareholder vote (in the form of an ordinary resolution).

Aer Arann's franchise agreement with Aer Lingus

Overview of Aer Arann

15. Aer Arann is an independent airline (neither Aer Lingus nor Ryanair is a shareholder). It is a private company. Aer Arann operates flights between the Republic of Ireland and the UK under a franchise agreement with Aer Lingus.

16. Aer Arann started operating passenger flights in 1970. Aer Arann is the operator of the Aer Lingus Regional franchise. Since March 2012, Aer Arann has operated all of its routes under the Aer Lingus Regional brand. All such flights are sold and distributed through the Aer Lingus website. Aer Arann assumes full operational and commercial responsibility for the services, and uses its ATR72 and ATR42 aircraft and its crew on these routes.[1]

17. In 2010, as a result of the disruption caused by the volcanic ash incident, Aer Arann entered a period of Examinership.[2] Aer Arann emerged from Examinership in October 2010 following a business restructure and new investment.[3]

Franchise agreement

18. The franchise agreement was first entered into in January 2010, under which Aer Arann operated routes from Dublin, Cork and Shannon to the UK under the Aer Lingus Regional brand. Previously, many of these routes were operated directly by Aer Lingus. In March 2012 the agreement was expanded to include all services operated by Aer Arann and was extended until April 2016. In late 2012, the franchise agreement was revised and extended for a further ten-year period.

19. The key terms of the agreement are as follows:

    (a) a franchise fee of [✂] is payable by Aer Arann to Aer Lingus. In addition, Aer Arann is obliged to pay Aer Lingus costs in respect of the distribution and sale of the franchise services;

    (b) [✂] The timetable is also set by Aer Arann in consultation with Aer Lingus. Aer Arann is responsible for all direct operating costs;

    (c) franchise services are sold exclusively through Aer Lingus direct and indirect sales channels, and while Aer Arann has principal responsibility for the marketing and promotion of the franchise services, Aer Lingus incorporates routes operated as franchise services in relevant information and promotional activity. All aspects of the Aer Lingus product suite are incorporated in the franchise services (including but not limited to seat selection, baggage fees, buy-on-board, card fees

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[1] The ATR 72 is a twin-engine turboprop short-haul regional airliner built by the French-Italian aircraft manufacturer ATR. It is generally configured to carry 78 passengers. The ATR 42 is a similar, but smaller aircraft which carries 40 to 52 passengers depending on seat configuration.
[2] This is a provision under Irish company law that is designed to help companies facing financial difficulties that also have a reasonable prospect of survival.
[3] www.aerarann.com/about-us/aer-arann-history.

etc). Aer Arann is required to deliver the franchise services in accordance with agreed Product and Brand Delivery policies and KPIs;

(d) changes to the franchise routes are subject to agreement between the parties. [✂];

(e) the franchise agreement also identifies a number of potential future routes. [✂]

20. In conjunction with this revised franchise agreement, Aer Lingus has also participated in associated financing arrangements which will facilitate the funding of Aer Arann's fleet replacement programme. Specifically, Aer Lingus has acquired 33.3 per cent of the equity in a joint venture company which will acquire the new aircraft over the course of the next 18 months and then lease these aircraft to Aer Arann. [✂]

Ryanair

21. Ryanair is managed as a single business unit which is active in the provision of air passenger services and other airline-related activities, including scheduled services, car hire, Internet income and related sales to third parties. Ryanair operates a single fleet of aircraft that is deployed through a single route scheduling system. The Chief Executive Officer of Ryanair, Michael O'Leary, is the Company's Chief Operating Decision Maker and the only executive director, who makes decisions directly related to airline operations by Ryanair including those in, to and from the UK.[4] The board of Ryanair has delegated responsibility for the management of the group to the CEO and executive management.[5]

22. The board of Ryanair is responsible for the leadership, strategic direction and overall management of the Ryanair Group.[6] The board's primary focus is on strategy formulation, policy and control and has a formal schedule of matters specifically reserved for its attention, including matters such as appointment of senior management, approval of the annual budget, large capital expenditure and key strategic decisions.[7]

23. We have reviewed minutes of board meetings of Ryanair Holdings plc which indicate that the board is provided updates on, inter alia, fuel requirements, the purchasing of aircraft, new routes and bases, customer service complaints, changes in the UK Air Passenger Duty, market shares on Dublin–UK routes, outsourcing of future staff requirements, safety protocols for all Ryanair pilots and on-board electronic point-of-sale systems. In addition, we note that the board unanimously approved management to proceed with the aforementioned outsourcing and sale systems projects.[8]

24. Ryanair's operations serving Great Britain and Ireland are operated by Ryanair Limited, its wholly owned subsidiary[9] incorporated in Ireland and the only operating company within the Ryanair Group. The management of Ryanair Holdings and Ryanair Limited are integrated, with the two companies having the same directors,

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[4] Ryanair Q1 results 2014—available at: www.ryanair.com/en/investor/investor-relations-news.
[5] Ryanair Holdings plc Annual Report 2011—Corporate Governance Report, p15.
[6] The Ryanair Group comprises Ryanair Holdings plc, its subsidiaries and their subsidiaries. As set out in Section 2 of the main report, we use the term Ryanair to refer to the Ryanair Group unless otherwise specified.
[7] Ryanair Holdings plc Annual Report 2011, the Board of Directors, p14.
[8] Minutes of the Board Meeting of Ryanair Holdings plc: 14 December 2006, 1 April 2010, 28 May 2010, 21 August 2012 and 14 December 2012.
[9] Ryanair Holdings plc is the sole member of Ryanair Limited and, as stated in its articles of association, under Irish law Ryanair Limited is a single-member company within the meaning of the European Communities (Single-Member Private Limited Companies) Regulations, 1994 (as amended). As the sole member of Ryanair Limited, Ryanair Holdings plc is entitled to dispense with the holding of annual general meetings and all matters requiring a resolution of the company in general meeting may be validly dealt with by the decision of Ryanair Holdings plc provided a written record of such a decision or a copy of any written resolution is provided to Ryanair Limited.

executive officers[10] and registered address. The Chief Executive Officer of Ryanair Limited is Michael O'Leary. The UK/Ireland operations are not managed separately nor is there a separate management team from the rest of Ryanair's airline operations. Ryanair Limited advertises and sells flights to UK consumers through its website (www.ryanair.com).[11] It has eight bases of operations in the UK: Bristol, Glasgow (Prestwick), Leeds Bradford, Liverpool, London (Luton), London (Stansted), Manchester and Nottingham East Midlands.

25. Coinside Limited (Coinside), a subsidiary of Ryanair Limited, acquired Ryanair's shareholding in Aer Lingus over the period 2006 to 2008. These shares are now held by Ryanair Limited. Coinside also made the most recent public bid on behalf of Ryanair for the outstanding 70.18 per cent Aer Lingus shares not already owned by Ryanair.[12]

[10] Ryanair Holdings plc Annual Report 2013, p102.
[11] www.ryanair.com is the only licensed website from which consumers may purchase Ryanair flights.
[12] We also note that Ryanair Holdings plc was the appellant in proceedings against the CC before the CAT in 2012 regarding this inquiry and is the entity that has made submissions to the CC throughout.

Aer Lingus corporate governance issues

Introduction

1. In this appendix we provide background information on relevant corporate governance issues for Aer Lingus, including:

   (a) shareholder participation in Aer Lingus general meetings and Ryanair's effective voting power;

   (b) voting patterns for resolutions opposed by Ryanair;

   (c) a list of matters requiring approval by shareholders by means of a special resolution under Irish Company Law;

   (d) Ryanair's ability to pass or defeat ordinary resolutions;

   (e) class tests for transactions under Irish stock exchange listing rules;

   (f) Ryanair's attempts to call EGMs and place items on the agenda of AGMs;

   (g) constraints on Aer Lingus's management time; and

   (h) Aer Lingus trading volumes and share price.

Shareholder participation in Aer Lingus general meetings and Ryanair's effective voting power

2. The overall participation by all Aer Lingus shareholders in resolutions called to a vote has fallen from an average of 77.1 per cent in the period 2007 to 2010 to 71.7 per cent in the period 2011 to 2013. The average participation by shareholders other than Ryanair and the Irish Government has reduced from 53.0 per cent to 37.2 per cent in the same period. A major factor that is likely to have contributed to this fall is the dispersion of the ESOT to individual beneficiaries (see Table 1).

TABLE 1 **Estimated participation in shareholder resolutions by Aer Lingus shareholders other than Ryanair and Irish Government**

Period	*Comment*	*Min participation %*	*Average participation %*	*Maximum participation %*
2007–2010	Pre-ESOT dispersal	29.1	53.0	61.6
2011–2013	Post-ESOT dispersal	23.4	37.2	41.4

Source: CC analysis of Aer Lingus voting records.

3. Low participation by some shareholders boosts Ryanair's effective voting power and that of the participating shareholders relative to the total shares outstanding. Table 2 shows the effective voting pattern that Ryanair has achieved based on the turnout of the various shareholder groups. In the period 2011 to 2013 Ryanair's 29.82 per cent stake in Aer Lingus had an average effective voting power of 41.6 per cent (ranging from 40.5 to 45.6 per cent) in its own right, which exceeds its 29.82 per cent economic interest as a result of the lower participation by other shareholders.

TABLE 2 **Estimated voting power of Ryanair and additional shares required to achieve a majority**

	Low	*Average*	*High*
Proportion of votes cast by shareholders			
Ryanair (%)	100.0	100.0	100.0
Irish Government (%)	100.0	100.0	100.0
Proportion of other shareholders participating (%)	23.4	37.2	41.4
Number of shares voted			
Ryanair	159,231,025	159,231,025	159,231,025
Irish Government	134,109,026	134,109,026	134,109,026
Other shareholders	56,212,606	89,629,923	99,597,487
Total shares voted	349,552,657	382,969,974	392,937,538
Ryanair effective voting power alone (%)	45.6	41.6	40.5
Additional effective voting power required to achieve a majority (%)	4.5	8.5	9.6
Subtotal (%)	50.0	50.0	50.0
Additional shares required to vote with Ryanair to achieve a majority, as a percentage of issued shares (%)	2.9	6.0	7.0

Source: CC analysis based on Aer Lingus voting records at the AGMs in the period 2011 - 2013

Note: A majority is achieved with a vote of 50 per cent plus 1 share. Participation by other shareholders has been derived by deducting the number of Ryanair and Irish Government shares from the total shares voted.

Voting patterns for resolutions opposed by Ryanair

4. In the past Ryanair has had less than 1 per cent of support from other shareholders in 12 resolutions between 2007 and 2013. However, in 2012 the resolution regarding the re-election of Director David Begg showed 3.14 per cent of shares voting the same way as Ryanair. In 2013, the same resolution showed 2.93 per cent voting the same way as Ryanair. Ryanair has been unsuccessful in its attempt to prevent Mr Begg's re-election despite this support. In the 2012 resolution, the proportion of votes against management recommendation reached 45.8 per cent (4.2 percentage points short of the votes required to achieve a majority). The voting pattern is set out in Table 3 (the Ordinary Resolutions are shaded).

TABLE 3 **Voting pattern in Aer Lingus resolutions opposed by Ryanair**

Year and resolution	*Type of resolution*	*Other shareholders voting with Ryanair*	*Other shareholder as % of Aer Lingus*	*Votes against management recommendation (% total votes cast)*
2007 Disapplication of pre-emption rights (BY POLL)	Special	412,976	0.08	31.8
2008 Approval of Airbus purchase agreement	Ordinary	31,724	0.01	36.4
2009 To disapply statutory pre-emption rights (BY POLL)	Special	371,137	0.07	37.0
2010 Authorization to allot equity security otherwise than in accordance with statutory pre-emption rights (BY POLL)	Special	1,261,934	0.24	38.7
2010 Amendments to the articles of association (Shareholders Rights Directive)	Special	1,244,883	0.23	38.7
2011 To re-elect David Begg (BY POLL)	Ordinary	1,359,213	0.25	43.0
2011 Authorization to allot equity security otherwise than in accordance with statutory pre-emption rights (BY POLL)	Special	1,374,093	0.26	43.0
2011 Amendments to the article 59 of the Articles of association (BY POLL)	Special	438,701	0.08	42.8
2012 To re-elect David Begg (BY POLL)	Ordinary	16,795,467	3.14	45.8
2012 Authorization to allot equity security otherwise than in accordance with statutory preemption rights (BY POLL)	Special	337,135	0.06	41.6
2012 Amendments to the article 59 of the Articles of association (BY POLL)	Special	246,931	0.05	43.8
2013 To re-elect David Begg (BY POLL).	Ordinary	15,671,661	2.93	44.5
2013 Authorization to allot equity securities otherwise than in accordance with statutory pre-emption rights (BY POLL).	Special	596,537	0.11	40.7
2013 Amendments to the Article 59 of Articles of Association (BY POLL).	Special	319,700	0.06	40.6

Source: Aer Lingus.

List of matters requiring approval by shareholders by means of a special resolution under Irish Company Law

5. Ryanair provided a list of matters requiring approval by shareholders by means of a special resolution under Irish company law:

- altering the objects of a company;[1]
- altering the Articles of Association of a company;[2]
- approving a change of the company name;[3]
- approving alteration of items in the Memorandum of Association which could lawfully have been in the Articles of Association;[4]
- the giving of financial assistance;[5]
- the reduction of share capital;[6]

[1] Section 10, Companies Act, 1963.
[2] Section 15, Companies Act, 1963.
[3] Section 23, Companies Act, 1963.
[4] Section 28, Companies Act, 1963.
[5] Section 60, Companies Act, 1963.

- rendering unlimited the liability of directors;[7]
- sanctioning a compromise between the company and its members;[8]
- sanctioning a winding-up by the Court;[9]
- sanctioning a solvent voluntary winding-up;[10]
- sanctioning a private company being converted to a plc;[11]
- sanctioning an unlimited company being converted to a plc;[12]
- sanctioning a plc to be registered as a private company;[13]
- disapplying pre-emption rights and issuance of new shares;[14]
- variation of rights attached to special classes of shares;[15]
- converting limited to unlimited companies and vice versa;[16]
- setting re-issue price of treasury shares;[17]
- purchase of own shares off-market;[18]
- purchase off-market of shares in holding company;[19]
- determining that any portion of its share capital that has not been already called up shall not be capable of being called up except in the event and for the purposes of the company being wound up;[20]
- reduce the period of notice to 14 days for a general meeting (other than the AGM or a meeting where a special resolution is to be passed);[21]
- altering its memorandum so as to render unlimited the liability of its directors or of any managing director;[22]
- the assignment by a director of his duties (if the company's Memorandum and Articles permit);[23]

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[6] Section 72, Companies Act, 1963.
[7] Section 198, Companies Act, 1963.
[8] Section 201, Companies Act, 1963.
[9] Section 213, Companies Act, 1963.
[10] Section 251, Companies Act, 1963.
[11] Section 9, Companies (Amendment) Act, 1983.
[12] Section 11, Companies (Amendment) Act, 1983.
[13] Section 14, Companies (Amendment) Act, 1983.
[14] Section 24, Companies (Amendment) Act, 1983.
[15] Section 38, Companies (Amendment) Act, 1983.
[16] Sections 52, and 53 Companies (Amendment) Act, 1983.
[17] Section 209(5), Companies Act, 1990.
[18] Section 213, Companies Act, 1990.
[19] Section 224, Companies Act, 1990.
[20] Section 67, Companies Act, 1963.
[21] Section 133(1)(c)(ii), Companies Act, 1963.
[22] Section 198, Companies Act, 1963.
[23] Section 199, Companies Act, 1963.

- the power of liquidator to accept shares as consideration for sale of property of company;[24]
- granting certain powers to a liquidator in a solvent winding up;[25]
- endorsing an arrangement between a company in the course of being wound up and its creditors;[26]
- disposal of books and papers of company in a members voluntary winding up;[27]
- exception to the prohibition of loans etc to directors and connected persons;[28]
- the purchase of the company's own shares in pursuance of a contingent purchase contract;[29] and
- approving a scheme of arrangement.[30]

Ryanair's ability to pass or defeat ordinary resolutions

6. Whether Ryanair's shareholding in Aer Lingus is sufficient to achieve a majority at a general meeting will depend in large part on the future of the Irish Government shareholding. We looked at three scenarios in relation to this shareholding:

   (a) the Irish Government retains its 25.1 per cent shareholding in Aer Lingus and votes at all general meetings;

   (b) the Irish Government retains its shareholding but abstains from voting on a particular issue; and

   (c) the Irish Government sells its shareholding (in full or part).

7. In considering these scenarios, we take into account the evidence from the Irish Government. In doing so, we note that the incentives of governments are likely to change over time as they react to current events.

No change in the Irish Government shareholding

8. First we consider the circumstances in which Ryanair could achieve a majority where the shareholding of the Irish Government remains unchanged. We looked at the effect of a reduction in shareholder participation and the effect of other shareholders voting with Ryanair against Aer Lingus's management.

9. The percentage of shares voted at general meetings has fallen, from an average of 77.1 per cent in the period 2007 to 2010, to 71.7 per cent in the period 2011 to 2013.[31] Assuming that Ryanair and the Irish Government have always voted all their shares,[32] the average percentage of shares voted by the other shareholders has

[24] Section 260, Companies Act, 1963.
[25] Section 276, Companies Act, 1963.
[26] Section 279, Companies Act, 1963.
[27] Section 305, Companies Act, 1963.
[28] Section 34, Companies Act, 1990.
[29] Section 214, Companies Act, 1990.
[30] Section 201, Companies Act, 1963.
[31] A major factor that is likely to have contributed to this fall is the dispersion of the ESOT shares to individual holders.
[32] Note: in 2009 Ryanair did not vote on the two resolutions that it put forward regarding board remuneration.

declined from 53.0 per cent in 2007 to 2010 (ranging from 29.1 to 61.6 per cent) to 37.2 per cent in 2011 to 13 (ranging from 23.4 to 41.4 per cent) (see Table 1).

10. In the period 2011 to 2013, Ryanair's 29.82 per cent shareholding in Aer Lingus has therefore had an average effective voting power of 41.6 per cent (ranging from 40.5 to 45.6 per cent) (see Table 2).

11. On the assumption that the Irish Government votes all of its shares, and that it always supports management, we estimate that for Ryanair to achieve a simple majority in opposition to the Irish Government, voting participation by all other shareholders would need to fall to 10.4 per cent (or less) of the remaining shares when other participating shareholders' votes support the position of the Irish Government.[33] We consider such a low level of shareholder participation to be unlikely given the historic levels of shareholder participation.

12. Furthermore, there are currently several 'strategic investors' in Aer Lingus, representing 10.3 per cent of the outstanding shares (see Table 2, Appendix B). We thought it unlikely that Ryanair would be able to rely on the support of these strategic investors in a vote opposing Aer Lingus's management, and their participation in meetings was likely to be high. If these shareholders retain their shares and vote with the Irish Government they collectively hold more shares than Ryanair. Ryanair would be not be able to achieve a majority unless 16 per cent of the remaining shareholders participated and voted in favour of Ryanair's position, which would be at odds with the historical pattern (see paragraph 4).

13. Shareholders decide how to vote on individual resolutions on a case-by-case basis. In the overwhelming majority of cases, shareholders support management recommendations. The exceptions to this tend to be a result of a breakdown of trust or confidence that shareholders have in the management, or fundamental differences of opinion as to the strategic direction or financial policies of a company.[34]

14. In theory, however, if a number of other shareholders voted with Ryanair, whether as a result of a concerted initiative by Ryanair to obtain their support, or due to an alignment of otherwise independent interests, Ryanair could have the ability to decide a vote on issues with wide ranging implications for Aer Lingus.

15. We considered whether Ryanair was likely to have this ability. Based on historic voter turnout in the period 2007 to 2013, Ryanair would need the support of an additional 4.5 to 9.6 per cent of effective voting power, corresponding to 2.7 to 7.0 per cent of Aer Lingus's issued share capital in order to achieve a majority.

16. Given the pattern of institutional investor ownership of Aer Lingus (see Table 2, Appendix B), Ryanair would need the support of several of the disclosed shareholders to achieve more than 50 per cent. We note that in the past, only a very small proportion of shareholders, representing less than 1 per cent of the vote, have supported Ryanair's position in 12 resolutions between 2007 and 2013 (see Table 3).

17. There may be several reasons why shareholders might vote with Ryanair, in opposition to management. We identified several examples of issues which could be particularly contentious, and where the probability of other shareholders (eg those with an 'activist' stance) opposing Aer Lingus's management in a shareholder vote

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[33] Calculation: Ryanair shares 159,231,025; Irish Government 134,109,026; Others 25,121,998 or fewer of the 240,700,039 remaining shares

[34] It should be noted, however, that in this situation shareholders also generally have the opportunity to sell their shares if they do not believe that the company is being managed in their interests.

may be particularly high: board nominations, an increased contribution by Aer Lingus to address the funding shortfall in its pension scheme;[35] opposition to major investment decisions; and/or requests that the company increases or accelerates the distribution of cash to shareholders, for example through higher dividends and disposal of Heathrow slots and other assets (eg aircraft).

18. The evidence set out in Table 3 shows that board nominations are an area where other shareholders may be relatively more likely to oppose the board's recommendation (see paragraph 16).

19. Aer Lingus has stated that, [✂] it would seek shareholder approval for a one-off additional pension payment to offset, in part, the shortfall in employees' pensions resulting from the deficit in the pension fund. We have been told that this might be a particularly contentious issue where there was a higher than average likelihood of other shareholders opposing the recommendation of Aer Lingus's board. Ryanair has told us that other shareholders supported its opposition to Aer Lingus's potential settlement of its pensions issue.

20. Ryanair has indicated that it would oppose further payments by Aer Lingus to its pension scheme if this was put to a shareholder vote. We cannot rule out the possibility that other shareholders may join Ryanair in opposing a payment to the pension fund. In the event that it were to have the deciding vote on an Aer Lingus payment to its pension scheme, we considered that opposition by Ryanair could have significant implications for Aer Lingus's effectiveness as a competitor, in that preventing such a payment could increase the likelihood of industrial action by Aer Lingus staff. Ryanair internal documents [✂]. Aer Lingus estimated that where strike action had previously been threatened, it had lost €[✂] of revenue for each day under strike threat. Ryanair told us that industrial action would not have significant implications for Aer Lingus, because careful planning by airlines could render industrial action ineffective (for example bringing in cabin crew and chartering aircraft from other airlines). Ryanair told us that in the past it had provided such assistance to Aer Lingus to enable Aer Lingus to continue to run its services during industrial action. However, although we agreed that such options would be open to Aer Lingus in the event of a strike, we considered that the cost of industrial action to the airline (including in terms of lost bookings, many of which we would expect to go to Ryanair) would remain significant.

21. Aer Lingus is subject to the listing rules for the Irish stock exchange and it must assess major transactions in relation to the class tests (see paragraph 39). Major transactions in the 'class 1' size category require shareholder approval via an ordinary resolution. This could include the purchase of assets or merger activity. For example, in 2008, the directors of Aer Lingus convened an EGM to seek shareholder approval for the purchase of aircraft. Ryanair opposed this resolution but it was passed by a majority of Aer Lingus's shareholders (see Table 3).

22. Based on the historical evidence of Aer Lingus general meetings, Ryanair has not been able to secure a majority as an insufficient number of participating shareholders has adopted the same position on a resolution as Ryanair. The likelihood of this happening in future depends on the nature of the issue, the turnout and participation by other shareholders and their stance towards a particular matter. Although it is not possible to quantify the likelihood that this will happen in future, it remains a possibility by virtue of the vote being based on a simple majority basis.

[35] For a description of this issue, see Appendix B, paragraphs 9 to 14.

Effect of the Irish Government abstaining in shareholder votes

23. Second, we consider the effect on Ryanair's effective voting strength if the Irish Government were to abstain from a shareholder vote. This might, for example, occur if the Irish Government could not vote as a result of being involved in a related party transaction.[36]

24. Aer Lingus told us that until July 2011, the Minister for Finance was a shareholder in both Aer Lingus and DAA. So long as this was the case, Aer Lingus's ability to contract with DAA was constrained because any transaction which triggered the ratio of consideration to market capitalization threshold of 5 per cent in the listing rules of the Irish Stock Exchange would have constituted a related party transaction. A related party transaction would need to be approved by an ordinary resolution of the company's shareholders on which the Related Party may not vote. Aer Lingus said that, therefore, until July 2011 (when the Government's shareholding in the DAA was transferred to the Minister for Public Expenditure and Reform), Ryanair was in a position to block all related party transaction between Aer Lingus and the DAA.

25. Aer Lingus said [✀].

26. In addition, Aer Lingus said that if there were any other transaction between Aer Lingus and any other entity which was controlled by the Minister of Finance, Ryanair would be able to block the transaction. [✀]

27. Aer Lingus also said that Ryanair's shareholding puts the Irish Government in the position of being the pivotal voter when Ryanair intends to oppose the Aer Lingus Board. It said that this increased the pressure on the Government to abstain when the issues being voted on might be of interest to the general public or politically sensitive. It gave two examples of issues where the Irish Government would have found it difficult to vote with the Aer Lingus Board—the withdrawal of the Shannon-Heathrow service to facilitate a Belfast–Heathrow service, and the Hangar 6 episode, where Ryanair publicly called on the Irish Government to support its position because of Ryanair's promised job creation. It said that while these issues were not ultimately brought to a shareholder vote, it was possible that similarly politically-sensitive issues might arise in the future and might come to a shareholder vote in which the Irish Government could abstain.

28. If the Irish Government were to abstain, either because of its position as a related party or for any other reason, and all shareholders participated in the vote (ie there was a 100 per cent turnout), Ryanair would be able to achieve a majority with the support of 16.9 per cent of other shareholders.[37] However, the average percentage of shares voted by other shareholders in the period 2011 to 2013 was 37.2 per cent, giving Ryanair effective voting power of 64.0 per cent.[38] Turnout by other shareholders would need to rise to 66.2 per cent before Ryanair's ability to carry a majority was not certain.[39]

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[36] A major shareholder in a listed company is a related party. Related party transactions where the percentage tests exceed 5 per cent must be approved by a shareholder vote in which the related party does not participate. Source: Irish Stock Exchange, listing rules, sections 8.1.3–8.1.11. www.ise.ie/ISE_Regulation/Equity_Issuer_Rules_/Listing_Rules/Chapter_8.pdf.
[37] Ryanair: 159,231,025; other shareholders: 240,700,039. Total: 399,931,064. Required to pass ordinary resolution: 199,965,533. Ryanair requires 40,734,508 other shareholders, ie 16.9 per cent of other shares voting.
[38] Ryanair: 159,231,025. Other shareholders: 240,700,039. Based on turnout 37.2 per cent; other shareholders: 89,540,415. Total: 248,771,440.
[39] Ryanair votes 159,231,025. Other votes required to defeat Ryanair 159,231,026 assuming all vote against Ryanair. 159,231,026/240,700,039, and 66.2 per cent turnout required.

29. We note that the Irish Government told us that it would expect to take an active role at shareholder meetings and that this would not necessarily preclude voting on potentially sensitive political issues, for example Aer Lingus's pensions situation or the appointment of a Ryanair board member. Ryanair highlighted that the Irish Government had never declined to vote its shares previously.

Reduction or elimination of the Irish Government shareholding in Aer Lingus

30. Third, we consider whether Ryanair could achieve a majority if the Irish Government's shareholding were reduced below 25.1 per cent.

31. The market value of the Irish Government's shareholding is around €148–228 million.[40] We note that the Irish Government intends to sell its shares as part of its commitment to sell state assets following the 2010 fiscal support package from the Troika.[41]

32. If the Irish Government's shares were sold to an individual shareholder, this shareholder would have the same economic interest (although not necessarily the same board representation) as the Irish Government (three board nominations). Ryanair considered that in these circumstances, the new owner of the shares would be able to prevent Ryanair from achieving a majority.

33. If the Irish Government's shares were dispersed, a major countervailing constraint on Ryanair's ability to control the outcome of shareholder votes would be lost (we note that the next largest shareholder is Denis O'Brien at 3.8 per cent). Such a significant change in the distribution of share ownership could have significant implications for the relationship between management and shareholders.

34. The Irish Government told us, however, that it was unlikely to choose to sell its shareholding in a fragmented way (ie to multiple buyers). It would prefer to sell its shareholding to a group that would drive effective competition on routes between the UK and Republic of Ireland.

35. The Irish Government told us that, despite its commitment to the Troika, the disposal of its shares in Aer Lingus was not a forced sale and there was no deadline. While the Irish Government continued to seek opportunities to dispose of the shareholding, it would only do so when market conditions were favourable and on terms and at a price that was acceptable. The Irish Government said that, in the meantime, it would continue to manage its shareholding actively to protect the state's interests and with the aim of maximizing the value of the shareholding, securing dividends and encouraging new routes and additional capacity where commercially viable.[42]

36. When considering whether to sells its shares, the Irish Government expects to take into account three important considerations (the list below is non-exhaustive):

(a) ensuring competition is maintained to provide travellers with a choice of airlines for travel to and from Ireland;

(b) maintaining good connectivity for Ireland through strong links with Heathrow for onward connections and, separately, the continuance of direct transatlantic services; and

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[40] Calculation: 134,109,026 shares at €1.10 to €1.70 per share.
[41] Troika: European Stability Fund/International Monetary Fund/European Central Bank.
[42] The Irish Government said that a report in the Irish Times of 21 June 2013 stating that 'the Government has decided against selling its 25 per cent in the airline' was inaccurate.

(c) obtaining a good price for the shareholding to provide value for the taxpayer.

37. The Irish Government said that it was unlikely to sell its shares in Aer Lingus while Ryanair continued to be a significant minority shareholder.

38. Aer Lingus said that while it believed that the Irish Government would be reluctant to dispose of its shareholding whilst Ryanair retained a significant shareholding in Aer Lingus, it could not be excluded that in the future the Irish Government could dispose of its shareholding irrespective of Ryanair's holding. It said that if no prospect of a forced sell down of Ryanair's shareholding remained, it was an open question how long the Irish Government would feel able to retain its own shareholding.

Class tests for transactions under Irish stock exchange listing rules

39. Irish listing rules (Chapter 7), categorize three classes of transaction:

- *Class 3 transaction:* a transaction where all percentage ratios are less than 5 per cent;

- *Class 2 transaction:* a transaction where any percentage ratio is 5 per cent or more but each is less than 25 per cent;

- *Class 1 transaction:* a transaction where any percentage ratio is 25 per cent or more; and

- *Reverse takeover:* a transaction consisting of an acquisition by a listed company of a business, an unlisted company or assets where any percentage ratio is 100 per cent or more or which would result in a fundamental change in the business or in a change in board or voting control of the listed company.

40. The percentage ratios are calculated using four methods:

- *Gross assets test:* calculated by dividing the gross assets which are the subject of the transaction by the gross assets of the listed company;

- *Profits test:* calculated by dividing the profits attributable to the assets which are the subject of the transaction by the profits of the listed company;

- *Consideration test:* calculated by taking the consideration for the transaction as a percentage of the aggregate market value of all the ordinary shares (excluding treasury shares) of the listed company; and

- *Gross capital test:* calculated by dividing the gross capital of the company or business being acquired by the gross capital of the listed company.

41. Class 2 and 3 transactions must be notified, whereas a shareholder circular and shareholder approval is required for a Class 1 transaction.

Ryanair's attempts to call EGMs and place items on the agenda of AGMs

42. Ryanair, in common with any other shareholder holding at least 5 per cent, can requisition Aer Lingus's management to hold an EGM and, in common with any shareholder holding at least 3 per cent, can place matters on the agenda of an AGM. It has sought to do so itself on four occasions and requested the Irish Government to do so on one occasion:

- 2007: requisition EGM to require Aer Lingus to maintain Shannon–Heathrow services and take certain action in relation to the proposed Belfast–London route.[43] The Aer Lingus Board rejected this requisition;

- 2009: on 6 January 2009, Ryanair requisitioned an EGM to vote on revocation of change of control provisions contained in the CEO/CFO employment contracts. These clauses had in fact already been removed and the EGM therefore did not take place;

- 2010: Ryanair called on the Irish Government to convene an EGM at which Ryanair's votes could be used along with the Government's to require Aer Lingus to surrender its lease of Hangar 6 at Dublin Airport.[44] The Government declined to requisition an EGM;

- 2010: Ryanair wrote to Aer Lingus to call for an EGM to consider what Ryanair believed was an unlawful payment of €25.3 million to the ESOT. The Board did not call an EGM; and

- [✄]

Constraints on Aer Lingus's management time

43. According to Aer Lingus, Ryanair has sought to use its position as a shareholder to challenge Aer Lingus's management in other ways, including making complaints to regulators, making public statements on the pensions issue, initiating judicial review proceedings and seeking undertakings or commercially sensitive information:

    - September 2007: Aer Lingus received correspondence from the Financial Regulator commencing an investigation (pursuant to a complaint by Ryanair) into whether it had complied with its disclosure obligations in relation to the announcement of its decision to operate flights on the Belfast–Heathrow route and cease operating the Shannon–Heathrow route. On 21 August 2007, Ryanair had written to the financial regulator (the IFRSA) requesting that it investigate a potential breach of EU securities regulation by Aer Lingus. Aer Lingus had chosen to inform just one of its shareholders (the Irish Government) of its decision to close the Shannon–Heathrow route before informing the others. Ryanair believed that this might have infringed applicable securities regulation.

    - In January 2008, Ryanair initiated judicial review proceedings (in which Aer Lingus was joined as a notice party) seeking to compel the Regulator to investigate Aer Lingus and to advise Ryanair of its findings. Judgment was issued rejecting Ryanair's judicial review proceedings and costs were awarded to Aer Lingus. The Financial Regulator concluded its investigation in September 2008 on the basis that there was insufficient information to pursue the matter further.

    - December 2008: Following Ryanair's second bid for Aer Lingus, Ryanair initiated judicial review proceedings against the Irish Takeover Panel in which Aer Lingus

[43] Ryanair opposed Aer Lingus's decision to close the Shannon–Heathrow route in order to use the relevant Heathrow slots for a Belfast–Heathrow route. They argued that it would have been better for Aer Lingus to redeploy the Gatwick slots used for the Dublin–Gatwick route to establish a Belfast–Gatwick service, or to establish a Belfast–Heathrow service by diverting two Heathrow slots used for Dublin–Heathrow and two Heathrow slots leased out to other airlines.

[44] Aer Lingus leased Hangar 6 following the closure of SR Technics which had previously provided maintenance services to Aer Lingus. Aer Lingus claimed that this hangar was important to their minor and scheduled maintenance activities as it was the only hangar at Dublin Airport which could accommodate its A330 aircraft. Aer Lingus also reduced its property costs by selling its head office building and moving many head office functions into Hangar 6. Ryanair wanted to lease Hangar 6 itself in order to expand its in-house aircraft maintenance operations.

was joined as a party. Ryanair was seeking to challenge certain directions issued by the Irish Takeover Panel which it believed to be unfair and contrary to the requirements of the Irish Takeover Panel Act 1997 and to certain other rules and principles. The matter was settled on 18 May 2009 as Ryanair's offer for Aer Lingus lapsed, so these issues became moot. Aer Lingus was awarded its costs.

- March 2009: Following Aer Lingus's publication of its 2008 preliminary results and revised guidance for 2009, Ryanair submitted complaints to the Irish Takeover Panel, the Irish stock exchange and the London stock exchange alleging that Aer Lingus breached the Takeover/Listing Rules during the 2008 takeover in relation to its profit guidance for 2008/9. The Irish stock exchange and the Takeover Panel subsequently confirmed that their investigations had not disclosed any breach of the relevant rules.

- September 2010 to March 2011: Various correspondence from Ryanair to Aer Lingus raising a number of issues and seeking information relating to corporate policies relevant to shareholders, costs, pension deficit, the sale of the Aer Lingus head office site, the payment of dividends and airport charges.

- December 2010 to April 2011: Following an announcement by Aer Lingus regarding the making of a one-off payment to the ESOT in order to extinguish the ESOT's borrowings and, with it, Aer Lingus's obligations to pay any further share of profits to the ESOT (the 'ESOT Transaction'), Ryanair alleged that Aer Lingus had committed multiple breaches of the Irish Listing Rules, the UK Listing Rules and Irish company law. Based on complaints by Ryanair, the Office of Director or Corporate Enforcement (ODCE) initiated an investigation. Following engagement with Aer Lingus in relation to this complaint, the ODCE subsequently confirmed that it had completed its investigation and was closing its file on the matter.

- March 2011: Ryanair sent a series of questions to Aer Lingus following publication of Aer Lingus's 2010 full year results, including questions on commercial matters relating to Aer Lingus's intentions regarding fuel surcharges and its expectations in relation to future yields.

- September to October 2011: Ryanair sent further questions to Aer Lingus following publication of 2011 half-year results including questions on commercial matters relating to Aer Lingus's intentions regarding fuel surcharges and its expectations in relation to future yields. There was also further correspondence relating to the ESOT Transaction; the settlement reached by Aer Lingus in March 2011 with the Irish Revenue Commissioners relating to tax liabilities arising from payments to staff under a 2009 restructuring programme; the payment of a dividend; and seeking assurances that no further payments will be made by Aer Lingus to any pension scheme without shareholder approval.

Aer Lingus trading volumes and share price

44. Table 4 shows the average closing price and daily trading volume and value for Aer Lingus shares since its IPO in October 2006. The table also shows the average number of trading days represented by stakes of 25 and 30 per cent. In other words, a 25 per cent stake in Aer Lingus is equivalent to the number of shares traded in 288 trading days based on the volumes traded in the last seven months.

TABLE 4 **Aer Lingus share price and volume traded**

Period	Average of closing price €	Average daily volume (shares)	Average value traded €m	Number of trading days represented by a: 25 per cent stake	30 per cent stake
2/10/06–1/10/07	2.76	1,371,425	3.78	97	117
2/10/07–1/10/08	1.90	785,427	1.49	170	204
2/10/08–1/10/09	0.86	839,558	0.72	159	191
2/10/09–1/10/10	0.73	622,647	0.45	214	257
2/10/10–1/10/11	0.87	670,048	0.58	199	239
2/11/11–1/10/12	0.89	401,191	0.36	333	399
2/10/12–8/5/13	1.21	464,229	0.56	288	345

Source: Bloomberg.

Note: Shares outstanding—534,040,090.

Substitutability and competition between the UK operations of Ryanair and Aer Lingus, and their rivals

Introduction

1. In this appendix we:

   (a) assess the overlap between the UK operations of Ryanair and Aer Lingus/Aer Arann;

   (b) discuss the substitutability of the two airlines' service offering;

   (c) review direct evidence of competition between the two airlines;

   (d) consider the extent to which the two airlines impose a competitive constraint on each other via the threat of entry (potential competition); and

   (e) consider the competitive constraint imposed on Ryanair and Aer Lingus by other airlines active on the corridors between London and Dublin, South-West England and Dublin, London and Northern Ireland and Northern Ireland and Faro.

Overlap assessment

Overview of the overlap between the UK operations of Ryanair and Aer Lingus

2. The primary area of overlap between Ryanair and Aer Lingus's UK networks is on routes between Great Britain and the Republic of Ireland. Table 1 lists all airlines operating services between Great Britain and the Republic of Ireland in 2012. It shows, for each airline, the number of routes operated, the total number of outbound flights in 2012, and the total number of passengers carried on these flights.

TABLE 1 **Total number of routes, outbound passengers and outbound flights for airlines operating services between Great Britain and the Republic of Ireland, 2012**

Airline	*Routes*	*Flights*	*Passengers*	*Share of all passengers %*	*Notes*
Ryanair	25	17,899	2,349,229	49.9	
Aer Lingus	9	12,292	1,491,617	31.7	
Aer Arann	22	10,912	478,786	10.2	
British Airways	1	1,878	191,020	4.1	
Flybe	6	1,939	93,991	2.0	
City Jet	1	1,486	80,105	1.7	
Jet2	1	114	10,970	0.2	
Bmibaby	1	112	10,182	0.2	Bmibaby closed summer 2012
Loganair	1	240	4,049	0.1	

Source: CC analysis of CAA data.

Notes:
1. The totals shown are for the number of outbound passengers/flights (ie departing GB airports).
2. Routes on which ten or fewer flights were flown in the period are excluded from the table.

3. Ryanair and Aer Lingus are the largest operators of flights between Great Britain and the Republic of Ireland by some distance, carrying a combined total of 82 per cent of all passengers in 2012. Aer Arann is the third largest supplier, operating a number of

lower volume routes, and carrying around 10 per cent of all passengers. A list of all routes operated by the three airlines between Great Britain and the Republic of Ireland in 2012 is given in Annex 1.

4. In addition to flights between Great Britain and the Republic of Ireland, there are two more limited areas of overlap between the UK operations of Ryanair and Aer Lingus.

5. First, both airlines offer services between London and Northern Ireland (where Ryanair operates from Derry, Aer Lingus from Belfast). Easyjet, British Airways and Flybe all also carry significant volumes of passengers between London and Belfast.

6. Second, in 2012 both Ryanair and Aer Lingus operated a number of overlapping routes between Northern Ireland and London and certain seasonal destinations in Spain, France, Italy and Portugal.[1] Of these routes, only Northern Ireland to Faro was operated by both airlines as of May 2013. There are many other airlines with substantial operations between UK airports and European seasonal destinations, including Easyjet, British Airways, Thomas Cook, Monarch and Thomson.

Route-level overlap

7. We now consider the extent of overlap on a route-by-route basis. We use a version of the origin and destination approach to identify individual overlap corridors—pairs of origin and destination airport groupings between which both Ryanair and Aer Lingus operate.[2]

8. In some cases, the routes of two airlines will serve exactly the same origin and destination airports. Identifying overlap in these cases will be straightforward. However, in other cases airlines may serve different airports in the same city, or different airports within a relatively short distance of each other. In such instances we must decide whether the airports associated with a given pair of routes are close enough to be sufficiently substitutable to warrant inclusion in the same overlap corridor.

9. We use a distance threshold to filter out airports that are located so far away from each other that it is unlikely that a significant number of passengers would consider them substitutable. Following the European Commission, we use as our starting point a 100km/1 hour threshold.[3] On this basis we identified the following groups of potentially substitutable airports relevant to our analysis:

(a) London airports (Heathrow, Gatwick, Stansted, Luton, City, Southend);

(b) North-West England airports (Manchester, Liverpool, Blackpool, Leeds-Bradford);

(c) Birmingham/East Midlands;

(d) Glasgow/Prestwick/Edinburgh;

(e) Bristol/Cardiff; and

(f) Belfast International/Belfast City.

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[1] Specifically, the routes operated by both airlines in 2012 were London–Malaga, London–Alicante, Northern Ireland–Alicante, Northern Ireland–Tenerife, London and Grenoble-Isére, London and Lamezia, London and Turin, and Northern Ireland and Faro.

[2] This approach has been used in numerous previous airline merger inquiries, including the European Commission's two investigations into Ryanair's bids for Aer Lingus.

[3] Road distances and drive-times are calculated using the Google maps API.

10. In order to ensure that we were not missing any other potential substitutable airports, we also considered the existence of any airports located a small distance farther away than the threshold, identifying:

(a) City of Derry (with a distance of 103km and a drive-time of 94 minutes between Belfast International and City of Derry airport, and situated 91 minutes by car from central Belfast);

(b) Southampton Airport (with a distance of 105km and a drive-time of 65 minutes from London Heathrow, and situated 87 minutes by car from central London); and

(c) Exeter airport (with a distance of 110km and a drive-time of 71 minutes from Bristol airport, and situated 80 minutes by car from Bristol city centre).

11. Having established these groups of potentially substitutable airports, we identified potential overlap corridors—pairs of origin and destination airports or airport groupings between which both Ryanair and Aer Lingus/Aer Arann operate. We began by using the larger airport groupings—including the additional airports set out in paragraph 10—so as to ensure that we did not miss any potentially substitutable routes in our assessment. However, we also considered the sensitivity of our results to alternative assumptions about airport substitutability.

12. Table 2 lists the overlap corridors identified. For each corridor, we use CAA traffic data for 2012 to calculate the combined total number of outbound passengers carried by Ryanair, Aer Lingus and Aer Arann, as well as the share of all passengers on the corridor that each of these airlines carries.

TABLE 2 **Summary of corridors on which the services of Ryanair and Aer Lingus/Aer Arann overlap**

Route	*Total number of passengers carried by Ryanair, Aer Lingus and Aer Arann*	*Share of <u>all</u> passengers travelling on the corridor %*			*Airport pair?*	*Other airlines present?*
		Ryanair	*Aer Lingus*	*Aer Arann*		
(GB/Republic of Ireland—Ryanair and Aer Lingus)						
London–Dublin	1,562,819	38.2	43.7	0.9	Yes	BA (10%), CityJet (4%), Flybe (3%)
London–Cork	389,843	44.4	55.6		Yes	
London–Shannon	280,767	53.3	46.7		No	
London–Knock	133,134	70.1	29.9		No	
NW England–Dublin	532,763	72.5	25.8	1.6	Yes	
Birmingham/East Midlands–Dublin	350,057	64.8	34.7	0.4	Yes	
(GB/Republic of Ireland—Ryanair and Aer Arann)						
Glasgow/Edinburgh/Prestwick–Dublin	330,786	56.2	6.2	37.4	Yes	
Bristol/Cardiff/Exeter–Dublin	182,040	61.7		29.9	Yes	Flybe (8%)
NW England–Cork	72,941	47.0		53.0	No	
NW England–Shannon	43,988	36.0		63.9	No	
Birmingham/East Midlands–Knock	36,229	58.5		19.6	No	
(Northern Ireland—Ryanair and Aer Lingus)						
London–Northern Ireland	197,580	6.0	11.8		No	easyJet (45%), BA (20%), Flybe (15%)
Northern Ireland–Faro	37,991	11.0	31.3		No	easyjet (49%)

Source: CC analysis of CAA data.

Note: Total passenger numbers and shares of all passengers are given for 2012, and refer to outbound passengers (ie passengers departing UK airports) only.

13. As Table 2 shows, there are six corridors connecting airports in Great Britain and the Republic of Ireland (encompassing 14 Ryanair routes and eight Aer Lingus routes) where services operated by Ryanair and Aer Lingus overlap. Ryanair and Aer Lingus services account for all or the vast majority of services on these corridors. Aer Lingus carried a total of 1.47 million outbound passengers on routes on these six corridors in 2012 (around three-quarters of all passengers carried by Aer Lingus from UK airports in the year), Ryanair 1.75 million outbound passengers (12.9 per cent of all passengers carried by Ryanair from UK airports in the year). Total calendar year 2011 revenue for Ryanair on these routes was around €[✂].[4] Aer Lingus total passenger revenue on these routes for calendar year 2011 was around €[✂].[5]

14. We considered the sensitivity of these findings to the assumptions made about airport substitutability. We find that:

(a) excluding the three airports falling just outside the 100km/1-hour distance threshold (City of Derry, Southampton, Exeter) has no impact on the six overlap corridors identified;

[4] Source: Ryanair. Total calculated as *totalgrossrev* + *totaladminexcessbag* + *totalotherrev*.
[5] Source: Aer Lingus. Total calculated as *purepaxrev* + *recoverablerev* + *retailrev*.

(b) adjusting the airport groupings to exclude those airports where the European Commission did not draw a firm conclusion on substitutability in its decision (Southend and the London airports, Birmingham/East Midlands, Manchester/Liverpool/Leeds Bradford) or to exclude airports in those cases where Ryanair argued that airports were not substitutes (Birmingham/East Midlands, Manchester/Liverpool/Leeds Bradford) does not affect the number of overlap corridors that we identify (although it does reduce our estimate of the combined total number of outbound passengers carried on these six corridors in 2012 from 3.2 million to 2.9 million). It has only a limited impact on the overall shares of supply of Ryanair and Aer Lingus on the corridors (generally making the shares of Ryanair and Aer Lingus more even); and

(c) finally, looking only at overlap where the airlines operate between the same airports, we found that Ryanair and Aer Lingus overlapped on three routes on which they were both still active in May 2013, between London Gatwick and Dublin, Manchester and Dublin and Birmingham and Dublin. The airlines are the only two operators on each of these routes, and carried a combined total of around 1 million outbound passengers in 2012.

15. We have also identified a further five corridors connecting airports in Great Britain and the Republic of Ireland (encompassing six Ryanair routes and eight Aer Arann routes) where services operated by Ryanair and Aer Arann overlap. In all cases the two airlines account for all or the vast majority of services. Ryanair carried a total of 0.39 million outbound passengers on these routes in 2012, Aer Arann 0.26 million.

16. Looking only at instances where the airlines offer services between the same airports, we found that both Ryanair and Aer Arann operate between Edinburgh and Dublin and Bristol and Dublin. Aer Lingus also operated a lower frequency summer service between Edinburgh and Dublin in 2012 (although this service was discontinued from summer 2013), while Ryanair and Aer Arann were the only two operators on the Dublin to Bristol route. The airlines carried a combined total of 0.33 million outbound passengers on these two routes in 2012.

17. Finally, we have identified two further overlap corridors, between Northern Ireland and London, and between Northern Ireland and Faro. The extent of overlap here is weaker, given the significant distance between City of Derry airport (where Ryanair operates) and the Belfast airports (from which Aer Lingus operated in 2012). A total of 0.24 million outbound passengers were carried by the two airlines on these routes in 2012.

18. In Annex 2, we provide detailed, route-level information on each of these overlap corridors, presenting:

(a) a map showing the airports served;

(b) information on the total number of flights and the total number of passengers carried by each airline on the route; and

(c) information on the average weekly frequency operated by each airline on the route.

Substitutability of the airlines' service offering

19. In addition to the route served, there are various other ways that one airline's offering may differ from another's, which will affect the extent to which passengers consider their services to be substitutable. Specifically, airlines can differentiate their product

in terms of the level of frills provided to passengers, both in terms of the additional services that passengers are offered, and the extent to which these services are included in ticket prices.

20. In this section we consider the substitutability of the offering of Ryanair and Aer Lingus in these other dimensions. We begin by setting out the European Commission's findings on the substitutability of the two airlines' offerings. We then go on to discuss the general business model of the two airlines, and compare the services offered and the average prices charged on overlap corridors. Finally, we set out our conclusions.

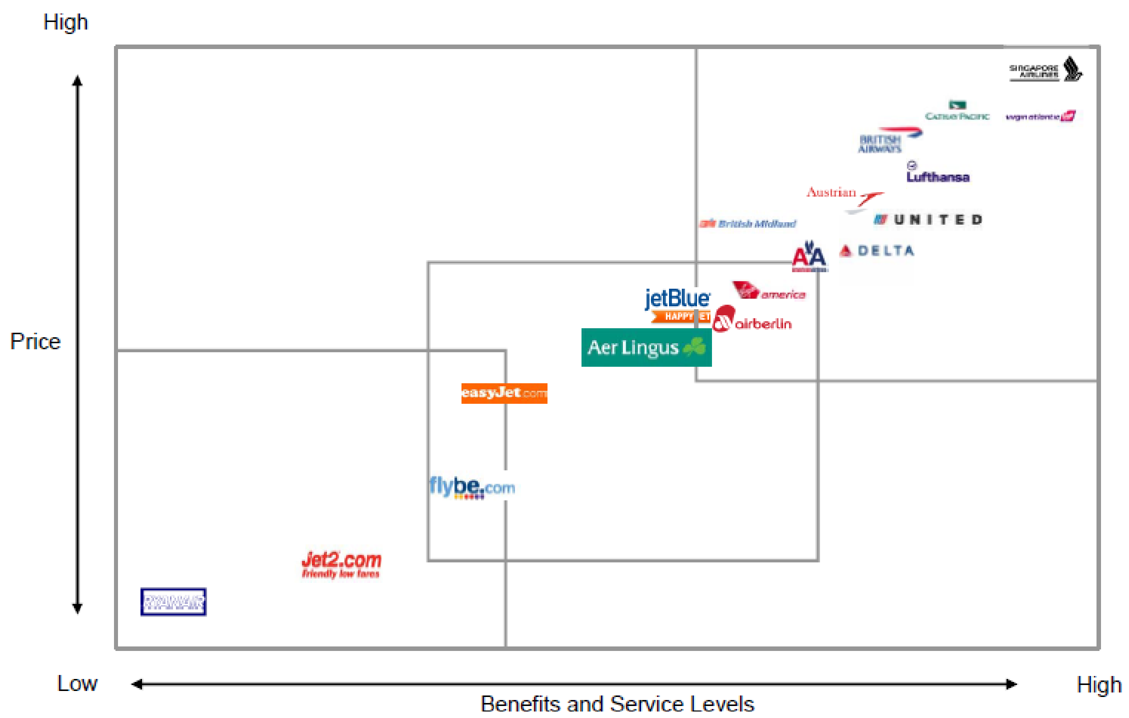
21. In its decision, the European Commission found that there were some differences in the business models of the two airlines, with Aer Lingus providing a mid-frills service offering when compared with Ryanair's no-frills model. However, it concluded that even if the services of the two airlines were not identical, Ryanair's service offering was the closest to that of Aer Lingus in comparison with other carriers on overlap routes, and that Aer Lingus's level of services was generally very close (if not the closest) to that of Ryanair in comparison with other carriers on overlap routes.

22. Aer Lingus said that since 2009 it had emphasized its positioning as a 'value carrier' between the low-cost and full-service carriers, with a strong core product and offering additional paid options.

23. Figure 1, taken from a 2010 board meeting presentation setting out Aer Lingus's strategy, shows Aer Lingus's assessment of its competitive position among a number of different airlines in terms of 'benefits and service levels'.

FIGURE 1

Slide from Aer Lingus internal strategy presentation showing its positioning in terms of benefits and service levels



Source: Aer Lingus.

24. Ryanair said that its business model is based on low costs, maximum efficiency, basic services, and consistently offering the lowest fares to customers. It typically serves secondary or regional airports which tend to be farther from city centres and offer fewer facilities. In contrast to many airlines, Ryanair does not specifically target customers who value additional services such as allocated seating, flexible fares, business lounges, airport check-in, frequent flyer programmes or connecting services.

25. Table 3 provides a comparison of the services offered by Ryanair and Aer Lingus across a number of different categories for passengers travelling on a basic ticket. In most cases the service offering of the two airlines is similar, with both airlines operating a single class, selling most or all of their tickets via their websites, and optional additional charges for checked baggage, seat choice and food and drink. However, consistent with its positioning as a mid-frills value carrier, in some categories Aer Lingus provides a higher level of ancillary services, offering passengers allocated seating and airport check-in included in the ticket price, and flexible ticketing and lounges for an additional charge.

TABLE 3 **Services offered by Ryanair and Aer Lingus**

Service	*Ryanair*	*Aer Lingus*
Off board		
Booking	Website only	Predominantly via website
Flexible tickets	No	Additional charge
Airport check-in	Additional charge	Yes
Jet-ways	No	Occasional use
Frequent flyer program	No	Yes (although points accrued only on Plus and Flex fares)
Lounges	No	Additional charge
Checked baggage	Additional charge	Additional charge
Airports	Secondary	Central
On board		
Travel classes	No	No
Seat choice	Additional charge	Additional charge
Allocated seating	Additional charge	Yes
Food and drink	Additional charge	Additional charge

Source: CC analysis of Ryanair's and Aer Lingus's websites and questionnaire responses.

26. Aer Lingus said that it introduced flexible tickets on its short-haul network in 2008.[6] 'Flex' tickets allow refund and rebooking, as well as lounge access.[7] Nevertheless, it told the European Commission that the vast majority of its short-haul fares are one-way restricted tickets, with flexible fares representing less than [✂] per cent of total Aer Lingus Internet bookings on short-haul routes. 'Low' and 'Plus' tickets are non-refundable and incur change fees. 'Plus' tickets carry the same underlying fare as 'Low' tickets but bundle optional ancillary products (advanced seat selection and checked baggage).

27. Table 4 provides estimates of the average prices charged by Ryanair and Aer Lingus on overlap corridors, based on CAA airport survey data for 2010 and 2011. Consistent with the different business models of the two airlines, we estimate that Ryanair's average prices were around [✂] per cent of Aer Lingus's in this period on the main overlap corridors between Great Britain and the Republic of Ireland. The average price estimates must be interpreted with caution, however, in particular

[6] Aer Lingus's flexible tickets were available prior to 2005; following the phasing-out of business class on Aer Lingus short-haul services by March 2005, only one fare type was offered until the introduction of 'Flex'.
[7] Aer Lingus website, www.aerlingus.com/i18n/en/htmlPopups/obe_help.html.

given the substantial degree of variation in the prices paid by different passengers. Aer Lingus said that in its experience, the price differential faced by the consumer between Aer Lingus and Ryanair was modest and that whilst the price of a given flight varied over time, the fares of Aer Lingus and Ryanair moved closely together.

TABLE 4 **Ryanair and Aer Lingus fares averaged across passengers on routes on overlap corridors**

		CAA survey data		
Corridor	*Airline*	*Mean price £*	*Standard deviation £*	*Sample size*
London–Dublin	Ryanair	[✂]	[✂]	[✂]
	Aer Lingus	[✂]	[✂]	[✂]
London–Cork	Ryanair	[✂]	[✂]	[✂]
	Aer Lingus	[✂]	[✂]	[✂]
London–Shannon	Ryanair	[✂]	[✂]	[✂]
	Aer Lingus	[✂]	[✂]	[✂]
London–Knock	Ryanair	[✂]	[✂]	[✂]
	Aer Lingus	[✂]	[✂]	[✂]
NW England–Dublin	Ryanair	[✂]	[✂]	[✂]
	Aer Lingus	[✂]	[✂]	[✂]
Birmingham/East Midlands–Dublin	Ryanair	[✂]	[✂]	[✂]
	Aer Lingus	[✂]	[✂]	[✂]

Source: CC analysis of CAA data.

Note: Price data is based on responses to CAA airport survey, 2010 and 2011, pooled across both years and all routes within each corridor.

28. We also considered the journey purpose of the passengers carried by the two airlines. Passengers travelling with different journey purposes may have different preferences, so if Ryanair and Aer Lingus serve entirely different customer bases, this could suggest that different passenger types may not consider them substitutable.

29. Table 5 sets out data from the CAA showing the stated journey purpose of passengers on overlap corridors between Great Britain and the Republic of Ireland on which both Ryanair and Aer Lingus are active. These figures are derived from passenger surveys carried out in 2010 and 2011.

TABLE 5 **Stated journey purpose of Ryanair and Aer Lingus averaged across passengers on routes on overlap corridors**

	Ryanair				*Aer Lingus*			
Corridor	*Business %*	*Holiday %*	*VFR* %*	*Sample size*	*Business %*	*Holiday %*	*VFR* %*	*Sample size*
London–Dublin	20.5	22.4	57.1	4,380	36.1	23.0	40.9	2,411
London–Cork	16.9	20.6	62.6	724	32.3	22.9	44.7	872
London–Shannon	14.4	21.9	63.7	730	27.4	25.1	47.5	518
London–Knock	7.6	16.9	75.5	775	7.9	16.9	75.3	178
NW England–Dublin	21.7	41.1	37.2	1,648	45.6	26.0	28.4	665
Birminham/East Midlands–Dublin	19.2	22.7	58.1	1,326	36.5	17.5	46.0	748

Source: CC analysis of CAA data.

*VFR = Visiting friends or relatives.

30. The table shows that Aer Lingus generally carries a greater proportion of business passengers than Ryanair, a slightly lower proportion of passengers on holiday, and a lower proportion of passengers travelling in order to visit friends or relatives.

Nevertheless, both airlines carry significant numbers of all three categories of passenger on all corridors.

Direct evidence of competition between Ryanair and Aer Lingus

31. We also considered direct evidence of the parties competing with each other.

Price comparisons

32. Both Ryanair and Aer Lingus take the behaviour of each other into account in determining their prices.

33. Ryanair said [✂].[8]

34. Extracts from [✂] highlight a number of instances where Ryanair has made price reductions in response to competition from Aer Lingus, or price increases in response to high Aer Lingus fares. [✂]

35. Similarly, Aer Lingus said that it continually benchmarked its product offering against competitors and set its fares accordingly. Fares are monitored using QL2 and via manual comparisons of competitors' websites (with the latter method particularly being used for promotions).[9] Although it does not generally aim to be cheaper than Ryanair (in particular because of some differences in offered services, like airports served and superior customer service levels), Ryanair's pricing has a direct effect on Aer Lingus's pricing (with Aer Lingus attempting to avoid the difference between the two companies' prices from becoming too great).

36. In addition to its core fares, Aer Lingus said that in setting the retail fees for ancillary products, it constantly reviewed its competitors' charges, particularly Ryanair's. The comparisons are performed manually. The charges for ancillary products are typically set on a uniform basis across all short-haul routes.

37. This evidence strongly suggests that the airlines place a direct competitive constraint on each other on overlap routes, with the prices set by one party having a direct impact on the prices set by the other.

Other competitor monitoring

38. In addition to this ongoing price comparison, we were provided with various other internal documents prepared by the parties in the course of business that confirmed that they monitored each other's behaviour.

39. [✂]

40. In addition, we saw a number of regular documents produced by Aer Lingus monitoring Ryanair's market share and capacity, as well as the ancillary services it offers (and the charges for these services). There are also documents carrying out detailed comparisons of the fare profiles of Ryanair and Aer Lingus, and discussing the reaction of Ryanair to Aer Lingus promotions.

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[8] [✂]
[9] In terms of specific routes, Aer Lingus uses QL2 to monitor Ryanair's prices on all routes on the overlap corridors identified in Table 1, with the exception of Ryanair's services between Dublin and East Midlands, Dublin and Liverpool and Dublin and Leeds Bradford (although these routes are subject to ad-hoc monitoring by analysts). In addition, Aer Lingus also monitors Ryanair's prices on some of the overlap corridors identified in Table 2, and passes this information to Aer Arann (who is responsible for setting prices on these routes).

Pricing econometrics

41. In its recent decision, the European Commission used regression analysis to investigate whether the presence of one of the parties on a corridor has an impact on the fares of the other, and to estimate the magnitude of any such effect. Using monthly data from Aer Lingus and Ryanair on fares and fuel costs, and DAA data on frequencies, passengers and capacity for the period November 2004 to July 2012, it regresses the average fares of Ryanair and Aer Lingus in each month on a variable indicating whether the other party is present, as well as a number of other explanatory variables.[10] It uses a fixed effects approach, including in its specifications route dummies to account for any factors affecting variation in average fares across routes that is not controlled for in the model.

42. It finds:

(a) Ryanair's presence on a corridor is associated with a 7 to 14 per cent decrease in Aer Lingus's average fares, depending on the specification. Aer Lingus's presence on a corridor is associated with a 3 to 14 per cent decrease in Ryanair's average fares. In both cases, the European Commission finds that the effect is economically and statistically significant in all tested regressions, and highly robust to the use of alternative specifications.

(b) In both models, the presence of Ryanair or Aer Lingus has a stronger economic impact than the presence of any other type of carrier. The presence of flag carriers is found to have a significant negative impact on Aer Lingus's average fares, the presence of non-flag carriers is found to have a significant negative impact on Ryanair's average fares (although this effect is not robust in the different specifications). The regressions indicate that the presence of other airlines has either no economic or statistically significant effect on the average fares of Ryanair or Aer Lingus.

(c) Finally, a 1 per cent increase in the frequencies of Ryanair is associated with a decrease in Aer Lingus's average fares of around 5 to 6 per cent. A 1 per cent increase in the frequencies of Aer Lingus is associated with around a 2 per cent decrease in Ryanair's average fares.

43. In our view this analysis provided further evidence of a competitive constraint between the two airlines, and their actions impacting upon each other's pricing behaviour.

Promotions and marketing

44. Finally, we noted a number of Ryanair promotional campaigns directly targeting Aer Lingus. Some examples of text from advertisements are:

(a) 'Ryanair's Fares are lower than Aer Lingus ... even in 1954' (2001)

(b) 'Aer Lingus's biggest ever sale fares are twice the price of Ryanair's fares' (2003)

(c) 'Ryanair fares at least half of Aer Lingus's lowest fares. (2005)

(d) 'Ryanair fares are less than half of Aer Lingus's lowest fares' (2007)

[10] These include variables indicating the presence of other airlines, month dummies, the airlines' capacity, total frequencies at the destination airport and fuel costs.

(e) ‘Beat the recession—avoid high fare airlines’, followed by text comparing Aer Lingus and Ryanair fares (2009)

(f) ‘Fly Ryanair and avoid Aer Lingus strikes’ (2011)

45. Again, these promotions show Ryanair directly targeting Aer Lingus passengers, suggesting a level of competition between the two airlines.

Potential competition

46. We considered the extent to which Ryanair and Aer Lingus might impose a competitive constraint on each other via the threat of entry.

47. In its decision, the European Commission found that both Aer Lingus and Ryanair exert a significant constraint on each other on a number of routes on which they are not currently both active, including two routes involving a UK airport. Specifically, it found that Ryanair would be the most credible potential entrant on Aer Lingus’s route between Cork and Birmingham, and that Aer Lingus would be the most credible potential entrant on Ryanair’s route between Newcastle and Dublin.

48. We assessed the credibility of the threat of entry by Ryanair and Aer Lingus on (i) routes between the Republic of Ireland and Great Britain and (ii) other UK routes.

Routes between the Republic of Ireland and Great Britain

49. In Appendix J, we consider the history of entry, expansion and exit on routes between Great Britain and Ireland since 2006. We note that Ryanair and Aer Lingus have entered on routes between Great Britain and the Republic of Ireland in competition with each other on various occasions in this period.[11] When we looked at airlines other than Aer Lingus, Aer Arann and Ryanair, we did not find any examples of sustained entry on the overlap routes into Ireland. Other airlines have typically entered for a few seasons and then exited, and/or gone bankrupt.

50. We identified a number of factors which may deter or impede entry on routes between Great Britain and the Republic of Ireland. These included early morning capacity constraints at Dublin Airport and some UK airports, the need to establish a well-known brand and base in Ireland, the relative unattractiveness of the Irish market, the potential for an aggressive response by Ryanair and the level of taxes and airport charges.

51. Given their established position on routes between Great Britain and the Republic of Ireland, we considered that many of these factors would be likely to be less of a deterrent to new entry by Ryanair or Aer Lingus than for other operators that were not active on corridors between Great Britain and the Republic of Ireland. However, early morning capacity constraints at Dublin and some UK airports could reduce the likelihood of Ryanair and Aer Lingus entering or expanding in competition with each other, as could the economic climate and size of the Irish market. This would be likely to weaken any competitive constraint imposed by the two airlines via the threat of entry.

52. We identified three corridors on which Ryanair was active in 2012 but Aer Lingus and Aer Arann were not: Bristol/Cardiff/Exeter–Knock; London–Kerry; and Newcastle–

[11] For example, Aer Lingus entered Dublin–London Gatwick in summer 2007 and has remained on this route.

Dublin. We identified seven corridors on which Aer Arann was active in March 2013 but Ryanair was not: Aberdeen–Dublin; Birmingham/East Midlands–Cork; Birmingham/East Midlands–Shannon; Bournemouth–Dublin; Bristol/Cardiff/Exeter–Cork; Edinburgh/Glasgow/Prestwick–Cork; Edinburgh/Glasgow/Prestwick–Shannon. We were not aware of any routes between Great Britain and the Republic of Ireland on which Aer Lingus was active, but Ryanair was not.

53. Given the above, our initial view is that Ryanair and Aer Lingus may—via the threat of entry—impose a competitive constraint on each other on routes between Great Britain and the Republic of Ireland on which both airlines are not already active.

Other UK routes

54. We also considered whether Aer Lingus was a potential entrant on domestic UK routes or routes from the UK to non-Irish destinations flown by Ryanair.[12]

55. With regard to the likelihood of entry, we noted that in the past Aer Lingus had previously operated routes from Gatwick to non-Irish destinations, announcing in 2008 that it planned to locate four aircraft at Gatwick from April 2009,[13] and subsequently operating services to Malaga and Turin among other destinations. In addition, Aer Lingus applied to the European Commission for slots for services between London and Edinburgh which were divested subsequent to the IAG/bmi transaction. Aer Lingus's bid was ranked below that of Virgin and Aer Lingus has appealed the European Commission's decision.[14]

56. We considered whether any of the impediments to entry on routes between Great Britain and the Republic of Ireland identified in Section 7 of our main report might also reduce the likelihood of entry by Aer Lingus on routes between the UK and destinations outside the Republic of Ireland:

(a) Airport facilities—we noted that there were some capacity constraints, particularly at peak times, at Gatwick, London City, Luton, Manchester and Stansted airports. Heathrow is capacity constrained throughout the day.

(b) Brand—we noted that the Aer Lingus brand was likely to be less well-known in the UK than in Ireland.

(c) Bases—we noted that Aer Lingus bases a single aircraft at Gatwick airport and three at Belfast City airport (although the number of aircraft based at London Gatwick by Aer Lingus has previously been higher).

(d) Economic environment—the UK economy is expected to grow slowly and there remains considerable uncertainty regarding the economic environment.

(e) Aggressive response—several airlines told us that possible entrants may expect an aggressive response by Ryanair.

(f) Taxes and airport fees—as discussed in Appendix J, we noted that UK airline passenger duties are higher than those in other European countries. There is

[12] Since Aer Lingus does not currently operate routes from Great Britain to non-Irish destinations we did not consider whether Ryanair was a potential entrant on these routes.
[13] http://corporate.aerlingus.com/investorrelations/regulatorynews/2008pressreleases/New_base_announcement_191208_Revised.pdf.
[14] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:101:0031:0032:EN:PDF.

also evidence to suggest that Heathrow airport charges are relatively high and this could also act to reduce entry or expansion by Aer Lingus from Heathrow.[15]

57. We noted that there were other airlines such as British Airways, easyJet and Flybe which may be better placed to enter or expand on UK routes because they have much larger bases than Aer Lingus in the UK and are also likely to have higher brand profiles in the UK.

58. Given the above, our initial view is that Aer Lingus is unlikely to impose a strong competitive constraint on Ryanair's operations from the UK via the threat of entry.

The competitive constraint imposed on Ryanair and Aer Lingus by other airlines

London to Dublin

59. As set out in Annex 2, in addition to Ryanair and Aer Lingus, both British Airways and CityJet operate between London and Dublin—British Airways from London Heathrow and CityJet from London City airport. Both airlines operated an average weekday frequency of around ten services a day in 2012.

60. In its assessment, the European Commission concluded that Ryanair and Aer Lingus are each other's closest competitors on the Dublin to London route.

61. We found that the overall competitive constraint imposed by British Airways and CityJet on the corridor was unlikely to be as strong as that between Aer Lingus and Ryanair:

(a) overall between London and Dublin, Aer Lingus and Ryanair have substantially higher frequencies, each operating around three times as many flights as British Airways and CityJet;

(b) British Airways and CityJet both operate a higher-frills business model than Ryanair and Aer Lingus, carrying more business passengers. Specifically, CityJet offers assigned seats, drinks and snacks included in the ticket price, central airport location and a frequent flyer program. British Airways offers a business class option, complimentary food and drink, and no charge for checked baggage. This suggests that these airlines may provide a weaker competitive constraint for passengers with a preference for a lower frills, cheaper fares service; and

(c) British Airways and CityJet would not present a strong alternative for Dublin-bound passengers with a strong preference for Gatwick, from which both Aer Lingus and Ryanair operate.

62. Notwithstanding this, we judged that CityJet and British Airways provide some constraint. [✂] Competition between the parties and British Airways and CityJet for business passengers (of which both Ryanair and Aer Lingus carry a significant proportion between London and Dublin) and passengers with a preference for travelling from central London is likely to be particularly strong. In addition, the constraint imposed on Aer Lingus by British Airways for passengers with a preference for travelling from London Heathrow may also be significant.

[15] www.caa.co.uk/docs/78/Q6LFComparingAptCharges.pdf.

South-West England to Dublin

63. Flybe operates a service between Exeter and Dublin, potentially offering an alternative to passengers travelling on Ryanair and Aer Arann flights between Bristol and Dublin.

64. We found that the strength of the competitive constraint from Flybe's Exeter service on Ryanair and Aer Arann's routes from Bristol was likely to be weak:

(a) as shown in Annex 2, Ryanair and Aer Arann operate a significantly higher average daily frequency on the corridor, running six and four daily services from Bristol respectively in 2012 compared with Flybe's average daily frequency of two services;

(b) Exeter is relatively distant from Bristol, with a drive-time of 71 minutes to Bristol airport and 83 minutes to Bristol city centre. Given this, we would expect Aer Arann's service to place a much stronger constraint on Ryanair's service (and vice versa) for passengers with a preference for travelling from Bristol airport; and

(c) [✄]

London to Northern Ireland, Northern Ireland to Faro

65. In addition to Ryanair and Aer Lingus, easyJet, British Airways and Flybe operate services between London and Northern Ireland. easyJet also operates services between Northern Ireland and Faro, and is the largest operator on both of the corridors.

66. In its investigation, the European Commission did not identify either corridor in its list of problematic overlap routes. The distance between the Belfast airports (from which Aer Lingus operates) and City of Derry airport (from which Ryanair operates) is significant, and may be sufficiently large that only a small proportion of passengers would consider the two airports to be substitutable.

67. We considered that to the extent that these airports are substitutable, the strength of the competitive constraint imposed on Ryanair and Aer Lingus by other airlines active on the corridor—and particularly easyJet—was likely to be strong:

(a) as shown in Annex 2, easyJet operates a substantially higher frequency between London and Northern Ireland than both Ryanair and Aer Lingus, with an average daily frequency of around 25 flights across all of its routes on the corridor, compared with Ryanair's two to four flights a day, and Aer Lingus's six daily flights;

(b) easyJet's business model places it somewhere between Aer Lingus and Ryanair, which is likely to make it a particularly strong competitor to Ryanair for passengers with a strong preference for a low-frills/fares service offering; and

(c) easyJet's routes are likely to offer a particularly strong alternative for Aer Lingus passengers with a preference for travelling from Belfast, and for Ryanair passengers with a preference for travelling from Stansted or Luton airports.

List of all Ryanair, Aer Lingus and Aer Arann routes between Great Britain and the Republic of Ireland operated in 2012

Ryanair

Origin airport	*Destination airport*
Birmingham International Airport	Dublin Airport
Bristol Airport	Dublin Airport
Bristol Airport	Ireland West Airport Knock
East Midlands Airport	Dublin Airport
East Midlands Airport	Ireland West Airport Knock
Edinburgh Airport	Dublin Airport
Glasgow Prestwick Airport	Dublin Airport
Leeds/Bradford Airport	Dublin Airport
Liverpool John Lennon Airport	Cork Airport
Liverpool John Lennon Airport	Dublin Airport
Liverpool John Lennon Airport	Ireland West Airport Knock
Liverpool John Lennon Airport	Shannon Airport
London—Gatwick Airport	Cork Airport
London—Gatwick Airport	Dublin Airport
London—Gatwick Airport	Shannon Airport
London—Luton Airport	Dublin Airport
London—Luton Airport	Ireland West Airport Knock
London—Luton Airport	Kerry County Airport
London—Stansted Airport	Cork Airport
London—Stansted Airport	Dublin Airport
London—Stansted Airport	Ireland West Airport Knock
London—Stansted Airport	Kerry County Airport
London—Stansted Airport	Shannon Airport
Manchester International Airport	Dublin Airport
Newcastle Airport	Dublin Airport

Aer Lingus

Origin airport	*Destination airport*
Birmingham International Airport	Dublin Airport
Edinburgh Airport	Dublin Airport
London—Gatwick Airport	Cork Airport
London—Gatwick Airport	Dublin Airport
London—Gatwick Airport	Ireland West Airport Knock
London—Heathrow Airport	Cork Airport
London—Heathrow Airport	Dublin Airport
London—Heathrow Airport	Shannon Airport
Manchester International Airport	Dublin Airport

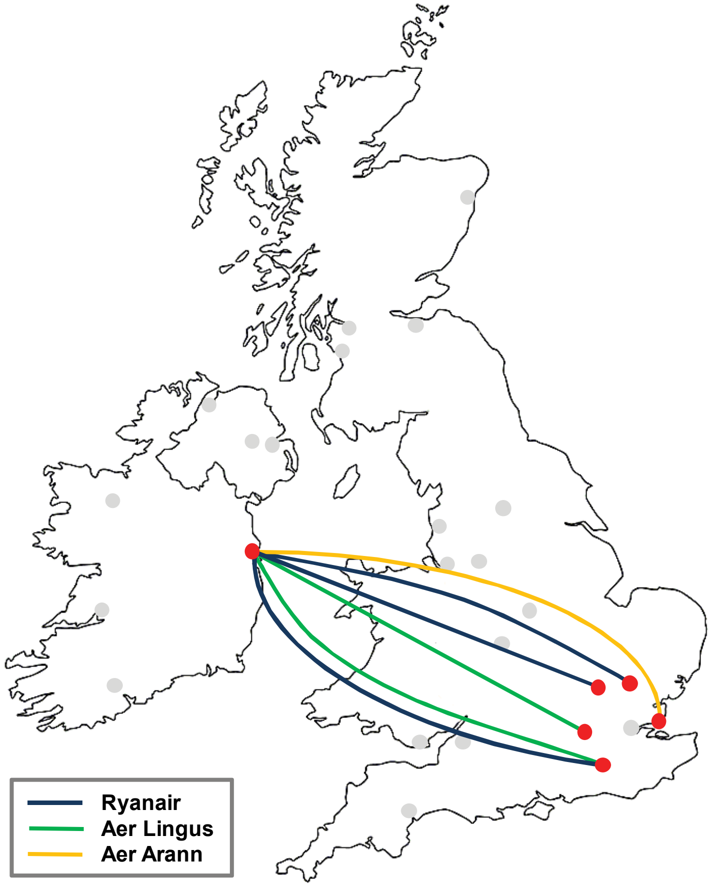
Aer Arann

Origin airport	*Destination airport*
Aberdeen Airport	Dublin Airport
Birmingham International Airport	Cork Airport
Birmingham International Airport	Dublin Airport
Birmingham International Airport	Ireland West Airport Knock
Birmingham International Airport	Shannon Airport
Blackpool Airport	Dublin Airport
Bournemouth International Airport	Dublin Airport
Bristol Airport	Cork Airport
Bristol Airport	Dublin Airport
Bristol Airport	Shannon Airport
Cardiff Airport	Dublin Airport
Edinburgh Airport	Cork Airport
Edinburgh Airport	Dublin Airport
Edinburgh Airport	Shannon Airport
Glasgow International Airport	Cork Airport
Glasgow International Airport	Dublin Airport
London—Luton Airport	Waterford Airport
Manchester International Airport	Cork Airport
Manchester International Airport	Shannon Airport
Manchester International Airport	Waterford Airport
Southend Municipal Airport	Dublin Airport
Southend Municipal Airport	Waterford Airport

Source: CC analysis of CAA data.

Overlap corridors

1. London–Dublin



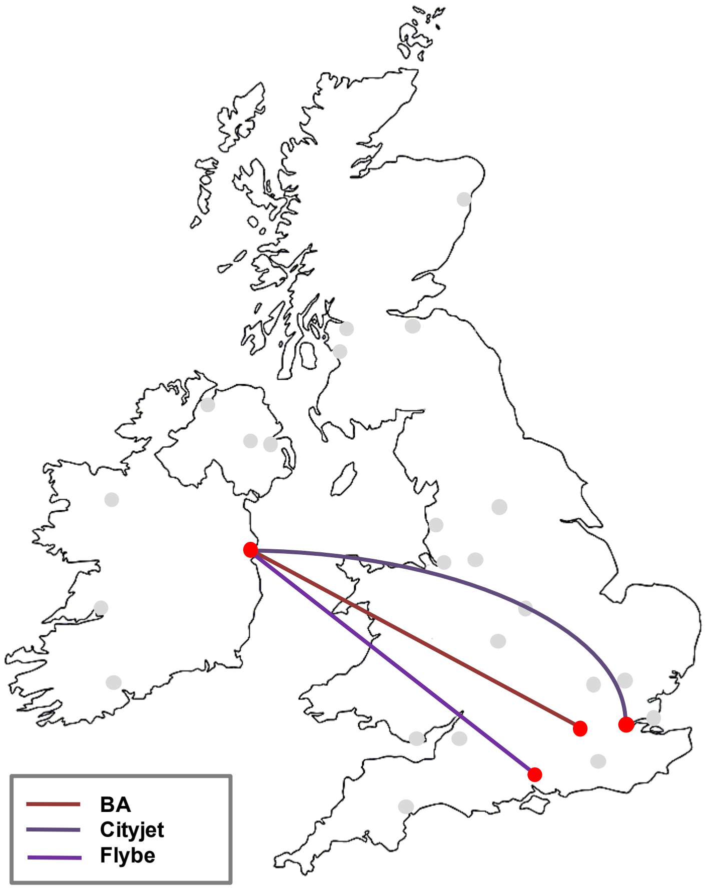


TABLE 1 **Number of outbound flights, passengers and average daily frequencies, London–Dublin**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*	*Notes*
STN	DUB	Ryanair	2,442	339,442	18.0	
LGW	DUB	Ryanair	1,625	234,125	12.4	
LTN	DUB	Ryanair	1,071	146,960	7.8	
		Ryanair—Total	**5,138**	**720,527**	**38.2**	
LHR	DUB	Aer Lingus	4,544	584,922	31.0	
LGW	DUB	Aer Lingus	2,001	239,509	12.7	
		Aer Lingus—Total	**6,546**	**824,602**	**43.7**	
SEN	DUB	Aer Arann	649	17,690	0.9	
		Aer Arann—Total	**653**	**17,890**	**0.9**	
LHR	DUB	British Airways	1,878	191,020	10.1	BA took over bmi routes summer 2012
LCY	DUB	CityJet	1,486	80,105	4.2	
SOU	DUB	Flybe	969	51,317	2.7	

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
STN	DUB	Ryanair	13	13	12	13	14	14	14
LGW	DUB	Ryanair	10	8	8	8	10	8	10
LTN	DUB	Ryanair	6	6	6	6	6	6	6
		Ryanair—Total	**29**	**27**	**27**	**27**	**30**	**28**	**30**
LHR	DUB	Aer Lingus	26	26	26	26	26	24	23
LGW	DUB	Aer Lingus	12	12	12	12	12	8	9
		Aer Lingus—Total	**38**	**38**	**38**	**38**	**38**	**31**	**32**
SEN	DUB	Aer Arann	5	4	5	5	5	5	5
		Aer Arann—Total	**5**	**4**	**5**	**5**	**5**	**5**	**5**
LHR	DUB	British Airways	10	10	9	10	9	7	7
LCY	DUB	CityJet	10	11	10	10	10	2	4
SOU	DUB	Flybe	6	6	6	6	6	3	5

Key:

STN	London Stansted	SEN	Southend
LGW	London Gatwick	LCY	London City
LTN	London Luton	DUB	Dublin
LHR	London Heathrow	SOU	Southampton

Source: CC analysis of CAA data.

Notes:
1. Flights and passenger number totals are for calendar year 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

1. Table 1 shows that:

(a) Ryanair and Aer Lingus directly overlap on flights between Dublin and London Gatwick. The airlines run similar frequencies on this route. No other airlines operate between these airports.

(b) In terms of the wider London to Dublin corridor, Ryanair and Aer Lingus are the two largest operators, carrying a combined total of 82 per cent of all passengers

travelling on the corridor. In addition, Aer Arann runs a lower frequency service to Southend (if this route is included, the combined share of passengers carried by Ryanair, Aer Lingus and Aer Arann on the corridor is 83 per cent).

(c) British Airways and CityJet also offer services on the corridor, and together account for around 14 per cent of all passengers flying between London and Dublin. British Airways operates from Heathrow (from which Aer Lingus also operates the majority of its flights between London and Dublin), CityJet from London City (from which neither Aer Lingus nor Ryanair operates).

(d) Flybe offers a service from Southampton, approximately an hour and a half from central London by car, and an hour and ten minutes by train.

2. London–Cork

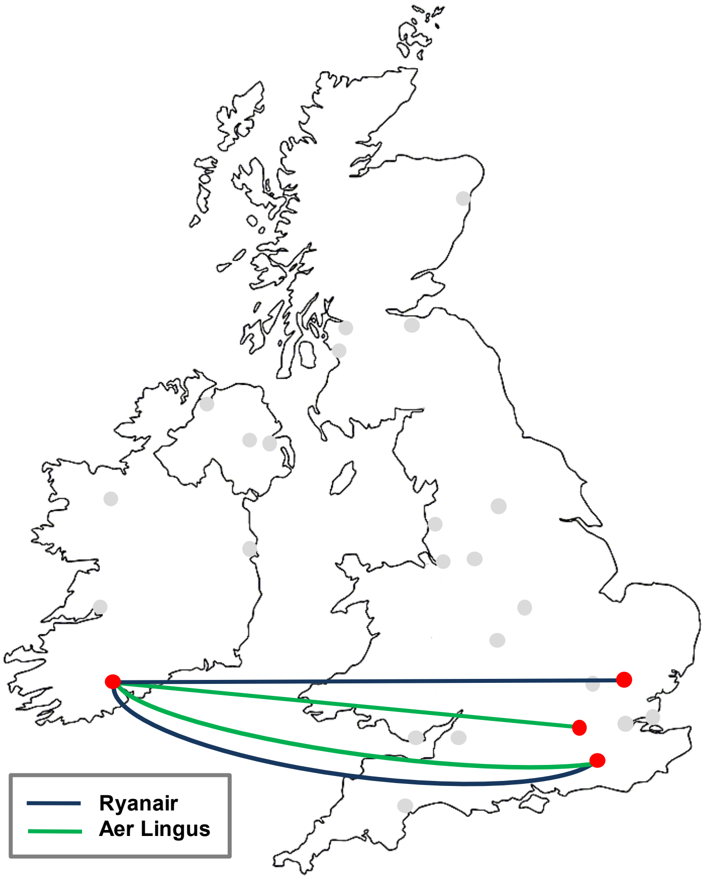


TABLE 2 **Number of outbound flights, passengers and average daily frequencies, London–Cork**

Origin	*Destination*	*Airline*	*Total number of outbound flight*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*
STN	ORK	Ryanair	798	115,612	29.7
LGW	ORK	Ryanair	374	57,363	14.7
		Ryanair—Total	**1,172**	**172,975**	**44.4**
LHR	ORK	Aer Lingus	1,463	190,539	48.9
LGW	ORK	Aer Lingus	272	26,329	6.8
		Aer Lingus—Total	**1,735**	**216,868**	**55.6**

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
STN	ORK	Ryanair	5	4	4	4	5	4	4
LGW	ORK	Ryanair	2	2	2	2	2	2	2
		Ryanair—Total	**7**	**6**	**6**	**6**	**7**	**6**	**6**
LHR	ORK	Aer Lingus	8	8	8	8	8	8	8
LGW	ORK	Aer Lingus	2	2	2	2	2	1	2
		Aer Lingus—Total	**10**	**10**	**10**	**10**	**10**	**9**	**10**

Key:

STN	London Stansted	LHR	London Heathrow
LGW	London Gatwick	ORK	Cork

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

2. Table 2 shows that:

(a) Ryanair and Aer Lingus directly overlap on flights between Cork and London Gatwick. Both airlines operate around one service in each direction a day on average. No other airlines are present on this route; and

(b) in terms of the wider London to Cork corridor, Ryanair and Aer Lingus are still the only airlines offering services, with Ryanair also operating services from Stansted and Aer Lingus from Heathrow. The overall daily frequency offered by the two airlines on the corridor is broadly similar.

3. London–Shannon

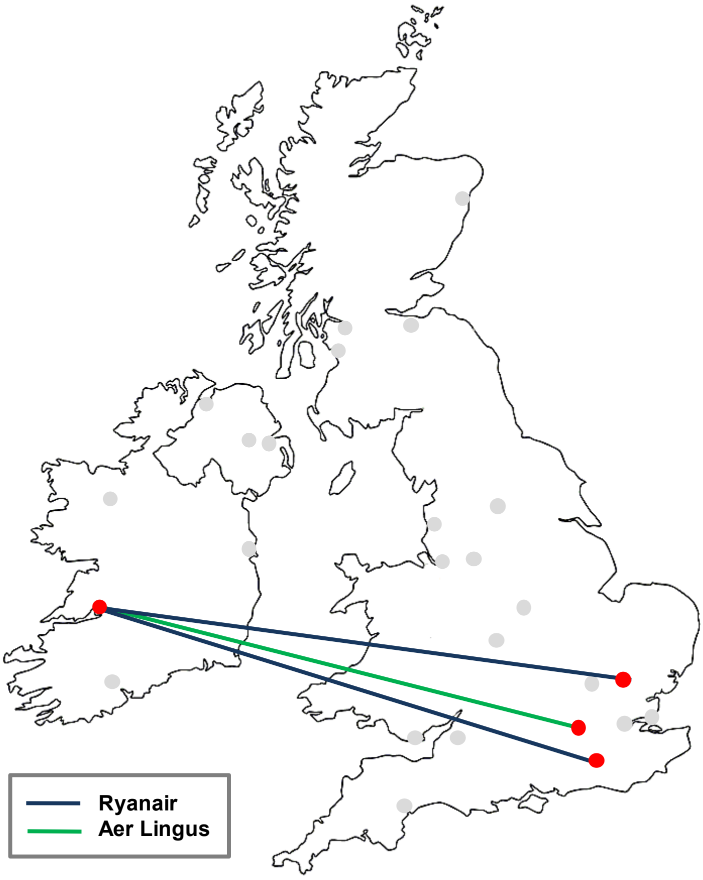


TABLE 3 **Number of outbound flights, passengers and average daily frequencies, London–Shannon**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*
STN	SNN	Ryanair	703	98,079	34.9
LGW	SNN	Ryanair	351	51,694	18.4
		Ryanair—Total	**1,054**	**149,773**	**53.3**
LHR	SNN	Aer Lingus	1,097	130,994	46.7
		Aer Lingus—Total	**1,097**	**130,994**	**46.7**

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
STN	SNN	Ryanair	4	3	3	4	4	4	4
LGW	SNN	Ryanair	2	2	1	2	2	2	2
		Ryanair—Total	**6**	**6**	**5**	**6**	**6**	**6**	**6**
LHR	SNN	Aer Lingus	6	6	6	6	6	6	6
		Aer Lingus—Total	**6**	**6**	**6**	**6**	**6**	**6**	**6**

Key:

STN	London Stansted	LHR	London Heathrow
LGW	London Gatwick	SNN	Shannon

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

3. Table 3 shows that:

(a) Ryanair and Aer Lingus do not fly to the same London airport from Shannon; and

(b) Ryanair and Aer Lingus are the only airlines to run services between any of the London airports and Shannon; with Ryanair operating from Stansted and London Gatwick, and Aer Lingus operating from Heathrow. The overall daily frequencies offered by the two airlines on the corridor are very similar.

4. London–Knock

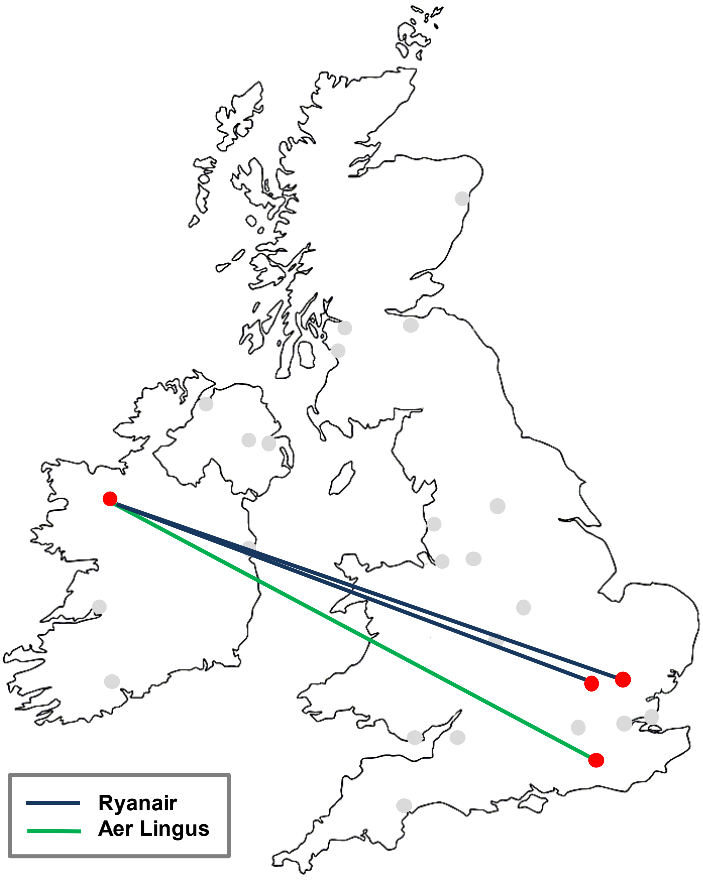


TABLE 4 **Number of outbound flights, passengers and average daily frequencies, London–Knock**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*
STN	NOC	Ryanair	370	49,483	37.2
LTN	NOC	Ryanair	303	43,830	32.9
		Ryanair—Total	**673**	**93,313**	**70.1**
LGW	NOC	Aer Lingus	362	39,821	29.9
		Aer Lingus—Total	**362**	**39,821**	**29.9**

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
STN	NOC	Ryanair	2	2	2	2	2	2	2
LTN	NOC	Ryanair	2	1	2	2	2	1	2
		Ryanair—Total	**4**	**3**	**4**	**4**	**4**	**3**	**4**
LGW	NOC	Aer Lingus	2	2	2	2	2	2	2
		Aer Lingus—Total	**2**	**2**	**2**	**2**	**2**	**2**	**2**

Key:

STN	London Stansted	LTN	London Luton
LGW	London Gatwick	NOC	Knock

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

4. Table 4 shows that:

(a) Ryanair and Aer Lingus do not fly to the same London airport from Knock; and

(b) Ryanair and Aer Lingus are the only airlines to offer services between London airports and Knock; with Ryanair operating from Stansted and Luton, and Aer Lingus operating from Gatwick. In total, Aer Lingus runs one service a day in each direction on the corridor, Ryanair two services.

5. NW England–Dublin

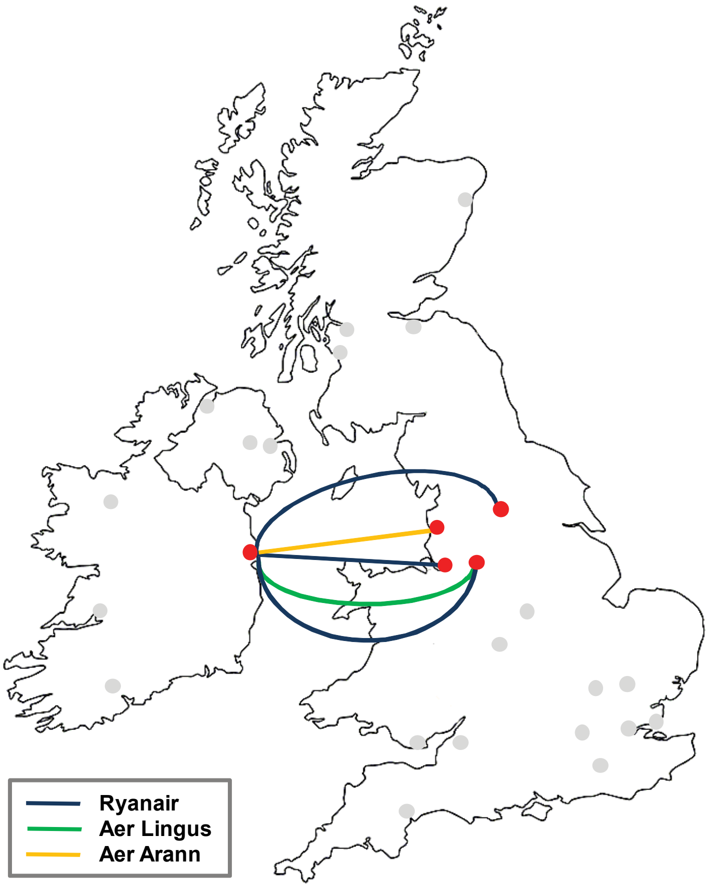


TABLE 5 **Number of outbound flights, passengers and average daily frequencies, NW England–Dublin**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*
MAN	DUB	Ryanair	1,235	157,343	29.5
LPL	DUB	Ryanair	1,223	137,997	25.9
LBA	DUB	Ryanair	715	91,316	17.1
		Ryanair—Total	**3,173**	**386,656**	**72.5**
MAN	DUB	Aer Lingus	1,281	137,758	25.8
		Aer Lingus—Total	**1,281**	**137,758**	**25.8**
BLK	DUB	Aer Arann	274	8,349	1.6
		Aer Arann—Total	**276**	**8,405**	**1.6**

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
MAN	DUB	Ryanair	6	6	6	6	8	8	8
LPL	DUB	Ryanair	7	6	6	7	8	8	8
LBA	DUB	Ryanair	4	4	4	4	4	4	4
		Ryanair—Total	**17**	**16**	**16**	**17**	**20**	**20**	**19**
MAN	DUB	Aer Lingus	8	6	7	7	8	5	8
		Aer Lingus—Total	**8**	**6**	**7**	**7**	**8**	**5**	**8**
BLK	DUB	Aer Arann	2	1	1	2	2	1	2
		Aer Arann—Total	**2**	**1**	**1**	**2**	**2**	**1**	**2**

Key:

MAN	Manchester	BLK	Blackpool
LPL	Liverpool	DUB	Dublin
LBA	Leeds Bradford		

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

5. Table 5 shows that:

(a) both Ryanair and Aer Lingus operate services between Manchester and Dublin, each with a similar frequency;

(b) Ryanair offers relatively high frequency services from Liverpool and Leeds–Bradford. Aer Arann offers a lower frequency service from Blackpool airport; and

(c) no other airlines offer services between Dublin and North-West England.

6. Birmingham/East Midlands–Dublin

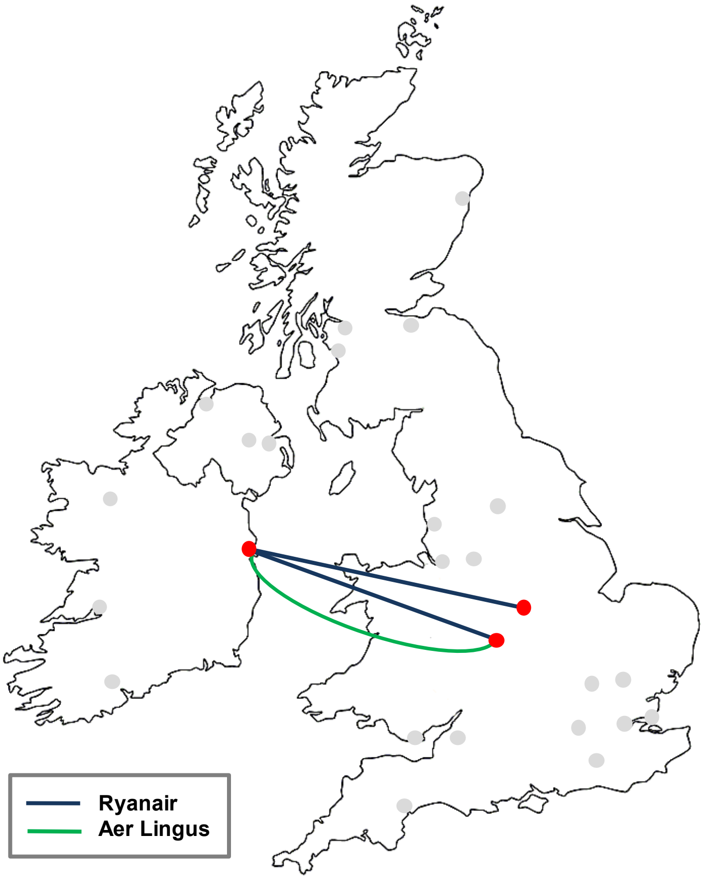


TABLE 6 **Number of outbound flights, passengers and average daily frequencies, Birmingham/East Midlands–Dublin**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*	*Notes*
BHX	DUB	Ryanair	1,040	139,534	39.8	
EMA	DUB	Ryanair	717	87,623	25.0	
		Ryanair—Total	**1,757**	**227,157**	**64.8**	
BHX	DUB	Aer Lingus	1,086	121,414	34.7	
		Aer Lingus—Total	**1,086**	**121,414**	**34.7**	
BHX	DUB	Aer Arann	42	1,486	0.4	Operated May and June 2012 only
		Aer Arann—Total	**42**	**1,486**	**0.4**	

Origin	*Destination*	*Airline*	*Approximate average daily frequency (inbound and outbound)*						
			M	*T*	*W*	*T*	*F*	*S*	*S*
BHX	DUB	Ryanair	6	6	6	6	6	6	4
EMA	DUB	Ryanair	4	4	4	4	4	4	4
		Ryanair—Total	**10**	**10**	**10**	**10**	**10**	**10**	**8**
BHX	DUB	Aer Lingus	6	6	6	7	7	4	6
		Aer Lingus—Total	**6**	**6**	**6**	**7**	**7**	**4**	**6**

Key:

BHX	Birmingham	DUB	Blackpool
EMA	East Midlands		

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

6. Table 6 shows that:

(a) both Ryanair and Aer Lingus operate services from Birmingham airport to Dublin with a similar frequency;

(b) Ryanair operates services to East Midlands airport; and

(c) no other airlines operate on the corridor.

7. Edinburgh/Glasgow/Prestwick–Dublin

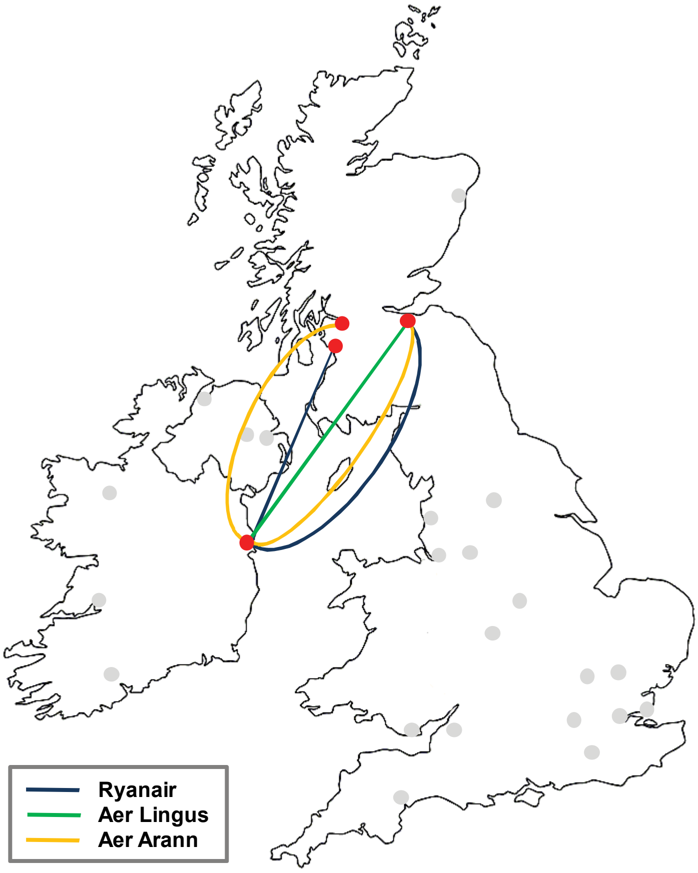


TABLE 7 **Number of outbound flights, passengers and average daily frequencies, Edinburgh/Glasgow/Prestwick–Dublin**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*	*Notes*
EDI	DUB	Ryanair	914	125,667	37.9	
PIK	DUB	Ryanair	567	60,701	18.3	
		Ryanair—Total	**1,481**	**186,368**	**56.2**	
EDI	DUB	Aer Lingus	186	20,331	6.1	Summer only
		Aer Lingus—Total	**187**	**20,439**	**6.2**	
GLA	DUB	Aer Arann	1,442	69,077	20.8	
EDI	DUB	Aer Arann	1,105	54,902	16.6	
		Aer Arann—Total	**2,547**	**123,979**	**37.4**	

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
EDI	DUB	Ryanair	6	4	6	4	6	4	6
PIK	DUB	Ryanair	4	2	4	2	4	2	4
		Ryanair—Total	**10**	**6**	**10**	**6**	**10**	**6**	**10**
EDI	DUB	Aer Lingus	2	2	2	2	2	x	2
		Aer Lingus—Total	**2**	**2**	**2**	**2**	**2**	x	**2**
GLA	DUB	Aer Arann	9	7	7	9	9	6	9
EDI	DUB	Aer Arann	6	6	6	6	6	5	6
		Aer Arann—Total	**15**	**13**	**13**	**15**	**15**	**11**	**15**

Key:

EDI	Edinburgh	PIK	Prestwick
GLA	Glasgow	DUB	Dublin

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

7. Table 7 shows that:

(a) both Ryanair and Aer Arann operate services to Edinburgh with a similar frequency (although Aer Arann carries substantially fewer passengers). Aer Lingus also operate a low frequency service to Edinburgh during the summer season;

(b) Aer Arann operates to Glasgow, Ryanair to Prestwick. Aer Arann's service is of a higher frequency, although again Ryanair carries more passengers on the route due to its larger capacity; and

(c) no other airlines operate on the corridor.

8. Cardiff/Bristol/Exeter–Dublin

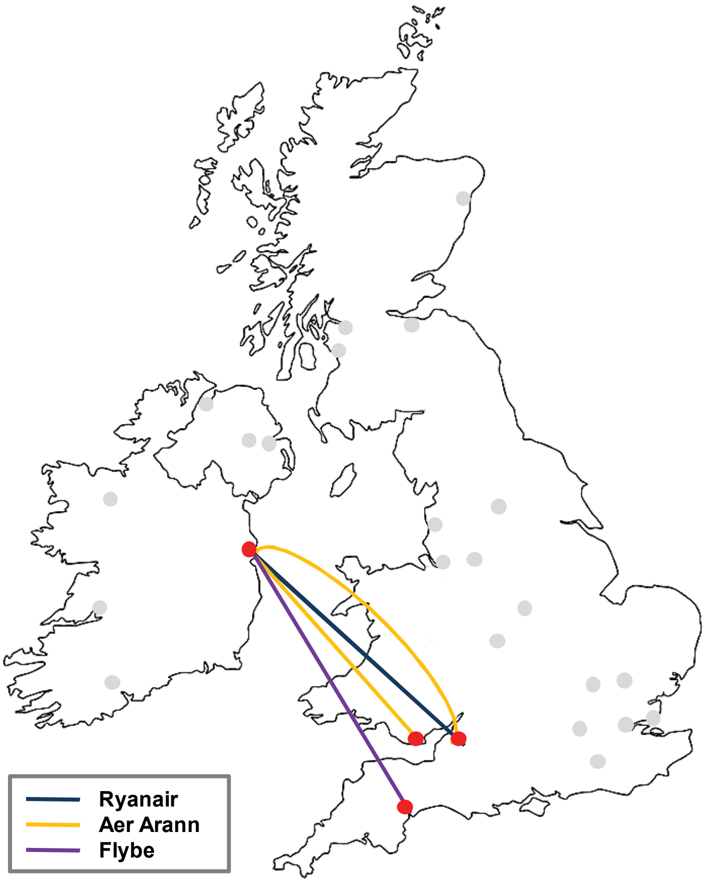


TABLE 8 **Number of outbound flights, passengers and average daily frequencies, Cardiff/Bristol/Exeter–Dublin**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*
BRS	DUB	Ryanair	1,033	122,572	61.7
		Ryanair—Total	**1,033**	**122,572**	**61.7**
CWL	DUB	Aer Arann	675	30,644	15.4
BRS	DUB	Aer Arann	734	28,770	14.5
		Aer Arann—Total	**1,409**	**59,414**	**29.9**
EXT	DUB	Flybe	277	15,484	7.8

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
BRS	DUB	Ryanair	6	6	6	6	6	6	6
		Ryanair—Total	**6**	**6**	**6**	**6**	**6**	**6**	**6**
CWL	DUB	Aer Arann	4	4	4	4	4	2	4
BRS	DUB	Aer Arann	4	4	4	4	5	4	4
		Aer Arann—Total	**8**	**8**	**8**	**8**	**8**	**6**	**8**
EXT	DUB	Flybe	2	2	x	2	2	1	2

Key:

BRS	Bristol	CWL	Cardiff
EXT	Exeter	DUB	Dublin

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

8. Table 8 shows that:

(a) Ryanair and Aer Arann both serve Bristol airport from Dublin. Ryanair's service is higher frequency and has higher capacity;

(b) Aer Arann also operates a service from Cardiff at a similar frequency to its Bristol service; and

(c) Flybe operates a lower frequency service between Exeter and Dublin, accounting for around 8 per cent of all passengers carried between Dublin and Bristol, Cardiff and Exeter.

9. NW England–Cork

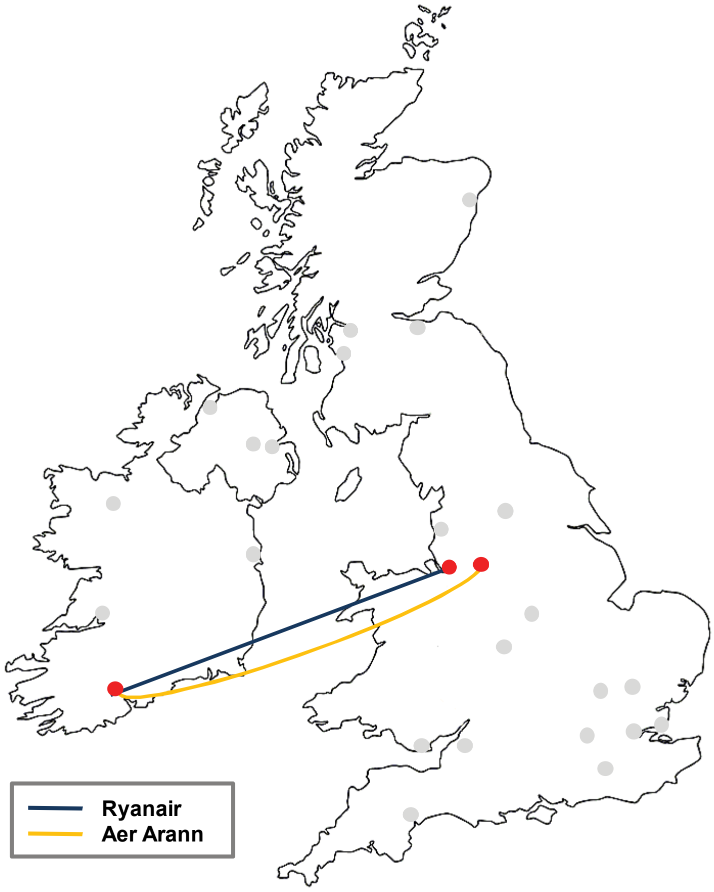


TABLE 9 **Number of outbound flights, passengers and average daily frequencies, NW England–Cork.**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*
LPL	ORK	Ryanair	256	34,265	47.0
		Ryanair—Total	**256**	**34,265**	**47.0**
MAN	ORK	Aer Arann	768	38,625	52.9
		Aer Arann—Total	**769**	**38,676**	**53.0**

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
LPL	ORK	Ryanair	2	x	2	1	2	1	2
		Ryanair—Total	**2**	x	**2**	**1**	**2**	**1**	**2**
MAN	ORK	Aer Arann	4	4	4	5	4	4	5
		Aer Arann—Total	**4**	**4**	**4**	**5**	**4**	**4**	**5**

Key:

LPL	Liverpool	ORK	Cork
MAN	Manchester		

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

9. Table 9 shows that:

(a) Ryanair operates a service from Cork to Liverpool and Aer Arann operates a service from Cork to Manchester. Although the Aer Arann service is higher frequency, the airlines carried a similar number of passengers on the two routes in 2012; and

(b) no other airlines operate between Cork and North-West England.

10. NW England–Shannon

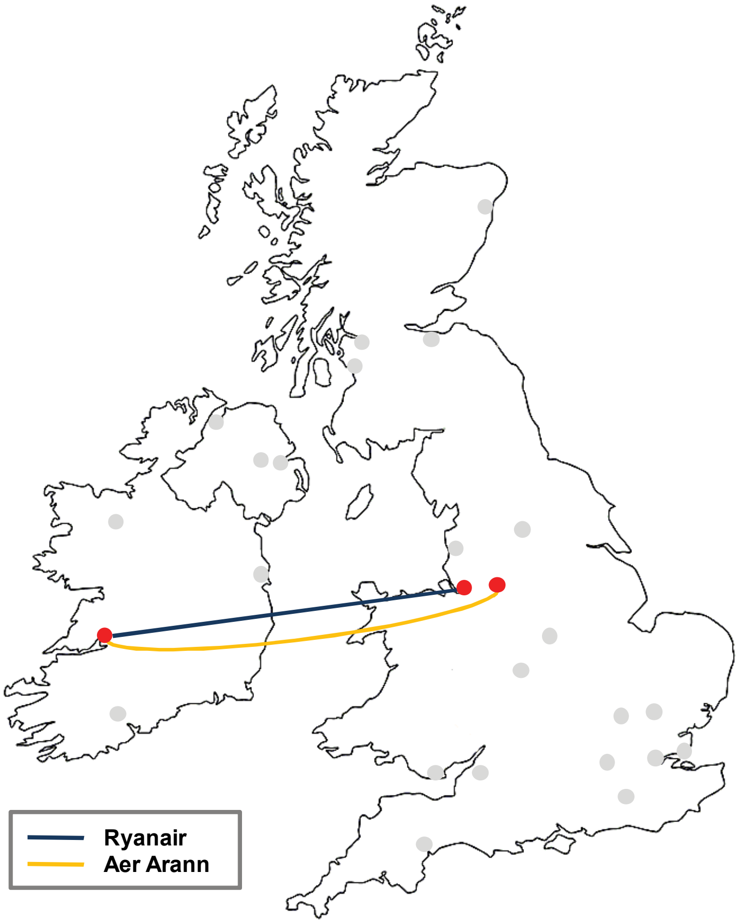


TABLE 10 **Number of outbound flights, passengers and average daily frequencies, NW England–Shannon**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*
LPL	SNN	Ryanair	145	15,846	36.0
		Ryanair—Total	**145**	**15,846**	**36.0**
MAN	SNN	Aer Arann	660	28,099	63.8
		Aer Arann—Total	**661**	**28,142**	**63.9**

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
LPL	SNN	Ryanair	1	x	2	x	2	x	2
		Ryanair—Total	**1**	x	**2**	x	**2**	x	**2**
MAN	SNN	Aer Arann	4	4	4	4	4	2	4
		Aer Arann—Total	**4**	**4**	**4**	**4**	**4**	**2**	**4**

Key:

LPL	Liverpool	SNN	Shannon
MAN	Manchester		

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

10. Table 10 shows that:

(a) Ryanair operates a service from Shannon to Liverpool and Aer Arann from Shannon to Manchester. Aer Arann operates a higher frequency service than Ryanair, and carries a larger proportion of passengers; and

(b) no other airlines operate between Shannon and North-West England.

11. Birmingham–Knock

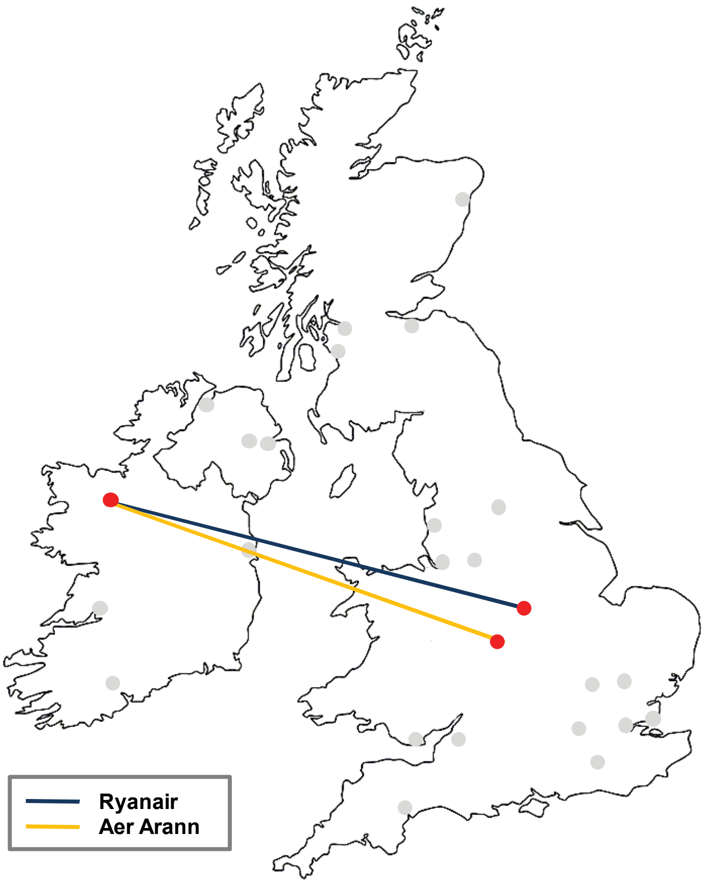


TABLE 11 **Number of outbound flights, passengers and average daily frequencies, Birmingham–Knock**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*	*Notes*
EMA	NOC	Ryanair	241	27,125	58.4	
		Ryanair—Total	**241**	**27,125**	**58.4**	
BHX	NOC	Aer Arann	192	9,104	19.6	
		Aer Arann—Total	**192**	**9,104**	**19.6**	
BHX	NOC	Bmibaby	112	10,182	21.9	Bmibaby closed summer 2012

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
EMA	NOC	Ryanair	1	x	2	1	1	1	2
		Ryanair—Total	**1**	x	**2**	**1**	**1**	**1**	**2**
BHX	NOC	Aer Arann	2	2	2	2	2	2	2
		Aer Arann—Total	**2**	**2**	**2**	**2**	**2**	**2**	**2**
BHX	NOC	Bmibaby	2	1	2	1	2	x	2

Key:

EMA	East Midlands	NOC	Knock
BHX	Birmingham		

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

11. Table 11 shows that:

(a) Ryanair operates between Knock and East Midlands and Aer Arann between Knock and Birmingham, both with a similar frequency; and

(b) Bmibaby operated a similar frequency service between Knock and Birmingham, which was withdrawn in summer 2012. No other airlines operate on the corridor.

12. London–Northern Ireland

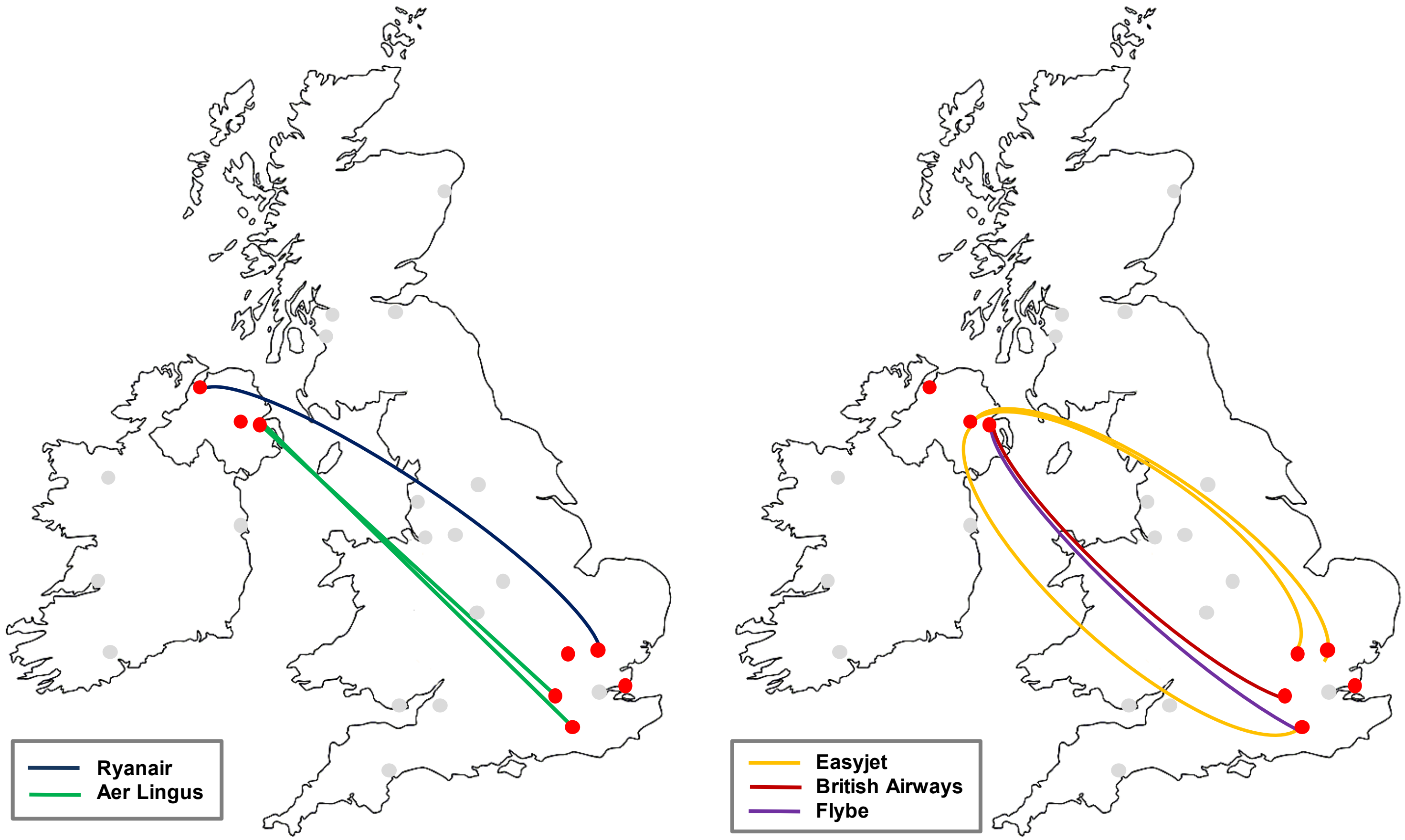


TABLE 12 **Number of outbound flights, passengers and average daily frequencies, London–Northern Ireland**

Origin	*Destination*	*Airline*	*Total number of flights ex-UK*	*Total number of passengers on flights ex-UK*	*Share of all passengers on corridor %*	*Notes*
STN	LDY	Ryanair	470	66,578	6.2	
		Ryanair—Total	470	66,578	6.2	
LHR	BFS	Aer Lingus	901	93,538	8.7	Aer Lingus switched its Northern Irish flights from Belfast International to Belfast City winter 2012
LHR	BHD	Aer Lingus	186	19,529	1.8	
LGW	BHD	Aer Lingus	192	17,765	1.7	
		Aer Lingus—Total	1,280	131,002	12.2	
LGW	BFS	easyJet	1,327	179,589	16.7	
STN	BFS	easyJet	1,274	157,699	14.7	
LTN	BFS	easyJet	948	115,477	10.8	
SEN	BFS	easyJet	497	46,365	4.3	
		easyJet—Total	4,046	499,130	46.5	
LHR	BHD	British Airways	2,123	228,587	21.3	
LGW	BHD	Flybe	1,476	123,343	11.5	
STN	BHD	Bmibaby	270	23,630	2.2	Bmibaby closed summer 2012

Origin	*Destination*	*Airline*	*Approximate average daily frequency (inbound and outbound)* *M*	*T*	*W*	*T*	*F*	*S*	*S*
STN	LDY	Ryanair	4	2	2	2	4	2	2
		Ryanair—Total	4	2	2	2	4	2	2
LHR	BFS	Aer Lingus	6	6	6	6	6	6	6
LHR	BHD	Aer Lingus							
LGW	BHD	Aer Lingus							
		Aer Lingus—Total	6	6	6	6	6	6	6
LGW	BFS	easyJet	8	8	8	8	8	4	8
STN	BFS	easyJet	8	7	7	9	9	4	7
LTN	BFS	easyJet	6	6	6	6	6	3	4
SEN	BFS	easyJet	4	4	4	4	4	2	4
		easyJet—Total	26	25	25	27	27	13	23
LHR	BHD	British Airways	9	9	9	10	10	6	6
LGW	BHD	Flybe	3	4	4	4	5	x	2
STN	BHD	Bmibaby	4	2	2	2	4	2	2

Key:

STN	London Stansted	SEN	Southend
LGW	London Gatwick	LHR	London Heathrow
LTN	London Luton	BHD	Belfast City
BFS	Belfast International	LDY	City of Derry

Source: CAA.

Notes:
1. Flights and passenger number totals are for 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

12. Table 12 shows that:

(a) Ryanair operates between Stansted and City of Derry airport and Aer Lingus between Heathrow and Belfast City airport, Aer Lingus with the higher frequency;

(b) easyJet operates services between Gatwick, Stansted, Luton and Southend and Belfast International airport, with a total daily frequency of more than 25 services; and

(c) services are also operated by British Airways (to Heathrow) and Flybe (to Gatwick).

13. Northern Ireland–Faro

TABLE 13 **Number of outbound flights, passengers and average daily frequencies, Northern Ireland–Faro**

Origin	*Destination*	*Airline*	*Total number of outbound flights*	*Total number of passengers on outbound flights*	*Share of all passengers on corridor %*	*Notes*
LDY	FAO	Ryanair	65	9,877	11.0	
		Ryanair—Total	**65**	**9,877**	**11.0**	
BFS	FAO	Aer Lingus	217	28,114	31.3	Aer Lingus switched its Northern Irish flights from Belfast International to Belfast City winter 2012
		Aer Lingus—Total	**217**	**28,114**	**31.3**	
BFS	FAO	easyJet	304	43,730	48.7	
BFS	FAO	Thomson Airways Ltd (charter)	19	3,440	3.8	
BFS	FAO	Jet2.Com Ltd	17	2,426	2.7	
BHD	FAO	Bmibaby Ltd	23	2,205	2.5	

			Approximate average daily frequency (inbound and outbound)						
Origin	*Destination*	*Airline*	*M*	*T*	*W*	*T*	*F*	*S*	*S*
LDY	FAO	Ryanair	x	x	x	2	x	x	2
		Ryanair—Total	**x**	**x**	**x**	**2**	**x**	**x**	**2**
BFS	FAO	Aer Lingus	2	2	2	2	2	2	2
		Aer Lingus—Total	**2**	**2**	**2**	**2**	**2**	**2**	**2**
BFS	FAO	easyJet	1	2	2	2	**1**	3	1
BFS	FAO	Thomson Airways Ltd (charter)	x	x	x	2	x	x	x
BFS	FAO	Jet2.Com Ltd	x	x	x	x	x	2	x
BHD	FAO	Bmibaby Ltd	x	x	x	1	x	x	1

Key:

BFS	Belfast International	LDY	City of Derry
BHD	Belfast City	FAO	Faro

Source: CAA.

Notes:
1. Flights and passenger number totals are for the period December 2011 to November 2012, daily frequencies are for the winter 2011/12 and summer 2012 IATA seasons.
2. Very low frequency (mostly charter) flights are excluded from the table, but are reflected in the shares of supply.

13. Table 13 shows that:

(a) Ryanair operates between City of Derry and Faro and Aer Lingus between Belfast City airport and Faro (previously it operated from Belfast International). Aer Lingus operates one service in each direction on average, Ryanair offers only very limited services on the corridor; and

(b) easyJet operates a service from Belfast International.

Trends in fares, overlap, frequency and service offering since 2006

Introduction

1. In this appendix, we consider whether there is evidence to suggest that the intensity of competition between Ryanair and Aer Lingus has changed compared with the level which existed when Ryanair's acquisition took place between autumn 2006 and summer 2007. We consider the trend in four dimensions of the competitive offering of Ryanair and Aer Lingus over the period: fares, overlap, frequency and the service offering of the airlines.

Fares

The European Commission's econometric analysis

2. Ryanair argued that the results of the European Commission's econometric analysis showed that Ryanair exerts a stronger competitive constraint on Aer Lingus in 2013 than it did in 2007. In particular, it highlighted that the model used in the two analyses was very similar, and that in the 2007 analysis (using data for the period January 2002 to December 2006) the estimated impact of Ryanair's presence on Aer Lingus's prices was 7 to 8 per cent when considering city pairs and around 5 per cent when considering airport pairs, while in the 2013 analysis (using data for the period November 2004 to July 2012) the estimated impact of Ryanair's presence on Aer Lingus's prices was 7 to 11 per cent when considering city pairs and 9 to 14 per cent when considering airport pairs.

3. In our view the results of the two analyses showed that Ryanair exerted a strong competitive constraint on Aer Lingus's fares in both periods. It was less clear to us the extent to which the differences in the estimated coefficients could be interpreted as showing that fare competition between the two airlines had increased since 2006, given the differences in the sample of routes in the two analyses, the overlapping time periods and the confidence intervals around the estimates.

Trend in average fares

4. Figures 1 and 2 show average revenue per passenger (ticket revenue only, excluding revenues from ancillary services) for Ryanair and Aer Lingus for each month from January 2005 to December 2011, averaged across the airlines' routes on the six primary overlap corridors: London–Dublin, London–Cork, London–Shannon, London–Knock, NW England–Dublin and Birmingham/East Midlands–Dublin. [✂]

FIGURE 1

Ryanair's average ticket revenue on overlap corridors, January 2005 to December 2011

[✂]

FIGURE 2

Aer Lingus's average ticket revenue on overlap corridors, January 2005 to December 2011

[✂]

5. In line with this, in its decision the European Commission reports pricing data provided by Ryanair showing Ryanair's and Aer Lingus's short-haul average fares between 2006 and 2011. The data show both companies' averages fares declining between 2007 and 2009, before increasing again between 2009 and 2011. Although it highlights some limitations with regard to the comparability of the pricing information, the European Commission notes that in 2011, Ryanair and Aer Lingus had short-haul average fares which were very similar to those observed in 2007.

Ryanair's difference-in-difference analysis

6. Ryanair submitted an econometric analysis of Ryanair's average fares in which it estimates the difference in average fares between the period prior to the transaction and the period subsequent to the transaction for both overlap and non-overlap routes. The fare changes are then compared for the two groups of routes, and the difference between them assumed to reflect any effect of the transaction on Ryanair's pricing incentives.

7. The key assumption underlying the analysis is that the only systematic difference in the underlying trend in average fares on the two groups of routes is that Ryanair's incentives on how it sets fares on the overlap routes will have been affected by the transaction, while fares on the control routes will not. Two different groups of control routes are used in the analysis: a group of routes with 'similar' characteristics selected by Ryanair, and a group of all UK non-overlap routes operated by Ryanair. Because the effect of some external events may differ across different types of routes (for example, longer routes may have been harder hit by the increase in fuel prices), in some specifications, additional control variables are also included to account for route-specific changes related to the observable characteristics of each route. The variables included are measures of direct costs, the extent of concentration on the route, and GDP per capita in the origin and destination countries.

8. To summarize the results of the analysis:

   (a) [✂] average prices on all Ryanair routes were found to decline between the period prior to the transaction and the period after the transaction (up to the end of 2010). Looking across all routes, this decline is around [✂] per cent (depending on the period considered).

   (b) After controlling for various demand and cost factors, average fares on overlap routes were estimated to fall by *more* than average fares on the set of comparator routes with similar characteristics chosen by Ryanair. In most specifications the confidence intervals associated with the estimates were wide,

and the estimated difference in fare changes was not statistically significantly different from zero.

(c) The results were sensitive to both the periods and the group of comparator routes used. In a small number of specifications, average fares were found to fall by less on overlap routes, although these differences were never statistically significantly different from zero.

(d) A pairwise comparison of the change in average fares on overlap routes and matched control routes was also carried out. Using this approach, the decline in fares on overlap routes was, in most specifications, estimated to be smaller than the decline in fares on non-overlap control routes, although again the confidence intervals around the coefficient estimates were wide and the estimates were not statistically significantly different from zero.

9. Ryanair concluded on the basis of the analysis that the Aer Lingus minority stake has caused no economically or statistically significant increase in Ryanair prices, and that this therefore did not support the contention that Ryanair has softened competition on routes where it competes head to head with Aer Lingus.

10. While we agreed that there was no evidence to suggest that Ryanair had increased its fares on overlap routes since the transaction, we considered that there were reasons to treat the results of the analysis with caution. Our primary concern was related to the likely low power of the test carried out in the analysis.

11. Specifically, we considered that the small number of overlap routes (there are only 13 overlap routes in the sample, some of which relate to the same corridor) would imply that there will be very limited variation in the variable of interest, making it very difficult to estimate the difference in fares for overlap and non-overlap routes with any precision. Consistent with this, the confidence intervals around most estimates of the difference in fares were very large and included economically significant effects.

12. Ryanair said that the model used all information that was available, and did not consider only a restricted sample size. It said that the total sample size used in the analysis (of at least 104 observations) was sufficiently large to obtain robust estimates, and that the model explained fare developments well (with an R-squared of between 0.73 and 0.81) and so should therefore pick up any effect from the transaction.

13. However, this did not remove our concern that the coefficient of interest was not estimated with any precision. For example, focusing on the unweighted specifications[1] with 2008 to 2010 as the 'after' period, the 95 per cent confidence interval on the coefficient estimate stretched from [✄] to [✄]. This would encompass very substantial negative and positive price effects (with a fare change of €[✄], for example, equating to nearly [✄] per cent of average fares in the period 2008 to 2010).

14. We were also aware of other potential concerns with the analysis, including the potential endogeneity of the concentration variable and the sensitivity of the results to the exact periods and group of comparison routes used.

[1] We considered the unweighted specifications to be more appropriate since we did not see any reason to expect unobserved error to vary in proportion to a route's total capacity.

Extent of overlap

15. We also considered how the extent of overlap between the UK operations of Ryanair and Aer Lingus had changed since the transaction took place.

16. Table 1 compares the overlap corridors identified in Appendix D with those overlap corridors involving a UK airport that were identified in the European Commission's 2007 prohibition decision. For each corridor, we also show the total number of outbound passengers carried by Ryanair, Aer Lingus and Aer Arann (trading as Aer Lingus Regional) on the corridor in IATA summer seasons 2007 and 2012, and the percentage change in total passenger numbers between the two.

TABLE 1 **Comparison of overlap corridors in the European Commission's 2007 prohibition decision and the CC's findings**

	Overlap corridor in...		*Total outbound passengers...*			
	EC2007	*CC2013*	*Summer 2007*	*Summer 2012*	*Change %*	*Comment*
Republic of Ireland—Ryanair/Aer Lingus						
London–Dublin	✓	✓	1,057,271	950,296	–10.1	Aer Lingus re-entered LGW–DUB winter 07/08
London–Cork	✓	✓	280,639	242,512	–13.6	
London–Shannon	✓	✓	236,651	178,250	–24.7	
London–Knock	x	✓	71,791	81,337	13.3	Aer Lingus entered NOC–LGW summer 09
NW England–Dublin	✓	✓	424,344	313,683	–26.1	Aer Lingus Regional entered BLK–DUB summer 10
Birmingham/East Midlands–Dublin	✓	✓	250,933	206,321	–17.8	
Newcastle–Dublin	✓	x	86,901			Aer Lingus exited NCL–DUB summer 09
Republic of Ireland—Ryanair/Aer Lingus Regional						
Glasgow/Edinburgh/Prestwick–Dublin	✓	✓	249,175	207,845	–16.6	Aer Lingus Regional replaced Aer Lingus services on GLA–DUB in summer 10. Aer Lingus Regional entered EDI–DUB summer 10. Aer Lingus service EDI–DUB fully withdrawn summer 13
Bristol/Cardiff/Exeter–Dublin	x	✓		111,203		Aer Lingus Regional entered BRS–DUB summer 11, CWL–DUB summer 10
NW England–Cork	✓	✓		43,880		Aer Lingus Regional replaced Aer Lingus service on MAN–ORK winter 10/11
NW England–Shannon	x	✓		28,056		Aer Lingus Regional entered MAN–SNN summer 10. Ryanair exited MAN–SNN summer 09
Birmingham/East Midlands–Knock	x	✓		25,463		Aer Lingus Regional entered NOC–BHX summer 12
Northern Ireland—Ryanair/Aer Lingus						
London–Northern Ireland	x	✓		111,152		Aer Lingus entered BFS–LHR winter 07/08 and then switched to serving BHD–LHR and BHD–LGW in winter 12/13
Northern Ireland–Faro	x	✓		36,956		Ryanair entered LDY–FAO summer 2009, Aer Lingus entered BFS–FAO summer 2008

Source: CC analysis of CAA data

17. To summarize:

(a) the overlap corridors accounting for the majority of passengers (91 per cent of all passengers on overlap routes in summer 2012) were active in both periods, ie London–Dublin, London–Cork, London–Shannon, Birmingham/East Midlands–Dublin, NW England–Dublin;

(b) two corridors where Ryanair and Aer Lingus overlapped in 2007 are now operated by Aer Arann rather than Aer Lingus itself: Edinburgh/Glasgow/Prestwick–Dublin and NW England–Cork;

(c) there is one additional overlap corridor between Great Britain and the Republic of Ireland on which both Aer Lingus and Ryanair are currently active but Aer Lingus was not in 2007, between London and Knock. There are three additional overlap corridors on which Aer Arann and Ryanair are currently active, but which Aer Lingus did not serve in 2007: between Bristol and Dublin, NW England and Shannon, and Birmingham/East Midlands and Knock;

(d) there is one overlap corridor between Great Britain and the Republic of Ireland that was active in 2007 but where the parties no longer overlap, between Newcastle and Dublin;

(e) there are two additional corridors on which the UK operations of the two airlines overlapped in 2012 but not in 2007—between London and Northern Ireland, and Northern Ireland and Faro; and

(f) total passenger numbers carried on overlap corridors have declined since summer 2007.

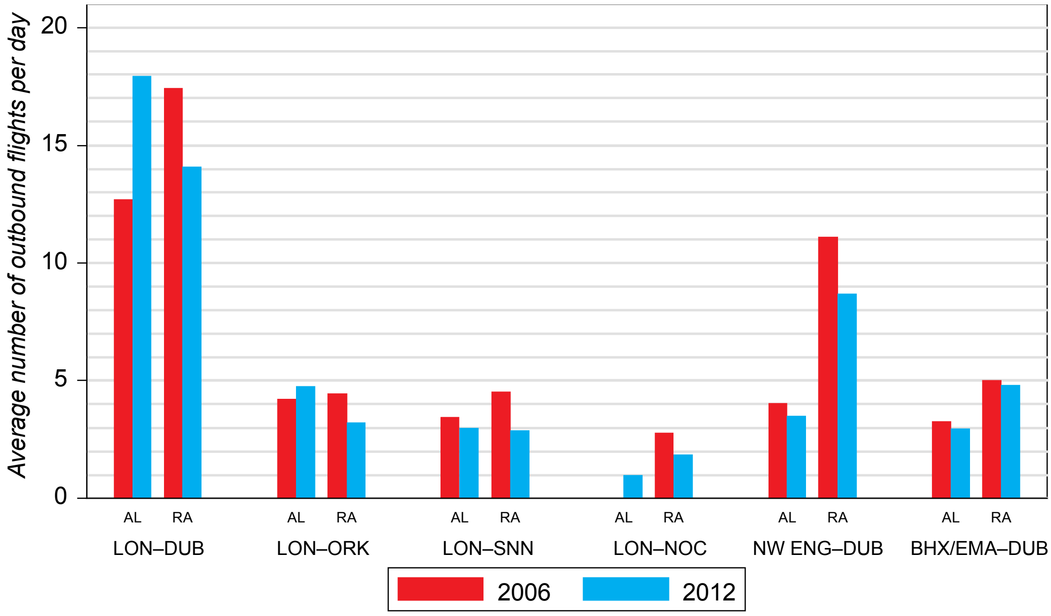
18. Ryanair said that the main motivation for Ryanair's entry decisions was [✂], and concluded that the minority stake had no effect on these decisions. Similarly, it said that most Ryanair exits were prompted by [✂] made because of [✂], with one instance where an exit was driven by [✂]. Again, it concluded that the minority stake had no influence on these decisions, and there was no difference according to whether the route had any possible overlap with Aer Lingus.

Frequency

19. We also considered the trend in frequencies on overlap routes over the period. Figure 3 shows the average number of daily outbound flights operated by Ryanair and Aer Lingus on routes on each of the primary overlap corridors in 2006 and 2012.

FIGURE 3

Average number of outbound flights operated by Ryanair (RA) and Aer Lingus (AL) across all routes on overlap corridors, 2006 and 2012



Source: CC analysis of CAA data.
Notes:
1. LON–DUB: includes Ryanair services Stansted–Dublin, Gatwick–Dublin and Luton–Dublin, Aer Lingus services Heathrow–Dublin and Gatwick–Dublin (launched winter 2007/08).
2. LON–ORK: includes Ryanair services Stansted–Cork and Gatwick–Cork, Aer Lingus services Heathrow–Cork and Gatwick–Cork (launched summer 2010).
3. LON–SNN: includes Ryanair services Stansted–Shannon and Gatwick–Shannon, Aer Lingus services Heathrow–Shannon.
4. LON–NOC: includes Ryanair services Stansted–Knock and Luton–Knock, Aer Lingus services Gatwick–Knock (launched summer 2009).
5. NW ENG–DUB: includes Ryanair services Manchester–Dublin, Liverpool–Dublin, Leeds Bradford–Dublin, and Aer Lingus services Manchester–Dublin
6. BHX/EMA–DUB: includes Ryanair services Birmingham–Dublin and East Midlands–Dublin, Aer Lingus services Birmingham–Dublin.

20. Figure 3 shows that Aer Lingus's frequency on the London–Dublin, London–Cork and London–Knock corridors has increased, as a result of its introduction of new services from London Gatwick in the period. There was a slight decrease in Aer Lingus's frequency on other routes. Ryanair's frequency on all of the overlap corridors decreased over the period, most significantly on London–Dublin and NW England–Dublin.

21. Ryanair attributed the reduction in its frequency in the period on routes between the UK and Republic of Ireland to a significant reduction in demand for air travel. It said that there was significant evidence that Ryanair would have been expected to cut capacity between the UK and Republic of Ireland regardless of its stake in Aer Lingus because of the major recessions over 2008 and 2009, the introduction of the Irish aviation tax in March 2009 and the increases in the UK's Air Passenger Duty in 2007, 2009 and 2010. It also referred to the increases in airport charges at Dublin, Stansted and Shannon. It said that there was substantial evidence that other airlines also cut capacity between the UK and Republic of Ireland since 2007, including British Airways' suspension of its Gatwick–Dublin service in 2009, bmi's frequency reduction between London and Dublin in 2010, and Flybe's withdrawal from a number of routes between the UK and Republic of Ireland.

Service offering

22. Aer Lingus said that it operated as a traditional full-service carrier until 2001. Post 9/11 it introduced a low-fares model to compete with low-cost carriers. Since 2009, Aer Lingus has emphasized its positioning as a 'value carrier' between the low-cost and full-service carriers.

23. Aer Lingus said that the change in positioning was a reaction to the global economic and financial crisis and that the repositioning had enabled it to compete more effectively with Ryanair. We considered internal strategy documents produced by Aer Lingus around the time of the repositioning, and did not find any references attributing the change to the Ryanair minority shareholding.

24. We are not aware of any material changes in Ryanair's service offering subsequent to the transaction, with the company continuing to position itself as a low-fares/no-frill airline.

Combinations involving Aer Lingus

Introduction

1. In this appendix we present additional evidence relating to the impact of the minority shareholding on Aer Lingus's ability to enter into combinations with other airlines. The structure is as follows:

   (a) first, we identify some of the different ways in which Aer Lingus could combine with another airline;

   (b) second, we describe EU airline ownership regulations;

   (c) third, we present different parties' views on the likelihood of Aer Lingus being involved in a combination with another airline;

   (d) fourth, we describe discussions between Aer Lingus and other airlines in the period since the IPO; and

   (e) fifth, we set out some evidence related to the potential synergies associated with combinations.

Forms of combination

2. There is a spectrum of different ways in which Aer Lingus and another airline could combine. These alternatives vary in the extent to which the operations of the airlines involved may be integrated, if at all. Table 1 sets out a range of potential ways in which airlines could combine, and the extent of business integration associated with each of them. At the top of the table is a full integration, working down to an alliance with no business integration.

TABLE 1 **Overview of potential combinations between Aer Lingus and other airlines**

Nature of the agreement	*Description and extent of integration*
Acquisition of Aer Lingus	Acquisition of 100% of Aer Lingus's shares and/or assets by another airline with full business integration
Acquisition by Aer Lingus	Acquisition of 100% of another airline's shares and/or assets by Aer Lingus (using cash and/or share consideration) with full business integration
Merger	A merger between Aer Lingus and another airline with relative equity ownership in the combined venture determined through negotiation between the parties. May be structured via a jointly controlled holding company. May involve a combination of share and cash consideration. Full business integration
Joint Venture	Creation of a corporate entity to which each partner contributes assets and other forms of consideration. Managed via a joint business plan with appropriate corporate governance principles in a shareholder agreement. The partners may continue to operate other business activities outside of the joint venture
Controlling equity in Aer Lingus (more than 50%)	An acquisition of a controlling stake by another airline, eg via the acquisition of the Irish Government's 25.1% stake followed by a successful public offer with a minimum acceptance criteria of 50%. Would not automatically result in business integration
Strategic equity investment (less than 50%)	An investment of a significant stake, but with no business integration
Minority investment (<5%)	Acquisition of a minority stake in Aer Lingus via a private placement or via market purchases of Aer Lingus shares
Franchise	Commercial agreement, no business integration
Code-share	Commercial agreement, no business integration
Bilateral alliance	Commercial agreement, no business integration

Source: CC analysis.

EU airline ownership regulations

3. Regulation (EC) No 1008/2008 of 24 September 2008 on common rules for the operation of air services in the Community (the 'EU Airline Regulation') governs the ownership requirements for airline companies in the EU.[1] For a company based in an EU Member State to carry air passengers, cargo or mail for remuneration and/or hire, it must have an operating licence granted by the competent authority in its home Member State.[2] It will not be entitled to be granted or continue to hold such an operating licence unless it satisfies certain conditions listed under Article 4 of the EU Airline Regulation and Article 4(f) requires that: 'Member States and/or nationals of Member States own more than 50 % of the undertaking and effectively control it, whether directly or indirectly through one or more intermediate undertakings, except as provided for in an agreement with a third country to which the Community is a party.'

4. The EU Airline Regulation contains a definition of 'effective control' which is expressed in terms of the ability to exercise decisive influence—articulated in the same fashion as under the EU merger control rules. The practical effect of the condition is that a non-EU airline or investor cannot own a majority stake or effectively control an EU carrier otherwise it will not be able to obtain an operating licence.

[1] This recast the 1992 Regulations No 2407/92, 2408/92 and 2409/92 into one consolidated Regulation.
[2] Article 3 of the EU Airline Regulation.
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:293:0003:0020:EN:PDF.

Views on the likelihood of Aer Lingus combining with another airline in the absence of Ryanair's minority shareholding

5. In this section we set out the views of Aer Lingus, Ryanair and other parties on the likelihood of Aer Lingus combining with another airline, and its attractiveness as an acquisition target.

Aer Lingus

6. Aer Lingus told us that in the near to medium term there was likely to be a continuing pattern of significant consolidation in the airline industry. It said that Aer Lingus had been and remained interested in attracting investment, and that its management had identified a need for growth and was actively considering both inorganic and organic options for expansion including a broad range of forms of cooperation with other airlines. The way in which any growth is realized could encompass being sold to, merging with or acquiring another airline, entering into a joint venture, joining a bi-lateral or multi-lateral alliance. The choice of transaction structure would depend on, among other factors, the nationality of any counterparties. It told us that the intention of the Irish Government to sell its stake increased the likelihood of a combination because the shares could be purchased by another airline.

7. Aer Lingus also said that it emerged during exploratory contacts with potential investors that Ryanair was seen as a major deterrent to an investment in Aer Lingus and the lack of interest shown by other airlines in Aer Lingus as an investment opportunity, despite its strong balance sheet and return to profitability (and having regard to the extent of consolidation which has occurred in the aviation sector since 2007), strongly points to the Ryanair shareholding being considered as a poison pill.

8. Aer Lingus listed a number of features which it considered would make it an attractive target for investment or acquisition by another airline, including its strong profitability; its business model; its valuable slot portfolio (particularly at Heathrow, JFK International Airport and Frankfurt); its effective and well-developed distribution model; its established and cost-effective network extension arrangements through the partnership model; its modern Airbus fleet; its iconic brand; and its strong balance sheet.

9. It said that the uncertainty related to Aer Lingus's pension scheme was a deterrent to counterparties in any M&A situation. The size of the overhang was very significant, and had been widely commented on, both in the media and within the industry.

10. Aer Lingus did not consider that the geographic location of its network would be a deterrent to possible combinations with other airlines. It said that although the Irish market is relatively modest in size, this would be offset by the connectivity opportunities to long-haul services in the North Atlantic.

11. Further, it did not consider that the recession would necessarily be a deterrent to consolidation (as proved by the multiple acquisition events witnessed in the industry in previous years). It said that Aer Lingus was attractive in that it was trading profitably despite the macroeconomic climate.

12. Aer Lingus told us that the Aer Arann franchise agreement was significantly complicated by the third Ryanair bid and the minority shareholding, which gave rise to significant uncertainty on the part of the counterparties as to the future ownership of Aer Lingus (and its implications for the franchise agreement), above and beyond the execution risk in the event that approval from shareholders were required for the transaction.

Ryanair

13. Ryanair said that whilst there was regular chatter about the possibility of a bid for Aer Lingus by a national flag carrier such as IAG, Air France/KLM or Lufthansa, any potential bidder would be concerned about Aer Lingus's heavy focus on Ireland, which was very weak economically and offered no prospects of growth in the medium term.[3] It also said that the cause of investors being deterred from acquiring Aer Lingus in whole or in part was the €700 million deficit in Aer Lingus's pensions fund, citing public statements by the Chief Executive of British Airways and others.

14. It said that Aer Lingus was well capitalized and able to implement its commercial strategy without needing to be taken over. In the five years since the IPO, it had not put itself up for sale or suggested that a takeover would be necessary or helpful to the implementation of its commercial strategy.[4]

15. However, Ryanair also said that Aer Lingus's cost base could not sustain long-term competition with Ryanair's much lower cost base to/from Ireland. In Ryanair's view, Aer Lingus had no future as an independent airline because of its small scale, its peripheral location and its repeated failure to expand outside Ireland. If Ryanair's offer for Aer Lingus was unsuccessful, Aer Lingus was likely to be acquired by another airline or financial investor that would break up Aer Lingus, sell off its valuable Heathrow slots and transatlantic routes and close its loss-making short-haul routes to the UK and Europe.

16. Ryanair said that Aer Lingus had recently implemented a number of partnerships and alliances without any difficulty being caused by Ryanair's shareholding. It gave the example of Aer Lingus's franchise agreement with Aer Arann, and noted that Aer Lingus has also entered into code-share agreements with United Airlines, KLM, British Airways and JetBlue, and most recently, Etihad.[5]

IAG

17. IAG said that it saw a general trend of consolidation in the airline industry. This was most advanced in the USA where only three major airline carriers plus a couple of low-cost carriers and a couple of niche regional operators remained, and a similar pattern was likely to emerge in Europe. To date the short-haul European market had not seen the same level of consolidation as European long-haul carriers had seen, but this would be likely to change in the future.

18. Currently there was a short-term reduction in the level of consolidation due to rising fuel prices and companies concentrating on maximizing the gains from recent mergers, although this might change in the next two to three years once the majors had finished implementing the recent deals they had been involved in.

19. IAG identified three factors that would determine the attractiveness of a potential acquisition target. The first factor was the nature of the market in which the target airline operated and how it related to the market of the acquiring airline. The second was ensuring the target airline was not a weak competitor within an important market. The third factor was whether the target airline had a sustainable good cost base.

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[3] Ryanair submission to the OFT on SLC, footnote 53.
[4] Ryanair submission to the OFT on material influence, paragraph 67.
[5] ibid, paragraph 72.

20. When considering European airlines that could be potential acquisition targets (not necessarily for IAG), IAG said that Aer Lingus was not the weakest contender as it made money and had a good cost position.

21. However, IAG said that the three main European groupings would probably not be interested in acquiring Aer Lingus at the moment because they were focusing on recent acquisitions. In addition, IAG said that the major European network carriers primarily made their money on their long-haul rather than short-haul operations. Given that Aer Lingus's long-haul route network is limited, this would limit the attractiveness of Aer Lingus relative to other possible acquisition targets. IAG did not think that any other European airlines would be likely to be interested in acquiring Aer Lingus.

22. IAG said that it would not really contemplate buying a controlling interest in an airline with a significant ongoing minority shareholder. [✄]

23. IAG told us that [✄]. In July 2012, IAG engaged in discussions with Ryanair over the upfront remedy package being offered to the European Commission.

Lufthansa

24. Lufthansa stated that consolidation in the airline sector was ongoing and necessary due to airlines' challenged profitability. Consolidation in the airline sector was subject to more restrictions than in other industries, making it rather difficult and slow. Two important reasons for this were the foreign ownership restrictions—which made any type of consolidation with airlines or entities outside Europe impossible or extremely difficult—and traffic right restrictions, which made cross-border consolidation challenging. Political and national interests also played a role in restricting the rate of consolidation, as countries typically wanted to have their own national carrier.

25. Lufthansa said that it had experienced [✄] in recent acquisitions that it had been involved in. In addition to the opportunity to realize synergies, another important factor for Lufthansa when considering acquisitions was the airline's strength and success in its home market. This had been an important criterion in Lufthansa's acquisition of Austrian and Swiss airlines.

26. Small shareholdings could sometimes be used as a way of committing to intensified cooperation. Lufthansa also said that another reason to acquire a minority shareholding could be as part of an ultimate intention to pursue a full merger.

27. Lufhansa said that Aer Lingus's strong position in its home market would in general probably make it an attractive takeover target for airlines. It offered short, medium and long-haul routes, which would be attractive to the customer. Lufthansa also highlighted Aer Lingus's profitability; Aer Lingus had undergone a successful restructuring process in the last years and had reached a level of profitability that was unusual for an airline of its size. Other factors that could make Aer Lingus attractive would be its position in the UK market, and its slots in London.

28. One factor that would [✄] was [✄]. In addition Lufthansa said that Aer Lingus had a difficult shareholder structure. The presence of fierce competitors like Ryanair and Etihad (although its share was small) as shareholders would make Aer Lingus a less attractive acquisition target. Lufthansa provided us with [✄].

29. Lufthansa said that [✄] might be more interested in acquiring Aer Lingus. [✄] were also considered to have potential interest in order to gain access to the Irish market.

30. Lufthansa said that [✂].

Air France

31. Air France said that there was less consolidation in the airline sector than in other services sectors. This was due to a number of reasons, such as airlines being traditionally state owned, ownership controls in Europe which limited non-EU stakeholders to a maximum of 49 per cent and low financial returns. It said that the economic crisis was a major limiting factor in preventing airlines merging or acquiring substantial interests in other airlines. This was due to the fact that there was a general need for airlines to focus internally in order to reduce costs and improve overall financial performance.

32. Air France said that overall the attractiveness of Aer Lingus as an acquisition target would depend on who was acquiring the airline and its objectives.

33. Aer Lingus's positive features as a target airline were its young fleet, a strong short-haul network, an established presence in the Irish and Irish-related market, particularly in the UK, and a strong brand identity. In addition it had strong North Atlantic connections, especially with Irish-Americans who were regular visitors to the Republic of Ireland. Aer Lingus's access rights to Terminal 2 in Dublin Airport offered a good hub structure. Air France also thought that Aer Lingus held a good cash balance sheet from its original flotation and had a relatively good cost structure.

34. Aer Lingus also had one of the biggest single pools of slots at Heathrow, although the fact that the Irish Government could prevent the transfer of these slots was a limiting factor. Despite this Air France said that it was still possible that an acquirer might purchase Aer Lingus solely for its Heathrow slots due to their high level of demand and economic value.

35. In relation to Aer Lingus's weaknesses, Air France said that Aer Lingus had an overhanging pensions deficit and a limited catchment base for growth due to Ireland's small size and population. It saw an issue with critical mass in its long-haul operations due to its small fleet size and base population of Ireland.

36. Air France told us that it had held discussions with Aer Lingus in 2011 on potential cooperation on routes between Ireland and France, and particularly on the Paris to Dublin route.

37. Air France said that potential airlines, other than Ryanair, which might be interested in buying an interest were IAG, Virgin or any US or Middle-Eastern carrier. This was due to Aer Lingus's long-haul routes and Heathrow slots, although Air France realized that any non-EU-based carriers which were interested would be restricted to 49 per cent ownership.

38. Ryanair's presence as an existing shareholder in Aer Lingus was not considered a deterrent to another airline acquiring an interest in the airline. However, there would be concerns over the illiquid share block between the shares held by the Irish Government, Ryanair and employees. Overall, Air France said that it would be difficult, but not impossible, for another airline to take a stake in Aer Lingus given its current share register.

easyJet

39. easyJet said that there was a trend of consolidation among airlines. In its view, there were too many airlines, many of which were poorly managed. A number of non-UK flag carriers had ended up receiving state aid, sometimes two or three times. Although easyJet's strategy focused on organic growth rather than mergers and acquisitions, it recognized that there were economies of scale to be gained from merging with another airline, particularly in purchasing (both fleet and areas such as ground handling).

40. easyJet thought that Aer Lingus had limited attraction as a takeover target for anyone but Ryanair. Its key attraction was its presence in the Irish market (for an airline that wished to have a presence in Ireland) and its peak-time slots at Dublin Airport. easyJet said that having to compete with Ryanair, and Aer Lingus's relatively small size, made it less attractive as a potential target. easyJet also said that Ryanair's position on Aer Lingus's share register would add to the complexity of buying Aer Lingus.

Flybe

41. Flybe said that there was a general desire for consolidation between European airlines. This was driven by the opportunity to realize efficiencies. It said that the attractiveness of an airline as an acquisition target would depend on its scope for synergies. Relevant factors would include the airline's costs, its business model, its fleet, its network (from the perspective of route complementarity) and its market presence. Poorer performing airlines could be more attractive because of the greater scope for synergies.

42. Flybe said that it would expect airlines to consider Aer Lingus to be an attractive acquisition target, as it would allow a geographical extension for the potential acquirer and could offer the possibility of further cost efficiencies.

43. Flybe highlighted British Airways as a potential acquirer. The geography of Aer Lingus's network would make it less attractive to the other large European network carriers. It also highlighted Middle or Far Eastern carriers as potential acquirers, although this would be subject to ownership constraints.

44. Flybe considered that the relatively small size of the Irish market and Aer Lingus's long-haul strategy would detract from its attractiveness as an acquisition target.

45. Flybe said that it was not impossible that another airline could own a significant stake in Aer Lingus at the same time as Ryanair—referring to the example of Etihad. However, it said that it could not imagine that dynamic lasting for long.

Aer Arann

46. Aer Arann said that there was a general trend of consolidation in the airline industry. It said that this was driven by high fuel prices and diminishing passenger numbers. The situation in the USA where six carriers had become three was likely to be replicated in Europe due to the large number of carriers which were facing declining demand.

47. Aer Arann said that Aer Lingus's financial strength, its brand, its Heathrow slots and its attractive route network would make it an attractive acquisition target. It also said that Aer Lingus had a complicated share register with a range of shareholders from a

prime competitor to Government to airline staff, and more recently Etihad. Aer Arann said that having a competitor as the biggest shareholder would raise some concerns for potential suitors.

48. Aer Arann told us that it did not consider the pension issues affecting Aer Lingus to be any different to those affecting any other company that was previously state-held.

Other parties

49. A shareholder[6] said that Aer Lingus might be an attractive investment due to its Heathrow slots. Ryanair's and the Irish Government's shareholdings in Aer Lingus might, however, be an inhibiting factor to any potential acquirer.

50. The Irish Government said that Aer Lingus was a strong company with a good management team and the potential to develop. It had the ability to succeed as an independent company in the medium to long term.

Discussions regarding possible combinations between Aer Lingus and other airlines since the IPO

51. In this section we set out in more detail some of the discussions regarding possible combinations between Aer Lingus and other airlines in the period since the IPO, referred to in Section 7 of our main report.

Review of Aer Lingus's [✂] 2013 board minutes

52. In [✂] 2013 Aer Lingus's board discussed the fact that Aer Lingus had a higher cost than its low-cost competitors and that [maintaining profitability would be an increasing challenge].

53. The board therefore considered three broad growth options: organic growth coupled with restructuring to reduce the cost base, either on a stand-alone basis or as part of an alliance ('base case' or 'Fortress Ireland'); growth as a subsidiary of a larger entity; and inorganic growth through acquisition or partnership. The Aer Lingus board agreed to decide on the different options in terms of their broad directional categories rather than as specific opportunities involving named counterparties. This was to ensure that the directional strategy could be pursued even if a specific opportunity could not be realized.

54. Aer Lingus's Chief Executive presented a number of specific opportunities to the Aer Lingus board that were under review:

(a) *[✂]* Aer Lingus considered that [✂] [was a] a prime acquisition target for Aer Lingus [✂].

(b) *[✂]* This proposal related to a potential combination with [✂]. It was considered that this partner may be prepared to sell [✂];

(c) *[✂]* This proposal concerned the creation of a new joint venture company in which Aer Lingus and [the other carrier] would invest. Aer Lingus's existing operations would be kept separate. [The joint venture would pursue opportunities

[6] Shareholder C in the summary of hearings with shareholders on the CC website. See www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus/evidence.

that were identified for expansion primarily on European routes not presently services by either party].

55. [✂]

56. The board resolved in favour of inorganic growth initiatives where this complemented the company's revenue model and approved further discussions with the identified entities. Non-disclosure agreements are in place with a number of those entities.

Discussions with [✂]

57. Aer Lingus told us that in the first part of 2012, Aer Lingus and [another airline] entered into confidential discussions regarding a possible combination, [✂]. At the time, Aer Lingus management believed that Ryanair might in time look to sell its stake; equally the readiness of [the other airline] to enter into discussions was understood by Aer Lingus to hinge on the expectation that Ryanair might be prepared to exit or to see its involvement in Aer Lingus reduced.

58. Discussions had progressed to the stage of a confidential exchange of financial information, and contacts had taken place between senior management and respective financial advisers, but these ended [✂] following the announcement of Ryanair's hostile bid.

59. Aer Lingus internal documents show that it considered two possible [✂] for the deal—[✂]. In both cases consideration would have been [✂]. The documents show that Aer Lingus considered that a shareholder vote would have been required in either case. In the context of a [✂], [✂] were mooted as possibilities.

60. [The other airline] told us that it had expected that the [✂] would have involved [✂], although consideration of the exact [✂] of how it might be achieved had not advanced far. Issues relating to [✂] were still unresolved.

61. It said that the shareholding of Ryanair in Aer Lingus was a key consideration when considering what could be achieved as a result of these discussions: it was clear that any proposal that Aer Lingus and [the other airline] developed would need to be acceptable to Ryanair, because of the assumption that [✂] would require shareholder approval [✂], and would not be determined by a simple majority outcome (given the nature of [✂]). Given the size of Ryanair's shareholding, Ryanair would therefore have a significant input into a decision as to whether to approve [✂]. However, the view was that, if the proposal were sufficiently strong, this could be overcome.

62. [The other airline] told us that it had not made any assumptions as to whether Ryanair might or might not [✂]. However, it said that, in the very short term, in particular [✂], its preference would have been for [✂] to give confidence in the [✂] and then to plan some sensible [✂] strategy a little later, in a way which would not lead to a substantial fall in the share price. [The other airline] explained that the process did not get to the stage where it had to decide how to deal with this issue.

63. While Ryanair's existing shareholding in Aer Lingus was not a direct factor in the decision not to proceed with the discussion, [the other airline] told us that it ceased its original discussions with Aer Lingus shortly after Ryanair announced its proposed acquisition of Aer Lingus. This was primarily because it did not want to be perceived as a key player in the acquisition process, and because Aer Lingus senior management needed to focus on their defence against the proposed takeover.

64. Aer Lingus told us that [✂] the opportunity for Aer Lingus to find an arrangement [✂] had been lost.

Discussions with [✂]

65. [✂]

66. On [✂] 2013 Aer Lingus's board was provided with a paper summarizing the status of discussions with [✂]. This stated [✂]. Aer Lingus would merge with [✂]. Consequently [✂] would become a significant shareholder in Aer Lingus. Aer Lingus had identified revenue opportunities including growth opportunities in [✂] but had concluded that these were likely to be limited and the opportunity was on the cost side. The main cost synergies were expected from [✂]. There were also potential synergies in fleet and maintenance.

67. A presentation prepared by [✂] dated [✂] 2013 was a follow-up to a meeting between the parties in [✂] 2013 and an exchange of profit and loss account information. This presentation contained an estimate of the cost synergies that might be achieved in a combination between Aer Lingus and [✂]. The annual cost synergies were estimated at [£30–£50] million. These synergies were expected to be achieved across seven separate expense items—[✂].

68. [✂]

Discussions with [✂]

69. Aer Lingus told us that prior to [✂], Aer Lingus and [another airline] discussed the possibility of Aer Lingus acquiring [the other airline]. This acquisition was mooted by Aer Lingus management as [✂]. Given the likely quantum of the consideration for the acquisition, [✂], Aer Lingus would have needed to put the acquisition to a shareholder vote.

70. Aer Lingus said that the acquisition of [the other airline] would have allowed it to [✂] and that significant scale advantages could have been obtained, resulting in cost reductions. [✂]

71. Aer Lingus told us that [the other airline] expressed concern with the execution risk implied by Ryanair's presence on the share register and potential opposition to the transaction, even if its shareholding did not de jure confer the ability to block an ordinary resolution. Ultimately negotiations were discontinued in any event due to differences in the parties' price expectations.

72. Aer Lingus said that although the transaction never got to the stage of shareholder approval, a business case was capable of being developed to win shareholder support.

73. Internal Aer Lingus documents show that Aer Lingus was continuing to monitor the position of [the other airline] in [✂].

74. [The other airline] told us that various discussions had taken place with Aer Lingus in the period regarding an investment or acquisition in the airline.

Discussions with [✂]

75. [✂]

76. [✂] told us that it had discussed various strategic initiatives and proposals with Aer Lingus management, and had been advised that the implementation of some of these initiatives might be blocked by Ryanair. [✂]

Discussions with [✂]

77. Notes from a meeting of the M&A committee of the Aer Lingus board also record Aer Lingus's interest in purchasing [✂]. The minutes show that the need for Aer Lingus to obtain shareholder approval for such a deal was discussed, although it was unclear that the transaction would have been sufficiently large to constitute a class one transaction. It was noted in the minutes that the seller could see the need for approval as a significant issue. The acquisition did not ultimately proceed, [✂].

Additional evidence on synergies

78. In this section we discuss some additional evidence on the possible synergies that might arise in the context of a combination between Aer Lingus and another airline.

Airline views on synergies

79. We spoke to a number of airlines about the synergies associated with airline combinations.

80. IAG distinguished between the revenue synergies and cost synergies associated with combinations between airlines. It said that revenue synergies—for example, combining networks—could be achieved via lighter forms of integration between airlines such as code-shares or bilateral alliances, with the extent of the synergies depending on the depth of cooperation. Cost synergies—for instance, using common management information systems and merging sales forces—would require an extra level of commitment and would be more associated with full mergers.

81. IAG gave some examples of the economies of scale associated with consolidation with reference to the merger of British Airways and Iberia. It differentiated between two types of cost synergies—local synergies associated with an airline having larger operations at the same airport (for example, purchasing of ground handling services) and synergies associated with the scale of the total entity (for example, buying aircraft). It also highlighted network effects—and in particular the range of routes offered to customers—as another benefit of consolidation. For example, IAG's merger with British Airways and Iberia led British Airways to have increased presence in the Latin American market. The acquisition of bmi had given British Airways access to slots at Heathrow allowing it to increase the breadth of its short-haul network, as well as allowing very material cost savings.

82. Lufthansa also distinguished between revenue and cost synergies. Cost synergies could arise in the form of economies of scale or joint purchasing. Lufthansa gave the examples of aircraft insurance, ground handling and airport fees, aircraft or fuel purchasing which could all be jointly negotiated at better terms by a larger airline. It said that these synergies were more reliable in realization. Revenue or network synergies could emerge as a result of joining airlines' networks, which could lead to superior network quality and a better customer offer. In order for synergies of this type to be realized, the airlines' networks needed to be compatible in some way—typically because of some overlap between the networks and from complementarity in the routes offered.

83. Lufthansa said that it had experienced [✂] in recent acquisitions that it had been involved in. While some synergies could be realized through lighter forms of integration, the full synergy potential of a transaction could only be realized via a full merger. This particularly applied to cost synergies.

84. Air France said that its merger with KLM in 2004 had led to a lot of synergies from complementarity of networks, procurement synergies and other cost savings. It had also led, inter alia, to a larger network for the travelling public, a single frequent flyers' programme and better conditions for corporate clients.

85. Aer Arann said that, from an airline's perspective, consolidation would be expected to achieve synergies in terms of costs and joint purchasing, and in some instances cooperation at various airports. Some (if not all) of these synergies could also be achieved via other forms of cooperation, such as alliances, joint ventures and codeshares; however, a full merger would allow the elimination of multiple back-office overheads and fixed costs.

86. Flybe said that its acquisition of BA Connect had allowed it to substitute more efficient aircraft on to routes, reduce staff costs, and reduce duplication of maintenance, repair and overhaul facilities. Typically the greatest synergies would be achieved through an acquisition and the least synergies derived from a small minority shareholding without a code-sharing arrangement.

87. We looked at three examples of recent/proposed airlines mergers in order to review some examples of the scale of cost synergies estimated:

(a) *British Airways/Iberia/bmi mergers:* IAG estimated €104 million in cost synergies in 2012, up from €31 million in 2011. It estimated that based on current forecasts, cost synergies should double in size over the next two years through improved supplier management programmes and further efficiencies within maintenance and global business services functions. These cost savings approximate to around 0.6 per cent of total operating expenditure in 2012.[7]

(b) *American Airlines/US Airways proposed merger:* The proposed merger is forecast to deliver $1.050 billion annual synergies from 2015, of which $150 million would be net cost synergies. American Airlines/US Airways suggest that these synergy estimates are conservative relative to those achieved in recent mergers between airlines in the USA. For example, it said that the Delta/Northwest merger generated synergies of $2 billion, including cost savings representing 2 per cent of combined revenues; the US Airways/America West merger delivered synergies of $680 million, including cost savings of 3.2 per cent of combined revenues; the Continental/United Airlines merger generated synergies of $1.0–$1.2 billion, including cost savings of 0.9 per cent of combined revenues.[8]

(c) *Continental Airlines/United Airlines merger:* The merger was forecast (in 2010) to deliver net annual synergies of $1.0–$1.2 billion by 2013, made up of $0.8–$0.9 billion revenue synergies and $0.2–$0.3 billion cost synergies. The airlines highlighted,[9] greater ability to match capacity with demand, improve aircraft utilization and optimize connectivity, improved access from Continental's hubs to United's Asia network, improved access from United's hubs to Continental's Latin America and European networks, single-carrier network is very attractive to

[7] Based on total operating expenditure of €16.6 billion in financial year 2012.
[8] Source: US Airways Investor Presentation, February 2013.
[9] Source: Continental Airlines Investor Presentation, May 2010.

corporate customers, streamlined corporate overhead, efficiencies of combined marketing, sales and advertising functions, efficiencies of common IT platforms, facilities and service integration due to larger scale.

Booz & Company report for Aer Lingus

88. In 2010 Booz & Company presented an M&A Opportunity Assessment to Aer Lingus. This report contained the results of a systematic screening exercise which started with a list of 116 potential merger partners, a longlist of 80 potential partners, and a shortlist of 22 potential partners. The shortlisted airlines were evaluated across a range of criteria including network attractiveness, UK presence, fleet compatibility, financial and operational performance, strategic fit and cultural fit to produce an overall score for their relative attractiveness as a merger partner. Based on this evaluation, the top seven best-fit merger partners for Aer Lingus were: [✂].

89. We noted that in the period since this report was presented to Aer Lingus, several of the potential merger partners for Aer Lingus had been acquired or merged. For example: [✂].

90. The Booz & Company report also contained an assessment of the indicative range of synergies that might flow from a merger with full integration and merger in which two separate brands were maintained based on historically transactions involving airlines other than Aer Lingus. In relation to the full merger scenario, cost synergies were estimated at [✂] per cent of combined costs and revenue synergies were estimated at [✂] per cent of combined revenues.[10] In relation to the two brand mergers, cost synergies were estimated at [✂] per cent of combined costs and revenue synergies were estimated at [✂] per cent of combined revenues.[11] This analysis indicated that the cost and revenue synergies from a merger with full integration might be higher than a merger in which two brands were maintained, but in both scenarios there were potential cost and revenue benefits from a merger.

91. Booz & Company also carried out a quantification exercise in relation to the top [✂] potential merger partners that it identified for Aer Lingus specifically. The range of cost synergies was [€ tens of millions] a year, and the range of revenue synergies was [€ tens of millions] (based on the combined costs and revenues of the merging airlines[12]). These estimates were based on the assumption that the two brands remained separate. If there was a full merger and a single brand was used for the combined airline, the synergy estimates were higher—for example, cost synergies for a full merger would range from [✂] per cent of combined operating costs rather than [✂] per cent of combined costs for the two brand scenario. The cost synergy estimates assumed savings would be achieved in relation to overheads, sales and marketing, maintenance, sourcing, station expenses and fleet optimization, ie they did not include any savings on capital expenditure, for example aircraft procurement.

Aer Lingus's cost structure

92. Table 2 summarizes Aer Lingus's different categories of operating costs in the last two years. We considered that if Aer Lingus were to merge with another airline, the

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[10] Based on the following mergers: [✂].
[11] Based on the following mergers: [✂].
[12] For the single brand merger scenario, cost synergies ranged from [✂] per cent of combined costs and revenue synergies ranged from [✂] per cent of combined revenue. For the two brand merger scenario, cost synergies ranged from [✂] per cent of combined costs and revenue synergies ranged from [✂] per cent of combined revenue.

potential for cost synergies from an increased scale of operations would exist across a number of the individual cost headings in the table.

TABLE 2 **Aer Lingus operating costs (before net exceptional items)**

	Year ended 31 December 2012		*Year ended 31 December 2011*	
	€'000	*%*	*€'000*	*%*
Staff costs	266,764	19.9	260,550	19.5
Depreciation and amortization	76,079	5.7	79,808	6.0
Aircraft operating lease costs	46,137	3.4	43,909	3.3
Fuel and oil costs	358,560	26.8	288,728	21.6
Maintenance expenses	60,096	4.5	58,104	4.3
Airport charges	295,336	22.1	275,631	20.6
Enroute charges	61,391	4.6	59,668	4.5
Distribution charges	46,957	3.5	46,728	3.5
Ground operations, catering and other operating costs	126,240	9.4	129,102	9.7
Other (gains)/losses—net	(13,330)		(3,028)	
Total	1,324,230		1,239,200	

Source: Aer Lingus.

93. We also looked at the trend in Aer Lingus's unit costs. Table 3 shows Aer Lingus's total operating expenditure per revenue passenger kilometre, available seat kilometre and passenger carried for the previous six financial years. It shows an upwards trend in unit costs since 2009.

TABLE 3 **Aer Lingus's unit costs since 2007**

	2012	*2011*	*2010*	*2009*	*2008*	*2007*
Unit cost (including fuel)						
Opex per RPK (€ cent)	9.12	8.82	8.37	8.13	8.45	8.15
Opex per ASK (€ cent)	7.09	6.66	6.37	6.06	6.15	6.14
Opex per passenger carried (€)	137.18	130.26	124.44	123.94	137.49	129.63
Unit cost (excluding fuel)						
Opex per RPK (€ cent)	6.65	6.76	6.45	6.04	5.98	6.44
Opex per ASK (€ cent)	5.17	5.11	4.91	4.50	4.35	4.85
Opex per passenger carried (€)	100.04	99.91	95.96	92.00	97.36	102.41

Source: CC calculations based on information from Aer Lingus.

94. The scale of any cost synergies arising from a combination involving Aer Lingus would depend on the identity of the partner and the specifics of the transaction. However, for illustrative purposes, in Table 4 we compare potential annual cost savings of between €10 million and €50 million to Aer Lingus's total operating costs and passenger numbers in the year ended 31 December 2012. [✂]

TABLE 4 **Cost synergies**

	Annual cost synergies, € million				
	10	*20*	*30*	*40*	*50*
Annual cost synergy as % of total operating costs	0.8	1.5	2.3	3.0	3.8
Annual cost synergy as % of operating costs excluding fuel	1.0	2.1	3.1	4.1	5.2
Cost synergy % of average yield per passenger	0.9	1.7	2.6	3.4	4.3
Cost synergy per passenger	1.04	2.07	3.11	4.14	5.18

Source: CC calculation. Based on 2012 operating costs of €1.324 billion (£965,670 excluding fuel and oils), 9.653 million passengers carried and €120.15 average yield per passenger.

95. Cost synergies in some categories of costs might be realized quickly (for example, procurement of fuel and oil). Cost synergies in relation to assets with longer lives may have a delayed or indirect effect (for example, savings in procurement may be achieved via more effective capital expenditure programmes; however, the magnitude of the effect on depreciation and amortization and aircraft operating lease costs would depend on the accounting policy adopted and the current asset base). There may also be one-off implementation costs that would delay the realization of cash savings.

96. The total value of the potential synergies can be quantified either by applying multiplier to the annual value, or a discount rate to calculate a present value. For example, based on the midpoint of the range in Table 4, if the synergies were to be sustained for 20 years, if a discount rate of 6 to 8 per cent is applied to an annual cash flow of €30 million for ten years, this would have a present value of €295–€344 million.[13] Alternatively, using a simple multiplier of 10, the cash value is €300 million. We would expect that synergies achieved by Aer Lingus in combination with another airline would accrue to the Great Britain/Ireland routes in broadly the same ratio as level of activity that this activity represents for Aer Lingus, and that they would be sustained for a long time, eg 20 years. Given that the Anglo-Irish routes represent a significant proportion of Aer Lingus's revenue, [20–30] per cent, attributing the range of €295–€344 million results in a range of [€60–€100] million.

[13] Note: to calculate the present value of a ten-year annuity at 8 per cent interest rate, the multiplier is ((1+1.08)^-10) / 0.08, The assumption of a range of 6 to 8 per cent is based on the same assumptions set out in Appendix H.

Share issuance by Aer Lingus

Introduction

1. Ryanair has the ability to block a special resolution that would be required for Aer Lingus to waive pre-emption rights when issuing new shares for cash.

2. This appendix sets out relevant background material to the discussion of this issue in the main text of our report. In particular, it discusses:

   (a) reasons why Aer Lingus may seek to issue new shares for cash;

   (b) pre-emption rights for existing shareholders during an equity issuance;

   (c) factors affecting Aer Lingus's choice of new sources of capital;

   (d) limitations on Aer Lingus's ability to issue new debt;

   (e) time and costs required for Aer Lingus to undertake a fully pre-emptive rights issue; and

   (f) likelihood of Aer Lingus issuing new shares for cash.

Reasons why Aer Lingus may seek to issue new shares

3. If Aer Lingus sought to issue new shares for cash it would need to demonstrate to its shareholders an appropriate use of the proceeds, for example:

   (a) refinancing the company if it was short of cash;

   (b) implementing a target capital structure (ie a debt/equity mix);

   (c) major investments, including purchasing aircraft, landing slots or other assets;

   (d) acquisitions or strategic alliances with other airlines; and

   (e) [✄]

Pre-emption rights for existing shareholders during an equity issuance

4. We identified three principal ways in which Aer Lingus could issue new shares for cash:

   (a) a rights issue with pre-emption rights available to all existing shareholders;

   (b) a rights issue with a selective disapplication of pre-emption rights affecting a sub-set of shareholders; and

   (c) a private placement of shares to an individual shareholder (eg investor or airline), without pre-emption rights for existing shareholders.

5. Pre-emption rights[1] require a company seeking to issue new shares for cash to offer the new shares to existing shareholders before they are made available to anyone else. These rights ensure that a shareholder's proportion of voting and other rights in the company are not diluted unless it decides not to participate in the share offering.

6. It is customary for a company partially to disapply the statutory pre-emption rights (typically on up to 5 per cent of its issued share capital) by passing a special resolution, to provide flexibility for equity financing, should it be needed. Ryanair can use its 29.82 per cent stake in Aer Lingus to block a special resolution, meaning that Aer Lingus is not able to launch a rights issue on a non pre-emptive basis to all shareholders.

7. Aer Lingus has routinely asked shareholders to vote at AGMs on a special resolution concerning two aspects of the company's authority to allot shares—firstly the disapplication of pre-emption rights in relation to rights issues and secondly the maximum amount that may be raised via a private placement.[2] Ryanair has routinely blocked this resolution.

8. Ryanair said that each time this motion had been tabled at the Aer Lingus AGM, Aer Lingus had sought shareholder approval for a new share issuance that was limited to 5 per cent of the currently issued equity share capital. It said that this would represent a trivial amount which would not enable Aer Lingus to pursue major strategic investments. Based on the trading range of Aer Lingus's shares the proceeds to which Ryanair refers are approximately €29–€45 million.[3]

9. Ryanair told us that the reason it had objected to the waiver of pre-emption rights was not to prevent Aer Lingus from raising equity financing for strategic purposes. Rather, Ryanair objected because it otherwise risked its shareholding being diluted disproportionately in relation to other shareholders. We note that Ryanair had supported the ordinary resolution granting the Directors of Aer Lingus general authority to allot shares in each AGM between 2007 and 2013, up to 33 per cent of the issued share capital.[4] Based on the recent range for Aer Lingus's share prices this authority corresponds to additional capital of €194–€300 million.

10. Aer Lingus told us that the special resolution had until now been tabled in a form which was virtually standard for all Republic of Ireland public companies. If the resolution was passed, it would permit Aer Lingus to:

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[1] Companies (Amendment) Act 1983, section 24.

[2] Text of the Special Resolution tabled to the AGM that took place on 26 April 2013:

> That pursuant to Article 8(d) of the Articles of Association and Section 23 and Section 24(1) of the Companies (Amendment) Act, 1983 the Directors are hereby empowered to allot equity securities (within the meaning of Section 23 of that Act) for cash pursuant to the authority to allot relevant securities conferred on the Directors by resolution 7 above in the notice of this meeting as if the said Section 23(1) did not apply to any such allotment, provided that this power shall be limited to the matters provided for in Article 8(d)(i) and (ii) of the Articles of Association and provided further that the aggregate nominal value of any shares which may be allotted pursuant to Article 8(d)(ii) may not exceed €1,335,100.20 (26,702,004 shares) being equivalent to approximately 5% of the aggregate nominal value of the issued ordinary share capital of the Company.

[3] Calculation: 534 million shares multiplied by 5 per cent equals 26.7 million shares. Based on a share price range of €1.10 to €1.70 per share (before any discount required to sell the shares).

[4] For example, resolution 7 at the 2013 AGM:

> As an Ordinary Resolution: that the Directors be and are hereby generally and unconditionally authorised to exercise all the powers of the Company to allot relevant securities (within the meaning of section 20 of the Companies (Amendment) Act, 1983) up to an aggregate nominal amount of €8,811,661.45 (176,233,229 shares) (representing approximately 33% of the nominal value of the issued share capital provided that this authority shall expire at the earlier of the close of business on the date of the next AGM after the passing of this resolution and 26th July 2014 provided however that the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry, and the Directors may allot relevant securities in pursuance of such offer or agreement as if the authority conferred by this resolution had not expired.

(a) issue shares for cash equivalent to 33 per cent of its issued share capital where this is done as part of a rights issue in favour of all its ordinary shareholders except for those shareholders with registered addresses outside the Republic of Ireland;[5] and

(b) issue shares via a private placement, provided that the aggregate amount of new shares did not exceed 5 per cent of the existing shares outstanding.

11. We asked Aer Lingus whether it had considered splitting the resolution into its two components, so as potentially to obtain shareholder approval for one part of it. Aer Lingus told us that it had made no decision about whether to split the resolution. Aer Lingus did not assume that Ryanair would let a resolution pass simply because it protected Ryanair's pre-emption rights, and considered that Ryanair's position might depend on particular concerns as to the purpose for which funds raised pursuant to a rights issue might be used. For example, Ryanair might be unwilling to approve such a resolution because it wished to ensure that funds raised pursuant to a rights issue could not be used in connection with a solution to the pension deficit or some other initiative with which it did not agree. Ryanair told us that it would not oppose any disapplication of pre-emption rights limited to other (eg North American) shareholders, and it would support a rights issue.

Factors affecting Aer Lingus's choice of new sources of capital

12. Aer Lingus told us it had a natural preference for equity rather than debt financing if it needed to raise new capital. There are a number of reasons underlying Aer Lingus's preference for equity rather than debt financing, for example:

(a) Variability of earnings and cashflows are characteristics of the airline industry. A significant debt raising programme would require predictability of cashflows in order to provide lending institutions with confidence that debt service payments could be made.

(b) New debt rather than fresh equity financing could potentially increase the financial risk profile of the company. The potential costs of financial distress for

[5] Aer Lingus's Articles of Association, paragraph 8(d)(i):

Where the Directors are authorised to allot relevant securities in accordance with Section 20 of the 1983 Act, the Company may at any time and from time to time resolve by a special resolution referring to this Article 8(d) that the Directors be empowered pursuant to Section 24 of the 1983 Act to allot equity securities (as defined by Section 23 of that Act) for cash pursuant to their authority to allot relevant securities as if sub-section (1) of the said Section 23 did not apply to any such allotment provided that this power shall be limited to: - (i) the allotment of equity securities in connection with any rights issue in favour of ordinary shareholders (other than those with registered addresses outside the State to who an offer, would, in the opinion of the Directors, be impractical or unlawful in any jurisdiction) and/or any persons having a right to subscribe for or convert securities into ordinary shares in the capital of the Company (including without limitation any holders of options under any of the Company's share option schemes for the time being) where the equity securities respectively attributable to the interests of such ordinary share holders or such persons are proportionate (as nearly as may be) to the respective number of ordinary shares held by them or for which they are entitled to subscribe or convert into subject to such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with any regulatory requirements, legal or practical problems in respect of overseas shareholders, fractional entitlements or otherwise; (ii) the allotment of equity securities (other than pursuant to any such issue as referred to in paragraph (i) above) up to the maximum aggregate nominal value specified in such special resolution; and such power (unless otherwise specified in such special resolution or varied or abrogated by special resolution passed at an intervening extraordinary general meeting) shall expire at the earlier of the close of business on the date of the next annual general meeting of the Company after the passing of such special resolution or the day which is 18 calendar months after the date of passing of such special resolution, provided that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offer or agreement as if the power conferred hereby had not expired.

an airline should be viewed in addition to the already relatively high operational risk profile of the sector (prone to cyclical results, disruptions).

(c) Equity financing would provide greater flexibility and fewer restrictions with regard to scheduled interest and principal repayments, information covenants, etc.

(d) Aer Lingus does not generally rely on conventional corporate debt financing but has instead used asset backed, finance lease debt to fund aircraft purchases. Conventional debt, such as corporate bonds, typically carries financial conventions and other conditions which could potentially restrict the flexibility of the business whereas finance leases backed by aircraft generally carry financing terms which are more appropriate for the company's requirements.

(e) Aer Lingus has significant tax losses to carry forward and hence the 'tax shield' advantages associated with the deductibility of additional interest payments are not available to Aer Lingus at present. This removes one of the reasons why corporations sometimes select debt ahead of equity financing when external funding is required.

(f) It is necessary for Aer Lingus to have maximum flexibility in relation to additional sources of funding. Aer Lingus has, in the past, considered engaging in corporate activity as opportunities arose and this is likely to continue to be the case.

Limitations on Aer Lingus's ability to issue additional debt

13. Aer Lingus told us that it had already issued debt secured on its assets, and sought to maintain a balance of cash and debt to provide balance sheet resilience. Aer Lingus said that its current incremental debt capacity was €[✂].

14. Aer Lingus said that there were several reasons why it might not be in a position to issue additional debt, including:

(a) If the company was not sufficiently cash flow generative or did not expect to be, it would be difficult to raise additional finance or service existing finance. There are a variety of both market and internal issues which could trigger such a scenario. For example, in 2009 Aer Lingus experienced a significant operating cash outflow of €168 million due to restructuring costs and adverse market conditions as a result of economic turbulence, recession in its key markets.

(b) In the event of a credit market liquidity crisis (eg in 2008), banks and other lending institutions may reduce the availability of finance to leasing companies and airlines alike. If credit financing was to be available in such a scenario, it would likely come at a significant premium which may be in excess of the company's ability to pay.

(c) If the company believed that the conditions associated with any debt financing would inhibit the operational flexibility of the business (eg onerous financial covenants, interest margins etc).

(d) If lending institutions assessed Aer Lingus as a poor credit risk, debt financing would be unlikely to be available. Aer Lingus would not be a conventional participant in the corporate bond market given the relatively small size of the company, its variability in historic earnings, etc and for this reason, it is unlikely that Aer Lingus could sustain a high quality credit rating over time. The company could instead attempt to access bank-provided, term-loan financing to fund aircraft purchases but this would mean that the company would have to match

long-term asset financing (eg 12 years) with short-term bank funding (eg three to five years). This mismatch could potentially expose Aer Lingus to an unacceptable level of refinancing risk.

Time and costs required for Aer Lingus to undertake a fully pre-emptive rights issue

15. Ryanair considered that there would be no practical difficulty in Aer Lingus conducting a rights issue with full pre-emption rights in place for shareholders worldwide.

16. We considered whether Aer Lingus could raise new equity capital by offering full pre-emption rights to all shareholders worldwide. We asked Aer Lingus whether there were any practical difficulties or costs involved in undertaking a rights issue with full pre-emption rights available to all shareholders, such that it would not need to pass a special resolution.

17. Aer Lingus told us that some of its shareholders resided outside the Republic of Ireland and the UK. For example, as at 7 March 2013 Aer Lingus had a total of 139 US, Canadian and Australian shareholders. We noted that this may be a sufficiently low number of shareholders for a private placement exemption to be available in some or all relevant jurisdictions. We noted Aer Lingus's observation that it was standard practice for rights issues in the Republic of Ireland or the UK to be conducted on the basis that the company has been permitted by its shareholders to exclude shareholders who may be resident in certain countries (including USA, Canada, Japan, South Africa and Australia). Including such shareholders will significantly increase the difficulty, expense and timing of the rights issue because of the risk that failing to provide full pre-emption rights would be in breach of securities rules in relevant jurisdictions.

18. Aer Lingus told us that even in those jurisdictions where a private placement exemption existed because the number of overseas shareholders was below a specified minimum, the exemption could be lost once the rights issue had been announced if investors in those jurisdictions started buying shares during the offer period so that the number of shareholders exceeded the maximum threshold permitted for the private placement exemption. Furthermore, in some jurisdictions, for example the USA, a private placement exemption can be lost if the company or its agents can be regarded as having made public disclosures in the USA of its intention to sell its shares in a private placement or other disclosures that could be deemed a general solicitation or advertisement in respect of the rights issue.

19. The incremental time and costs involved in extending a rights issue to all shareholders worldwide would include:

    (a) Aer Lingus would need to prepare a registration statement and submit it on a non-public basis for review by the US Securities and Exchange Commission (SEC) in advance of the announcement of the rights issue. The registration would need to comply with the standard disclosure. Aer Lingus considered that it would require around ten weeks to obtain approval for a US registration statement.

    (b) If Aer Lingus finds itself with too many shareholders in any jurisdiction outside the UK and the Republic of Ireland before the rights issue offer period had closed, it could be required to prepare a full prospectus in accordance with the laws of the relevant jurisdiction.

(c) Aer Lingus would have to take into account in its planning the fact that it would need to appoint lawyers to represent it in the USA and that the underwriters to the rights issue would also have to have similar US legal advice. The cost of retaining two US legal advisors would more than double the legal costs of the rights issue and would be somewhere in the region of an extra €500,000 to €1,500,000, depending on the size of the offer.

(d) As Aer Lingus does not prepare its accounts in accordance with US GAAP, the US registration statement would require some form of GAAP reconciliation to be prepared by the company's auditors at incremental expense, for example double the fee charged by the accountants in the transaction. The registration document would require historical financial statements covering a three-year period prepared in accordance with US accounting standards.

(e) The consequences in other countries such as Canada and Australia: it is difficult to be precise as to what this might cost without Aer Lingus first seeking specific advice in each of these jurisdictions. In the case of each jurisdiction, the time required to prepare a prospectus, and have it approved by the local regulator, would not be the same as the time required in the Republic of Ireland and this would be more expensive and would also have to be allowed for in the planning of the rights issue timetable.

Likelihood of Aer Lingus issuing new shares for cash

20. In the following paragraphs we set out a forward-looking assessment of Aer Lingus's financial standing; and the potential impact of adverse events on the need to raise cash.

Aer Lingus's financial standing in the medium to long term

21. At present, Aer Lingus is a well-capitalized airline that is generating positive cash flow from its operations and it has no need to raise additional equity for general corporate purposes. Aer Lingus currently forecasts free cash flow generation (after maintenance capex, but before aircraft purchases) of €86.6 million a year.

22. As at 31 December 2012, Aer Lingus had gross cash of €908.5 million, gross debt of €531.6 million and net cash of €376.9 million. Aer Lingus has a capital programme to finance long-haul aircraft. It has nine A350 aircraft on order, with the first deliveries expected in 2016, and a committed capital cost at 31 December 2012 of €937 million.

23. Aer Lingus told us that whilst it had significant cash balances at present, a large portion of these balances would be required to finance the company's long-term capital commitments for aircraft deliveries. The company also maintained a cash reserve in respect of unforeseen external events (such as economic downturns, periods of prolonged fuel price inflation, unexpected and severe operational disruptions etc). The amount which was estimated to be required for this reserve would vary depending on the company's view of likely future events but management have generally estimated this reserve at several hundred million euros. In the event that a significant amount of the company's current cash balances were to be applied on a strategic opportunity or to address some other large cash need faced by the business (eg pension funding requirements as a result of legal action), it was likely that Aer Lingus would seek to restore cash reserves to a level deemed sufficient to provide the level of operational flexibility noted above. In this scenario, it was likely that Aer Lingus would seek to arrange fresh equity rather than new debt financing.

24. Aer Lingus provided a long-term forecast of its cash balance [✂] taking into account its expected operating cash flow, capital expenditure [✂] and financing cash flows. This analysis indicated that [✂] Aer Lingus's cash balance would be [✂]. The analysis indicated that Aer Lingus could fund its aircraft purchases, net of disposals and other capital expenditure from its operating cash flow without any requirement to issue new debt.

TABLE 1 **Aer Lingus projected cash balance [✂]**

	€m	
Gross cash at 31 December 2012	*908.5*	*As per 2012 Annual Report*
[✂]	[✂]	[✂]

Source: Aer Lingus.

Potential impact of adverse events on the need to raise cash

25. Aer Lingus provided three examples of past events that resulted in an unexpected call on the company's cash reserves. These are set out in the table below.

TABLE 2 **Impact of adverse events in the past**

Year	*Event*	*Cash outflow €m*	*Comments*
2001/02	9/11 terrorist incident	118	Of which, €82.8m cash costs for restructuring and severance
2009/10	Restructuring costs	166	Cash outflow for exceptional costs following a fundamental restructuring of the company relating to the severe economic downturn
2010	Volcanic ash incident	14	Passenger compensation, lost bookings and unavoidable costs

Source: Aer Lingus.

26. Aer Lingus has, over time, recognized exceptional charges in several years, and considers that accounting charges are broadly equivalent to the related cash outflows.

TABLE 3 **Aer Lingus historical exceptional costs**

€ million

	2001	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*
Net exceptional credit/ (charge)	–104.1	–25.7		–102.4		–133	3.5	–140.9	–88.6	–31.0	37.2	–26.5

Source: Aer Lingus.

27. Aer Lingus considered that its experience with regard to exceptional charges was broadly consistent with the experience of the wider European airline sector; for example, in 2012 three major international airlines recorded exceptional charges: Air France KLM (€587 million); IAG (€590 million); and Lufthansa (€396 million).

28. Aer Lingus considered that the airline industry was arguably more exposed to the effects of unpredictable and unforeseen external events than other economic sectors. The financial effect of these 'shocks' was usually negative and resulted in Aer Lingus and other airlines incurring significant exceptional cash costs. Aer Lingus considered that based on its past experience, it would not be unreasonable to expect a recurrence of these 'shocks' with the related exceptional financial cost being borne

by the company in future years. Examples of such external events included, but were not limited to: future economic crashes; fuel price inflation and, related to this, strengthening US$ trends, acts of terrorism, and extreme meteorological or natural events. In addition, airlines have demonstrated a periodic tendency to engage in significant restructuring activity to achieve lower unit costs and operational efficiencies. This tended to drive exceptional cash costs in the form of redundancy programmes. In Aer Lingus's case, these restructuring programmes had historically been driven by periodic organizational restructuring and staff redundancy programmes.

29. Aer Lingus provided examples of potentially higher costs that would have an adverse effect on financial performance. [✂]

TABLE 4 **Impact of potential adverse events in future**

Year	*Event*	*Operating costs*	*Comment*
[✂]	[✂]	[✂]	[✂]

Source: [✂].

30. In relation to the pension fund, we noted that [✂].

31. In relation to a major investment, or acquisition by Aer Lingus, over and above the existing, shareholder approved, acquisition of new aircraft, Ryanair has the ability to block the special resolution required to disapply pre-emption rights to enable Aer Lingus to proceed with a capital raising. We note, however, that Aer Lingus could change the terms of the special resolution so as to disapply pre-emption rights only to non-EU shareholders, and that Ryanair has said that it would vote in favour of such a resolution. If this were to occur, it would be possible for Aer Lingus to proceed with a rights issue.

Economic benefits accruing to Ryanair from its shareholding in Aer Lingus

The value of Ryanair's stake in Aer Lingus

1. Ryanair owns 29.82 per cent of the issued ordinary share capital of Aer Lingus. The historical cost to Ryanair of acquiring the 29.82 per cent shareholding in Aer Lingus was €407.2 million. There are several possible methods to value the economic benefit that Ryanair derives from this equity investment on a forward looking basis. We have considered the following approaches to quantification:

   (a) market value of the shares, based on share price on the London or Irish Stock Exchanges;

   (b) present value of Ryanair's dividend based on the dividend proposed by management and subject to shareholder approval; and

   (c) present value of Ryanair's proportionate share of the free cash flow generated by Aer Lingus.

Market value of the 29.82 per cent stake in Aer Lingus

2. The first approach concerns the market value of the shares, and the contribution of this stake to the Ryanair share price.

3. Table 1 indicates that the market capitalization of Aer Lingus has varied between €587 million and €908 million, and the corresponding market value of a 29.82 per cent stake in Aer Lingus, has varied between €175 million and €271 million in recent months (December 2012 to July 2013) without any discount or premium applied.

4. Over the same period, the market capitalization of Ryanair has varied between €6,800 million and €10,852 million. Therefore the contribution of the Aer Lingus stake to Ryanair's market capitalization is in the range of 2.5 to 2.6 per cent (representing €0.12–€0.19 per Ryanair share).

TABLE 1 **Market value of Ryanair's stake in Aer Lingus**

	Trading range Dec 12–Jul 13	
	Low	*High*
Current market price per share (€)	1.10	1.70
Issued share capital (number of shares)	534,040,090	534,040,090
Market capitalization (€m)	587.44	907.87
Shares owned by Ryanair (shares)	159,231,025	159,231,025
Market value of stake (€m)	175.15	270.69
Equity value of Ryanair		
Current market price per share (€m)	4.70	7.50
Number of shares in issue (shares)	1,446,910,000	1,446,910,000
Market capitalization (€m)	6,800.48	10,851.83
Contribution of Aer Lingus to Ryanair		
Contribution of Aer Lingus stake to Ryanair market cap (%)	2.58	2.49
Value of Aer Lingus stake per Ryanair share (€/share)	0.12	0.19

Source: CC calculation.

Present value of Aer Lingus dividends plus capital gains to Ryanair

5. The second approach is to consider the dividends earned by Ryanair from its stake in Aer Lingus plus the capital gains it may achieve. Aer Lingus's management are responsible for setting the dividend policy, which is subject to shareholder approval via an ordinary resolution.

6. Aer Lingus did not pay a dividend during its first five years as a listed company (2006 to 2010 inclusive). The maiden dividend of €0.03 per share (€16 million in aggregate) was approved by shareholders in 2011 and paid in July 2012. On 6 February 2013, Aer Lingus announced its preliminary results for the year ended 31 December 2012. Management recommended a 33 per cent increase in the dividend to €0.04 per share (€21.2 million in aggregate), which was approved by shareholders at the AGM on 26 April 2013 and which is due for payment in July 2013. Based on a share price range of €1.10 to €1.70, the dividend yield is 2.3 to 3.6 per cent.

7. In 2011 Aer Lingus generated earnings per share of €0.134 and it distributed €0.03 in dividends per share, representing a payout ratio of 22.4 per cent. The dividend payment received by Ryanair would have been equal to €4.8 million. In 2012, Aer Lingus generated earnings per share of €0.064 and the dividend of €0.04 per share represents a 62.5 per cent payout ratio. This would imply a dividend payment to Ryanair of €6.3 million.

8. If Aer Lingus pays no dividend at all, the value of the dividend stream is nil. However, Aer Lingus paid a dividend in 2012 and will pay a dividend in 2013, and it appears from public statements by management that it intends to continue to propose dividends if this is in the interests of the company. For illustrative purposes we have assumed a range of 2 to 3 per cent[1] for dividend growth and 6 to 8 per cent[2] for the return on equity for Aer Lingus to calculate a perpetuity rate and applied this to the actual dividend paid in 2012 and the expected dividend in 2013 per share. The results are as follows:

   (a) Based on the actual dividend paid in 2012, the present value of the dividend stream to Ryanair is €96–€119 million (which equates to 1.1 to 1.8 per cent of Ryanair's market capitalization).[3]

   (b) Based on these 2013 expected dividend, the present value of the dividend stream to Ryanair is €127–€159 million (which equates to 1.4 to 2.3 per cent of Ryanair's share price).

9. There are three main reasons why these results are lower than the current market value of the shares: firstly, the market expects capital growth in the value of the shares over and above the dividend stream; secondly, the market may expect higher dividends in future than the assumptions we have made; and thirdly, the market has a lower return expectation than our range of cost of capital assumptions.

10. In relation to capital gains, given that Ryanair accounts for its investment as an 'available for sale financial asset', the value of the investment is revalued each year to reflect its market value. The periodic revaluation could be a gain or a loss from one

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[1] Assumption: outlook for GDP growth.
[2] Assumptions: Risk Free Rate = 3 per cent, Equity Risk Premium = 5 per cent, Beta of Aer Lingus = 0.61 (source: Bloomberg based on weekly data for two years, Aer Lingus relative to Irish Stock Exchange). Based on the CAPM formula, cost of equity = 6 per cent. A higher assumption of 8 per cent is derived by varying the beta to the value 1.0 (ie market value). To calculate the range of present values we have combined the 3 per cent growth rate with the 8 per cent cost of capital, and the 2 per cent growth rate with the 6 per cent cost of capital.
[3] Calculation: present value of dividend divided by the ranges for Ryanair's market capitalization in Table 1 above.

year to the next, depending on the market value at the balance sheet date. The Aer Lingus share price has declined since its IPO (see Appendix C, Table 4) but it has increased in the last year. In Ryanair's results for the year ended 31 March 2013, the carrying value of its investment in Aer Lingus is stated to be €221.2 million (representing €1.389 pence per share). This represented a gain of €71.5 million over the prior year value of €149.7 million, or €0.94 per share). The gain was recognized as other comprehensive income. Given the unpredictability of changes in share prices between balance sheet dates we have not set out a quantification of the present value of potential capital gains.

Ryanair's share of Aer Lingus's net profit and free cash flow

11. The third approach considers the present value of Ryanair's 29.82 per cent share of the cash flow of Aer Lingus.[4] This approach can be used to value the combination of dividends and capital growth in a single step.

12. It also serves to illustrate the range of value that Ryanair might be expected to derive from Aer Lingus if it were in a position to influence the dividend policy of Aer Lingus such that it distributed 100 per cent of free cash flow in the form of dividends, pro-rata to its shareholders.

13. In 2012, Aer Lingus generated operating profit before exceptional costs of €69.1 million (2011: €49.1 million); and net profit for the year of €34.1 million (2011: €71.2 million). In 2011 Aer Lingus suffered a free-cash[5] outflow of –€24.9 million. This reversed in 2012, during which Aer Lingus generated free cash flow of €75.2 million. We have examined cash flow rather than accounting profit, because it is not affected by accounting policies and estimates and is therefore more representative of the economic value to Ryanair.

14. The cash value of the 2012 dividend, €21.2 million will represent 32 per cent of operating profit, 28 per cent of free cash flow, and 62 per cent of net profit for the year ended 31 December 2012 respectively.

15. The assumptions of 2 to 3 per cent growth and 6 to 8 per cent cost of equity can be applied to Ryanair's proportionate share of Aer Lingus 2012 free-cash flow to estimate the value of the stake in perpetuity. This calculation results in a range of €448–€560 million (representing 5.3 to 6.6 per cent of Ryanair's share price).

16. Given the historical volatility of Aer Lingus's cash flow, it is, however, difficult to judge whether cash flow in future will be higher or lower than the 2012 free cash flow of €75.2 million, and it may be more appropriate to consider a range, eg €50–€100 million. For illustrative purposes, using the lower end of this range for the annual free cash flow of Aer Lingus, and projecting growth from this lower base of €50 million a year, the present value of Ryanair's 29.82 per cent would be €298–€373 million (equating to 3.4 to 4.5 per cent of Ryanair share price). Using the upper end of this range for the annual free cash flow of Aer Lingus, and projecting growth from this higher base of €100 million a year, the present value of Ryanair's 29.82 per cent would be €596–€745 million (equating to 6.8 to 11.0 per cent of Ryanair share price).

[4] Note, however, that Ryanair's accounting policy for its stake in Aer Lingus is to regard it as an investment available for sale.
[5] Free cash flow represents cash generated from operating activities less net capital expenditure (purchases of fixed assets exclusive of finance lease raised less proceeds from disposals) plus or minus net interest received/paid.

17. The resulting valuation ranges, based on the lower end of the illustrative range, €50 million and the 2012 actual cash flow of €75.2 million free cash flow, both exceed the current market value of the shares. The main reason for this is that shareholders would not expect that 100 per cent of the free cash flow of an independent Aer Lingus would be distributed as dividends, because management would adopt a prudent distribution policy so as to maintain an appropriate capital structure for it to continue in business. Nevertheless, if Aer Lingus were part of another airline with its own balance sheet, the entire free cash flow may be more relevant to the value of the cash flow to the parent company.

Other quantification methods

18. We also identified a number of additional quantification methods that might be relevant; however, we have not pursued these for the following summary reasons:

(a) Intrinsic value of the stake, based on established valuation methodologies (eg discounted cash flow, net asset value). These approaches are relevant to the valuation of the whole of Aer Lingus (ie 100 per cent). We have not quantified these approaches because we are considering a minority stake rather than a controlling interest.

(b) Relative value, based on established methodologies such as comparable transaction and company multiples. These approaches are also relevant to the valuation of the whole of Aer Lingus (ie 100 per cent). We have not quantified these approaches because we are considering a minority stake rather than a controlling interest.

In relation to both the intrinsic and relative value methods, the resulting valuation is most likely to result in a higher value than the other methodologies due to the presence of a bid premium.[6] We note that Aer Lingus considered that Ryanair would be likely to attach a premium to its valuation of the minority stake because of its role as a toe-hold for future bids. We do not think that it is necessary to carry out a quantification using these approaches because we know the direction of the result (ie a valuation of 100 per cent is greater than or equal to the value of a minority stake).

(c) Realizable value of the company in a break-up scenario, based on the price that could be achieved from the underlying assets owned by Aer Lingus. Generally speaking the market value of a healthy and viable company exceeds the value of its tangible assets because of the goodwill in the business (eg customers, loyalty, branding). This is not relevant because we are assuming that Aer Lingus continues in business.

(d) Realizable value of a block of shares. Generally speaking, a major minority shareholder that sought to sell its shares into the market (eg via a block-trade to institutional shareholders, or directly into the market) would need to consider how to mitigate the potential downward pressure on value that could be caused by a temporary increase in the number of shares offered for sale (eg by building a book of demand and/or marketing the shares to new investors). This is not relevant to Ryanair’s share of Aer Lingus if the shares are retained. As a working assumption we have assumed that the realizable value would be the same as the market value.

[6] Note that in a public market bid situation the typical premium of an offer for a controlling stake tends to be around 30 per cent premium to the pre-bid market price. In a negotiated sale for a controlling stake there would be a negotiation over value. The negotiated price is likely to be influenced by the extent to which a seller can extract the value of synergies or efficiencies from the buyer. This is not relevant in a minority stake valuation.

Variable margins and pricing pressure

Introduction

1. In this appendix we:

   (a) discuss the variable margins of Ryanair and Aer Lingus; and

   (b) set out the parties' analysis of the possible pricing pressure associated with the transaction.

Variable margins

2. Measuring the airlines' variable margins is difficult. First, we are constrained by the revenue and cost data recorded by the airlines. These are often not comparable between the airlines and may not capture the most relevant revenue or cost definition. For this reason, we must interpret with caution any apparent differences in the margins of the two airlines.

3. Second, exactly what margin should be measured (and in particular which costs should be included as relevant variable costs) is not straightforward, because the most appropriate formulation will depend on the number of passengers switching and which element of the airlines' competitive offering is being treated as 'variable'. For this reason, we calculate the margins of Ryanair and Aer Lingus with a range of different categories of costs included.

4. Figure 1 shows for Ryanair:

   (a) average revenues for the financial year 2011/12 per passenger on the main six corridors between Great Britain and the Republic of Ireland on which both Aer Lingus and Ryanair are active.[1] The revenue data provided includes Total gross revenues,[2] Total administration and excess baggage fees[3] and Total other revenues.[4] Government taxes are excluded;

   (b) different categories of average per passenger variable costs. In particular, we show airport charges,[5] fuel costs,[6] staff costs[7] and maintenance costs;[8]

[1] These are London–Dublin, London–Cork, London–Shannon, London–Knock, NW England–Dublin and Birmingham/East Midlands–Dublin.
[2] Total gross revenue includes all revenues generated from the sale of the ticket including published airport charges, check-in fee, insurance levy, ETS levy, and EU 261 levy, other miscellaneous revenue including missed flight fee, and change fees. It excludes government taxes as Ryanair acts a tax collector and this is a flow through.
[3] This was calculated by reference to the total administration and excess baggage fees generated during the particular month and dividing by the total number of passengers booked during the month. The resulting number is multiplied by the number of passengers who travelled on each route.
[4] Total other revenue is mainly comprised of revenue from the following services: On-board Sales, Bus & Rail Tickets, Payment Admin Fees, Hotel Commissions, Car Hire Commissions, Travel Insurance Commissions and Priority Boarding/Reserved.
[5] Ryanair described airport charges as including passenger charges, landing charges, parking charges, security costs, PRM costs, and airbridge costs. It excludes aircraft handling costs and local air traffic control costs.
[6] Ryanair told us that fuel costs were calculated by taking the total fuel costs incurred during the month and dividing by the total flight hours for the month. This generates a fuel cost per flight hour which is then multiplied by the total flight hours on each route by month.
[7] Ryanair told us that staff costs were calculated by taking the total staff costs incurred during the month and dividing by the total flight hours for the month. This generates a staff cost per flight hour which is then multiplied by the total flight hours on each route by month.

(c) the implied variable margins, with respect to the different cost items. We define two variable margins:

(i) Margin 1 = revenues minus airport charges.

(ii) Margin 2 = revenues minus (airport charges + fuel costs + staff costs + maintenance costs).

FIGURE 1

Ryanair's margins on the six overlap corridors, financial year 2011/12

[✂]

5. Figure 2 shows for Aer Lingus:

(a) average revenues for the financial year 2011/12 per passenger on the main six corridors between Great Britain and the Republic of Ireland on which both Aer Lingus and Ryanair are active.[9] The revenue data is total revenues minus cargo and mail revenues. Government taxes are excluded;

(b) different categories of average per passenger variable costs. In particular, we show airport charges, fuel costs, staff costs and maintenance costs;

(c) the implied variable margins, with the respect to the different cost items. We define two variable margins:

(i) Margin 1 = revenues minus airport charges.

(ii) Margin 2 = revenues minus (airport charges + fuel costs + staff costs + maintenance costs).

FIGURE 2

Aer Lingus' margin on the six overlap corridors, financial year 2011/12

[✂]

6. We estimate a variable margin of [✂] per cent for Ryanair when only airport charges—the main costs associated with carrying an additional passenger—are considered ([✂]). We estimate a variable margin of [✂] per cent for Aer Lingus under this definition ([✂]).[10] Margin 1 can be thought of as the margin associated with carrying an extra passenger, with no change in capacity.

7. We estimate a variable margin of [✂] per cent for Ryanair when other variable costs associated with the operation of an aircraft (specially, fuel, staff and maintenance

- - - - - - - - -

[8] Ryanair told us that maintenance costs were calculated by taking the total maintenance costs during the month and dividing by the flight hours for each route for the month. This generates a maintenance cost per flight hour which is then multiplied by the total number of flight hours flown on each route by month.

[9] These are London–Dublin, London–Cork, London–Shannon, London–Knock, NW England–Dublin and Birmingham/East Midlands–Dublin.

[10] Aer Lingus told us that some of the airport charges included in the estimate would be levied on flights rather than passengers, and so would not relate to changes in passenger numbers. It estimated that around [✂] per cent of its airport charges on overlap routes in 2012 were charged on the basis of passenger numbers. It also said that, in addition to airport charges, certain other direct operating costs—principally food, passenger insurance, passenger commissions, CRS fees and passenger security charges—would also be incurred if an additional passenger was carried. It estimated that these costs were equivalent to around [✂] per cent of the total airport charges. On this basis it said that, even including these other direct operating costs, the CC's margin estimates likely understated the true margins earned on an additional passenger on these routes.

costs) are included in the formulation (in absolute terms, Ryanair's margin is €[✂] under this definition). We estimate a variable margin of [✂] per cent for Aer Lingus under this definition ([✂]). Margin 2 will be more relevant if the competitive action being considered involved frequency and/or capacity changes.

8. [✂]

Analyses of pricing pressure submitted by the parties

9. Both Ryanair and Aer Lingus submitted estimates of the pricing pressure associated with the transaction, derived by combining estimates of the closeness of competition between the airlines with estimates of their margins, and assuming that Ryanair shares in Aer Lingus's profits in proportion to the size of its shareholding.

10. Specifically, Ryanair calculated the 'Indicative Price Rise' (IPR) that Ryanair might be incentivized to implement as a result of the acquisition by combining information on prices and estimates of the margins and diversion ratios of the two airlines with assumptions about the conditions of supply and demand in the market.

11. It calculated the IPR associated with the transaction as:

$$IPR = \frac{2 \times 29.8\% \ \times m_a \ \times d}{4 - d^2} \times \frac{p_a}{p_r}$$

Where m_a is Aer Lingus's variable margin, d is the diversion ratio, and p_a and p_r the pre-transaction prices of Aer Lingus and Ryanair.[11]

12. Ryanair derived estimates of Aer Lingus's variable margins of between 20 to 30 per cent from a presentation given by Aer Lingus to investors in 2010. On the basis of a price-sampling exercise, it estimated Aer Lingus's prices to be around [✂] per cent higher than Ryanair's fares. It inferred from the survey carried out by the European Commission in its investigation of Ryanair's original bid for Aer Lingus that the relevant diversion ratio between the airlines would lie between 18 to 54 per cent.

13. On the basis of these parameters, it concluded that even using conservative estimates of margins and the difference between the prices of Aer Lingus and Ryanair, the implied critical diversion ratio that would be required to yield an estimate of the price increase above 5 per cent—a threshold used by the OFT in previous phase one merger investigations—would not be met. Specifically, using a price ratio of [✂], a margin of [✂] and a diversion ratio of [✂] per cent (the highest plausible values of these parameters identified by Ryanair), it estimated an IPR of [✂] per cent.

14. Aer Lingus submitted an analysis based on the 'Gross Upward Price Pressure Index' (GUPPI) framework in order to generate an idea of what the incentives could be for Ryanair to increase its prices as a result of the transaction. As with Ryanair's analysis, estimates of the parties' margins and diversion ratios were combined in order to derive an estimate of the upwards pressure on prices that is generated by Ryanair's minority stake in Aer Lingus. Unlike with the IPR analysis, however, no assumptions are made about the conditions of demand in the market, and as a result no estimate of the ultimate impact on prices is generated.

[11] This formulation assumes a linear demand curve (ie the elasticity of demand increases with price), Bertrand competition (ie that Ryanair and Aer Lingus compete on prices rather than capacity) and that the diversion ratio from Ryanair to Aer Lingus and from Aer Lingus to Ryanair is equal.

15. Specifically, Aer Lingus estimates the GUPPI associated with the transaction as:

$$GUPPI = 29.8\% \times m_a d \frac{p_a}{p_r}$$

Where m_a is Aer Lingus's variable margin, d is the diversion ratio, and p_a and p_r the pre-transaction prices of Aer Lingus and Ryanair.

16. Aer Lingus argued that, for routes on which they were the only competitors providing direct flights, close to 100 per cent of passengers switching away from Ryanair would switch to Aer Lingus and vice versa, and so the diversion ratio between the airlines would be high, and in excess of 60 per cent.

17. Aer Lingus concluded that given this, and assuming that gross profit margins were above 30 per cent and that the ratio between the fares of Aer Lingus and Ryanair was above 1, Ryanair's shareholding would be associated with a GUPPI of well above 5 per cent, and that the effect would be in excess of 10 per cent for realistic combinations of margins and diversion ratios. It said that competition authorities would generally consider a GUPPI of more than 10 per cent to be problematic, and a value between 5 and 10 per cent to be worth investigating further.

18. Although we did not draw any firm conclusions from the parties' analyses, we considered that the work highlighted that—given the closeness of competition between the airlines and the scale of their variable margins, and assuming that Ryanair attached importance to Aer Lingus's profitability in proportion to the size of its shareholding—the incentive for Ryanair to increase prices associated with the transaction while small, could be significant.

Entry and expansion

Introduction

1. This appendix sets out the background material to our assessment of possible entry and expansion by an airline wishing to enter new routes or expand capacity on existing routes.

2. The primary area of overlap between the UK operations of Ryanair and Aer Lingus/ Aer Arann is on routes between Great Britain and the Republic of Ireland (see Appendix D). We focus therefore on the likelihood of entry and expansion on these routes.

3. We discuss the following:

   (a) history of entry, expansion and exit;

   (b) views expressed by airlines and airports regarding likely future entry and expansion; and

   (c) issues which would affect the likelihood, timeliness and scale of entry and expansion.

History of entry, expansion and exit since 2006

Third party entry and exit

4. We reviewed the instances of entry and exit by parties other than Aer Lingus, Aer Arann and Ryanair on the current overlap routes and routes across the Irish Sea more generally.[1] Our analysis covers the period from winter 2005/06 forwards and is based on data provided by the CAA. We found no examples of sustained entry on a current overlap route between Great Britain and the Republic of Ireland (although British Airways took over the Heathrow–Dublin route following its purchase of bmi). There was evidence of sustained entry by easyJet on to current overlap routes into Northern Ireland, as well as some evidence of entry on to non-overlap routes. However on both the current overlap and non-overlap routes the evidence showed many cases of exit by parties other than Aer Lingus, Aer Arann and Ryanair, rather than successful entry. Firms which have exited routes across the Irish Sea included Air Berlin, Air Southwest, Air Wales, bmi (including bmi Regional and bmibaby), British Airways (including BA Connect and BA CityFlyer), British Northwest Airlines, CityJet, Eastern Airways, easyJet, Flybe, Flyglobespan, Jet2.com, Loganair, Luxair, White Eagle Aviation, XL Airways and Zoom Airlines.

5. In addition to entry and exit we also investigated capacity increases and decreases. We found that British Airways was the only firm which had increased capacity by a substantial amount. British Airways said that following its purchase of bmi it had expanded its capacity on the Dublin–Heathrow route from five to eight flights a day.[2]

[1] We considered all routes from mainland Great Britain to Ireland.
[2] Note that this expansion occurred after the OFT referral decision, in which it found that there had been no material expansion.

6. The evidence above is consistent with the views of Aer Lingus, which stated: 'Since the 2007 prohibition decision, there has been no entry of note on short-haul routes out of Ireland. Indeed, the opposite is the case and the level of concentration in the market has increased.'

Entry and exit by Aer Lingus, Aer Arann and Ryanair

7. There have been three examples of Aer Lingus entering a route in competition with Ryanair and remaining on that route. Aer Lingus entered Dublin–Gatwick in October 2007 and has continued to operate this route. Aer Lingus entered Knock–Gatwick in April 2009 and has continued to operate on this route. Aer Lingus entered Cork–Manchester in March 2007 and was replaced by its franchisee Aer Arann in October 2010.[3] There have been four examples of Aer Lingus entering and exiting overlap routes: Dublin–Bristol from April 2004 to March 2007; Dublin–Liverpool from November 2004 to June 2006; Cork–Gatwick from April 2010 to October 2012 and Shannon–Gatwick from April 2011 to September 2011.

8. Aer Arann said that it had commenced operations on Dublin–Cardiff, Dublin–Blackpool, Dublin–Doncaster and Shannon–Manchester after Ryanair had vacated the routes. Aer Arann had commenced operations on the Birmingham–Knock route after bmibaby vacated the route. Aer Arann had commenced operations on the Cork–Manchester route as a migration from Aer Lingus to Aer Lingus Regional. Aer Arann said that it did not compete directly on the airport pairings of Dublin–Southend and Dublin–Glasgow International. Aer Arann said that it had previously only operated from Dublin–Birmingham on a short-term, temporary contract basis to support Aer Lingus services.

9. There have been seven occasions when Ryanair entered an overlap route and remained on that route. These are Dublin–East Midlands, Cork–Gatwick Cork–Liverpool, Knock–East Midlands, Knock–Luton, Shannon–Gatwick and Shannon–Liverpool. There have been five examples of Ryanair entering an overlap route and then exiting that route. These were Dublin–Blackpool, Knock–Gatwick, Shannon–Leeds/Bradford, Shannon–Luton and Shannon–Manchester.

10. Aer Lingus said that there had been further entry and exit by Aer Lingus, Aer Arann and Ryanair on routes between Great Britain and Ireland which were not currently overlap routes:

(a) Aer Lingus entered Belfast–Heathrow in January 2008, competing with Ryanair's Belfast–Stansted route (Ryanair exited in October 2010).

(b) Aer Lingus entered Dublin–Newcastle in March 2006 and exited in April 2009 competing with Ryanair's Dublin–Newcastle route.

(c) Aer Arann entered Dublin–Aberdeen (operating as Aer Lingus Regional under the franchise agreement) in March 2011, competing with Ryanair's Dublin–Aberdeen service. Ryanair exited in October 2011.

(d) Aer Arann entered Shannon–Glasgow and Shannon–Edinburgh (operating as Aer Lingus Regional under the franchise agreement) following Ryanair's departure from these routes (Ryanair ceased serving Shannon–Glasgow in March 2010 and Aer Arann entered in July 2010; and Ryanair ceased serving Shannon-Edinburgh in October 2010 and Aer Arann entered in March 2011).

[3] There was a break in the service from June 2007 to October 2007.

(e) Ryanair entered Dublin–Doncaster in April 2005 and exited in July 2009. Aer Arann subsequently served this route in summer 2010 (operating as Aer Lingus Regional under the franchise agreement).

(f) Ryanair entered Cork–East Midlands in December 2007 and exited in October 2008, competing with Aer Lingus's Cork–Birmingham service.

Respondents' views on entry and expansion

Airlines

11. Aer Arann said that it was entering two new routes between the Republic of Ireland and Great Britain—Dublin–Birmingham and Dublin–Manchester. Aer Lingus said that entry into routes between the Republic of Ireland and Great Britain by airlines other than Ryanair was highly unlikely. [✂]

12. Ryanair identified easyJet, Flybe, Jet2, Air Berlin, Air France-KLM, IAG, Lufthansa and Virgin as potential entrants.

13. CityJet said that it could open new routes, like Dublin–[✂], Dublin–[✂] and Dublin–[✂], but exact plans were not available at this time.

14. easyJet said that it had carried out very high level assessments of routes from Dublin to London, Dublin to important continental European cities and other major Irish destinations. It said that [✂].

15. Flybe said that it intended to operate Manchester–Waterford and Glasgow–Shannon in summer 2013. We note that neither of these is an overlap route. Flybe said that it was not planning to open a base in Dublin because the market was well-served. However, in its submission to the European Commission, Flybe said that if prices rose by 5 to 10 per cent following the transaction (ie the full merger of Aer Lingus and Ryanair) Flybe would reconsider its decision not to establish a base and would consider expanding capacity on Birmingham–Dublin, Edinburgh–Dublin, Exeter–Dublin, Glasgow–Dublin and Manchester–Dublin.

16. IAG said that [✂]. IAG said that it had limited resources and would have to be convinced that these Irish routes offered a better financial return than existing operations. IAG said that it should be considered a potential entrant should market conditions warrant it. IAG said that [✂].

17. Jet2 said that it had not looked at entering to compete with Ryanair or Aer Lingus and said that it had no plans to add new services between Great Britain and the Republic of Ireland. Lufthansa said that [✂]. TUI said that it had not considered entering on routes between Great Britain and the island of Ireland and had no plans to enter in the next two years. Thomas Cook Airlines said that its operating decisions were driven primarily by the tour operators and had no plans to enter routes between Great Britain and Ireland in the next two years.

Airports

18. The airports had mixed views on the likelihood of entry and expansion. DAA said that it was unlikely that there would be substantial and sustained entry by airlines other than Aer Lingus or Ryanair on UK to the Republic of Ireland routes. Other airports, including Belfast International, thought a couple of new routes could open. Others, including Glasgow Airport were concerned about the loss of existing services.

Issues affecting the likelihood, timeliness and scale of entry and expansion

19. In this section we consider the main issues which could affect the ability of competitors to enter or expand their capacity on overlap routes. We discuss four topics:

(a) First, we identify the assets that would be required to enter and/or expand on a route and consider the extent to which the need to obtain these assets is likely to deter entry. As part of this we consider the importance of bases and whether a potential entrant would need to establish a base at an Irish airport to be an effective competitor to Aer Lingus and Ryanair.

(b) Second, we consider whether the threat, fear or expectation of an aggressive response by Aer Lingus and/or Ryanair could affect entry.

(c) Third, we consider the impact of the current and expected economic climate in the UK and the Republic of Ireland on entry and the attractiveness of the Irish market.

(d) Fourth, we consider whether taxes on flying and airport fees could affect entry.

Assets required to enter/expand

20. The material provided by respondents did not suggest that obtaining aircraft, pilots and aircrew was likely to represent a particularly significant barrier to entry. Aircraft can be purchased and staff can be hired and aircraft and crew are also available through leasing deals.[4] This is consistent with the views expressed by the European Commission in its recent decision on the Ryanair/Aer Lingus case.

21. We therefore focus on three other areas and discuss these below:

(a) airport facilities, including check-in, baggage handling, security controls, stands for parking aircraft and slots for take-off and landing;

(b) the importance of a well-known brand; and

(c) the importance of bases and network effects.

Airport facilities

22. In this section we consider whether the need to obtain access to airport facilities is likely to represent a barrier to entry or expansion. If there are capacity constraints and an airline cannot access each of the facilities described below then the airline may be unable to expand or enter new routes:[5]

(a) *Check-in facilities.* These are needed to issue boarding passes and check-in luggage, unless an airline applies a mandatory web check-in policy, in which case passengers who do not check-in baggage do not use check-in facilities.

[4] See, for example, Virgin Atlantic's wet lease agreement with Aer Lingus. http://corporate.aerlingus.com/investorrelations/regulatorynews/2012pressreleases/RNS_re_wet_lease_Final_Draft_071212.pdf.

[5] Additional facilities may be required for particular flights. For example, in poor weather airlines may require de-icing facilities.

(b) *Immigration and security controls.* Passengers must pass through security controls and immigration checks.

(c) *Baggage handling.* The departing passengers' checked-in luggage needs to be transported through the airport and loaded on to the plane. The reverse is true for arriving passengers.

(d) *Stands.* This is the name given to the space where the aircraft is stationed during the loading and unloading of passengers. There are two types of stands: contact stands and remote stands. Contact stands allow passengers to move directly between the gate and the aircraft on foot. This will sometimes be through an air-bridge which extends from the terminal to the aircraft door, but can also involve walking a short distance from the terminal to the aircraft across the apron.[6] Remote stands require passengers to be bussed between the terminal and the aircraft.

(e) *Slots.* These are required for take-off and landing and represent a particular time window when the airline is allowed to use the runway.

23. We first summarize the views of the European Commission on access to airport facilities. We then discuss capacity constraints at the relevant Irish and British airports. We discuss Dublin Airport first because many of the overlap routes involve Dublin Airport and Ryanair and Aer Lingus have important bases at Dublin. We then discuss those other airports where respondents have said that there are capacity issues: Gatwick, Heathrow, London City, Luton, Manchester and Stansted airports.

Views of the European Commission

24. The European Commission found that in the early morning peak hour Dublin Airport operated close to its maximum capacity. In addition, it found that runway capacity could not be increased through better management, that the second runway should not be taken into consideration when assessing capacity and that an additional runway was unlikely to be built before 2019. In relation to parking stands, the European Commission found that airlines may face difficulties accessing contact stands for early morning peak hour flights. The European Commission found that terminal constraints, such as check-in facilities and immigration and security controls, were not a barrier to entry at Dublin.

25. The European Commission found that capacity constraints were not an issue at Cork and Shannon. At Knock the European Commission found that there was a constraint because the airport only had three aircraft stands, but there were plans to build new stands.

26. The European Commission analysis of UK airports did not go into as much depth as its Dublin analysis, but it noted there were capacity constraints at London City, London Gatwick and London Heathrow, based on its conclusions in the IAG/bmi case.

[6] Airbridges are also called jet bridges, jetways or jetway bridges.

Dublin Airport

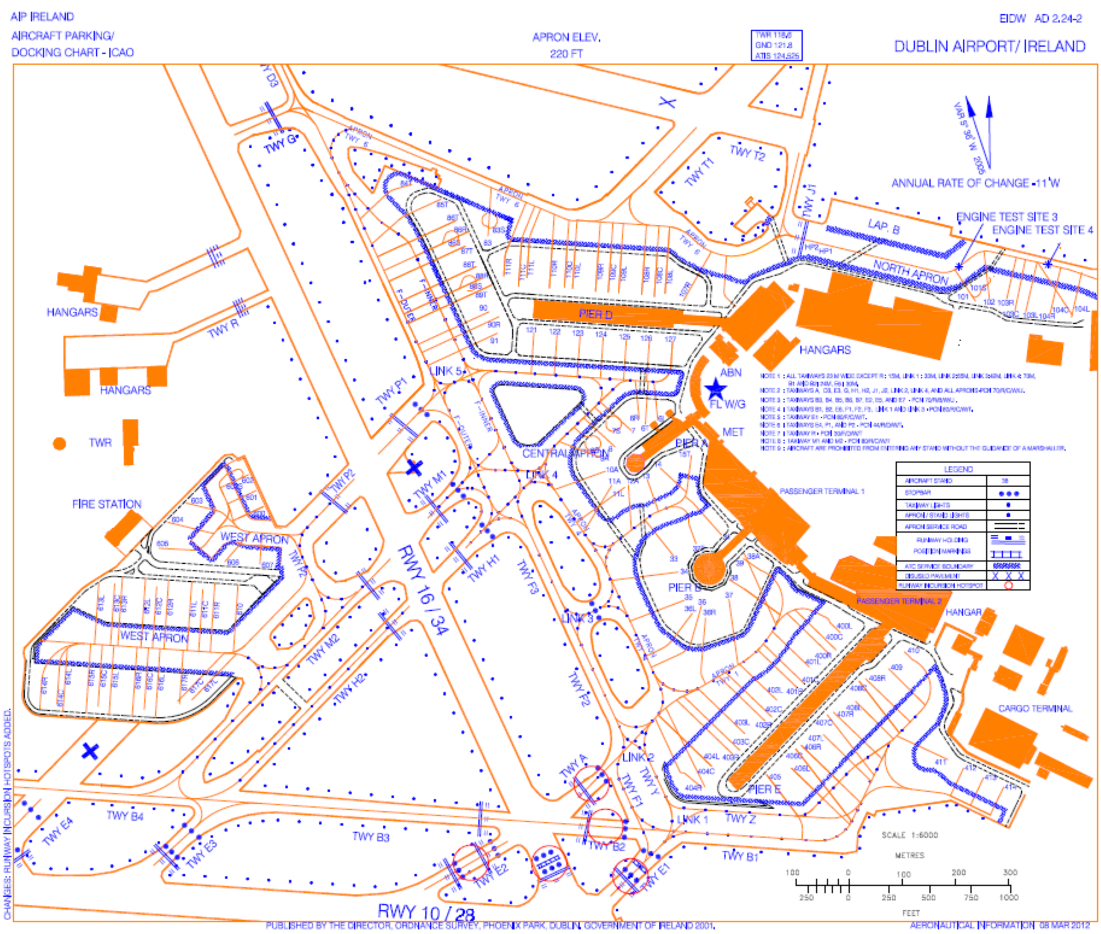
- *Background*

27. Dublin Airport is located to the north of Dublin and is the only airport used by commercial aircraft flying to Dublin.[7] The airport is operated by DAA and is owned by the Irish state. The airport has two runways. Runway 10/28 is to the south-west of the airport and is the main runway. Runway 16/34 is to the west of the airport and this secondary runway is only used when weather conditions allow and/or when maintenance work is being carried out on the main runway. The airport has two terminals. Terminal 1 was opened in 1972 and has three piers: Pier A, Pier B and Pier D.[8] Terminal 2 was opened in 2010 and has one pier, Pier E.[9]

28. Figure 1 below shows a map of Dublin Airport.

FIGURE 1

Map of Dublin Airport



Source: DAA.

[7] Weston Executive Airport is located to the west of Dublin, but this airport only handles executive jets and helicopters and is not used by commercial airlines.
[8] A pier is an extension to the terminal which juts out on to the apron and has multiple gates for passengers and stands for aircraft.
[9] Pier C was attached to Terminal 1, but was demolished to make way for Terminal 2. Pier B is also available for use by Terminal 2 traffic, particularly for the early morning and late evening peak departure/arrival activity.

29. Aer Lingus said that Aer Lingus passengers checked in at Terminal 2 and the majority of its flights departed from Pier E. However, a number of Aer Lingus short-haul flights departed from Pier B. Aer Lingus Regional passengers travelling on flights operated by Aer Arann currently checked in at Terminal 1 with most of the flights departing from Pier A. However, it was intended that from May 2013 Aer Lingus Regional passengers would check-in at Terminal 2 with flights departing from Pier E and from other piers linked to Terminal 1.

30. For the summer 2012 season Terminal 2 was also used for long-haul flights by American Airlines, Delta, Emirates, Etihad Airways, United and US Airways.[10]

31. All Ryanair flights use Terminal 1. In the summer 2012 season Terminal 1 was also used by other airlines, including Aer Arann, Air France, Blue Air, British Airways, CityJet, Flybe, Iberia, Lufthansa, Norwegian, SAS, SATA airlines, Swiss and Turkish Airlines.[11]

- *Check-in facilities, immigration and security controls and baggage handling*

32. DAA said that there were no significant terminal constraints (check-in facilities, immigration, security controls and baggage handling) at Dublin Airport which would prevent an airline from launching additional services between Dublin and Great Britain. Aer Lingus said that there were no terminal constraints at Dublin Airport.

- *Stands*

  - *Pier A*

33. DAA said that stand capacity could be a constraint on expansion or entry at Dublin Airport. DAA provided evidence on a daily profile of stand usage for Pier A at Terminal 1 for Friday 24 May 2013 (see Figure 1 in Annex 1). This diagram shows the higher demand overnight, while the aircraft are parked on the stands and a peak around 05:00 UTC[12] (06:00 local time). Demand then falls off as aircraft depart in the morning. This suggests that there is at least one stand available at Pier A throughout the day.

34. DAA said that that Pier A was unsuitable for many airlines for four reasons:

(a) Pier A was non-segregated so departing passengers were not separated from arriving passengers. As a result, non-EU flights and flights from certain EU destinations (eg Amsterdam) were not permitted by the regulatory authorities to operate from Pier A.[13]

(b) There were limits on the size of aircraft that could be operated from Pier A. DAA said that of the 11 narrow stands on the pier, three stands could only accommodate up to commuter size aircraft,[14] nine could accommodate aircraft like the A320 and seven could accommodate B737-800 aircraft. In particular, we understand that the free stand in Figure 2 in Annex 1 is stand 15T and this stand

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[10] www.dublinairport.com/gns/at-the-airport/terminal2.aspx.
[11] www.dublinairport.com/gns/at-the-airport/terminal1.aspx.
[12] UTC stands for Co-ordinated Universal Time and is the time used by airlines and airports to avoid confusion resulting from different time zones. UTC corresponds with Greenwich Mean Time so that in Ireland UTC is one hour in advance of local time in the summer and 05:00–06:00 UTC will be 06:00–07:00 local time. In the winter, UTC is the same as local time.
[13] However, we understand from Flybe that this is not a problem for flights between the UK and the Republic of Ireland.
[14] The commuter-size aircraft operated by Aer Arann and Flybe are smaller than the A320 and B737 aircraft. Aer Arann operates ATR42 and ATR72 aircraft. Flybe operates Q400 turboprop aircraft and Embraer E195 aircraft.

would be too small for an A320 or B737-800—the aircraft typically operated by low-cost carriers.

(c) Pier A was not airbridge-served, so airlines including British Airways, Swiss Air, Lufthansa and bmi had refused to operate from this pier or expressed a strong preference not to do so.

(d) Pier A was the oldest pier in Dublin Airport. The product offering (aesthetics, comfort, facilities) was adjudged by some airlines to be inferior to other piers.

35. Since the availability of Pier A increases after 05:00 UTC (06:00 local time) we considered whether it would be possible to park an aircraft overnight somewhere else in the airport and tow it to Pier A (or any other pier) and then depart with passengers.

36. DAA said that this would be possible, but this would lead to a later departure time for the outbound aircraft. This later departure would mean the aircraft would fly fewer sectors during the day, reducing aircraft utilization. DAA also said that a later departure time would also reduce the attractiveness of the service to business passengers, who were typically the highest yielding customers. This was supported by Aer Arann, Aer Lingus and Flybe.

- *Pier B*

37. DAA provided evidence on stand occupancy for Pier B. Figure 2 in Annex 1 shows the stands are fully occupied until 06:00 UTC (07:00 local time), with capacity appearing after this time as the aircraft depart.

- *Pier D*

38. DAA provided evidence on stand occupancy for Pier D. Figure 3 in Annex 1 shows that there is one stand available throughout the day on Friday 24 May 2013. However, DAA said that this stand was kept clear during the day for emergencies when possible after the morning peak.

- *Pier E*

39. DAA provided evidence on stand occupancy for Pier E. Figure 4 in Annex 1 shows that the stands are fully occupied from around 04:00–05:00 UTC (05:00–06:00 local time) and for three other short periods during the day on Friday 24 May 2013. At other times some capacity is available.

- *Remote stands*

40. DAA said that there was capacity available on the remote stands at the West, Central and South Aprons at Dublin Airport. However, DAA stated that the West Apron stands were not approved by the Department of Transport or the Irish Aviation Authority for passenger operations and could only be used for long-term remote parking and positioning aircraft. DAA said that there was space at the Central and South Aprons, however, if aircraft were placed on the remote stands then passengers would need to be bussed to the aircraft. DAA said that bussing capacity was limited at Dublin Airport and the gates allocated to buses had only the capacity to serve one aircraft like an A320 or a B737-800 per hour, assuming that the other gates were being used for commuter type aircraft.

41. DAA said that there were no plans to expand stand capacity in the short-term. DAA also said that all capital expenditure had to be approved through the regulatory system, which was heavily influenced by Aer Lingus and Ryanair through consultation processes. DAA said that both airlines had demonstrated themselves to be averse to capital expenditure on the part of DAA.

- *Views of other parties*

42. Aer Arann said that contact stands were constrained during the morning peak. Aer Arann said that because it had smaller aircraft it preferred to use remote stands and its customers were being bussed from the terminal. Bussing gates at Dublin, however, were limited. Aer Arann said that there were no plans to extend stand space at Dublin Airport. Aer Lingus said that there were issues with contact stands during the early morning peak.

43. Ryanair said that 49 of the 57 pier served stands (86 per cent) were available during the morning peak of 05:30–07:30 UTC (06:30–08:30 local time) and that 11 of 12 remote stands (92 per cent) were available during the 05:30–07:30 UTC (06:30–08:30 local time). Ryanair also recalculated the results for a 35-minute turnaround and the results were similar, with 47 of 57 and 11 of 12 available. However, we understand that Ryanair’s method of calculating capacity would involve towing aircraft on to stands after the initial aircraft have departed (see paragraphs 35 to 36).

44. CityJet said that stand capacity was a huge issue in 2007, but this was no longer relevant. Contact stands were available, but only at Pier A. Flybe said that it had a small presence at Dublin so had not investigated the scope for adding additional flights. Flybe said that it had had problems in the past trying to obtain a 07:00 UTC (08:00 local time) departure, but had fewer problems with a 17:00 UTC (18:00 local time) departure. Lufthansa said that there were no barriers to entry at Dublin Airport. However, it did say that during peak times stand availability was lower and that it would not use remote stands because bussing was difficult at Dublin. IAG said that the availability of contact stands at Terminal 1 was limited between 05:00–08:00 UTC (06:00–09:00 local time) and in Terminal 2 there were stand capacity issues between 05:00–11:00 UTC (06:00–12:00 local time).

- *Slots*

45. We next consider whether access to slots is likely to be a barrier to entry at Dublin Airport.

- *Current runway capacity*

46. DAA said that there was unsatisfied demand for runway space during the peak morning hours of 05:00–06:55 UTC (06:00–07:55 local time) and that this meant that airlines could not secure the key slots necessary to operate effectively their programme at Dublin Airport. DAA said that at other times of the day slots were available.

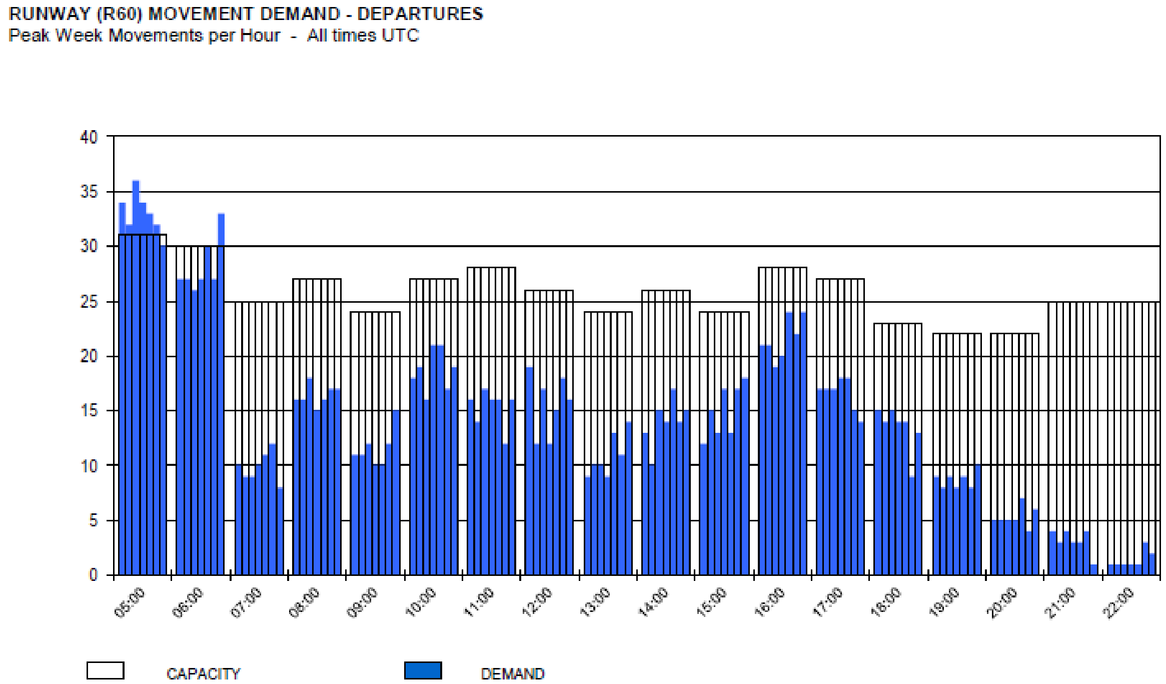
47. Aer Lingus said that there was runway congestion during morning peak hours (ie 05:00–07:00 UTC (06:00–08:00 local time) particularly during 05:30–06:30 UTC (06:30–07:30 local time)). Aer Lingus also told us that operating before 05:30 UTC (06:30 local time) would be less attractive to passengers and would lead to an airline incurring additional crew costs. This was because cockpit crew restrictions implied that any flight commencing before 05:30 UTC (06:30 local time) could not be coupled with another flight (typically an airline would strive toward four medium sectors or six

short sectors per day to maximize crew efficiency); and any time operated before 05:45 UTC (06:45 local time) was subtracted from the maximum crew duty time of 14 hours, limiting the routes that could be served at certain times and route range. However, we noted that 05:30 UTC (06:30 local time) was still within the peak hours of 05:00–07:00 UTC (06:00–08:00 local time) and therefore we understood that operating before 05:30 UTC (06:30 local time) was less attractive relative to operating after 05:30 UTC (06:30 local time).

48. We reviewed the Dublin 2012 report produced by Airport Co-ordination Limited (ACL),[15] the body responsible for allocating slots at Dublin Airport. Figure 2 below, taken from their report, shows that there was excess demand for departure slots from 05:00–06:00 UTC (06:00–07:00 local time).[16]

FIGURE 2

Slot demand at Dublin Airport



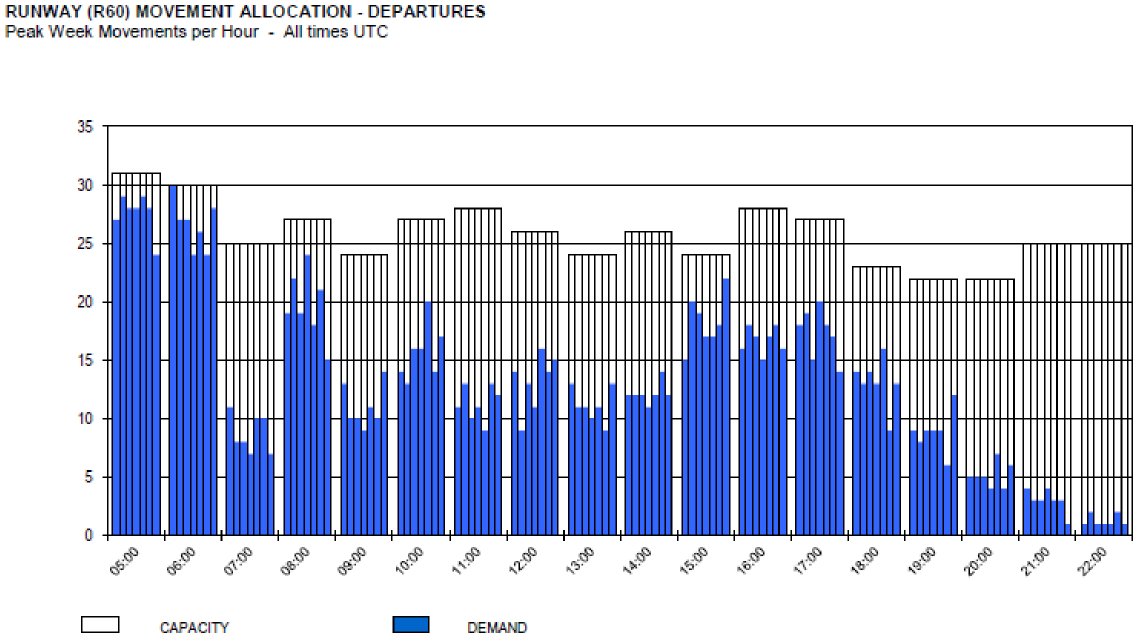
Source: ACL.

49. Figure 3 below is from the same report and shows the departure slots that were ultimately allocated to airlines. This shows that not all the slots were taken.

[15] Airport Co-ordination Limited is responsible for slot allocation, schedules facilitation and schedule data collection at a large number of varied airports, including Dublin Airport. They have also been engaged in setting capacity limits at Dublin airport.
[16] Available at www.acl-uk.org/UserFiles/File/DUBLIN%20SUMMER%202012%20START%20OF%20SEASON.pdf. The seven individual bars for each time period denote the availability on each day of the week. The first bar is Monday and the last bar is Sunday.

FIGURE 3

Slot allocation at Dublin Airport



Source: ACL.

50. On the issue of spare slots DAA said:

> When looking at the slot information provided, it is important to note that in some instances (particularly during the peak hours) even though the allocated slots are less than the listed slot capacity, some airlines' demands remain unsatisfied. This is due to the fact that airlines apply for excess slots ahead of the coming season and some airlines at times release them too late to be redistributed to fulfil the requirements of other carriers. Therefore airlines that may have originally bid for these newly released slots have already finalised their schedule based on their less preferred time slot. This explains how demand for slots in the peak times exceeds supply when it appears that there is slot capacity available.

51. ACL, which is responsible for slot allocation at Dublin Airport, said that no request for slots, even peak morning slots, had been rejected at Dublin Airport since the downturn in traffic from 2008. Initial demand may have been above capacity during some hours, but ACL had resolved this by offering the airlines slots which were slightly earlier or later than their requests. For example, if there was excess demand for 05:00–06:00 UTC (06:00–07:00 local time), some of the demand for slots later in that hour, eg 05:55 UTC (06:55 local time), could be moved into the beginning of the 06:00–07:00 UTC hour (07:00–08:00 local time).

52. Ryanair said that initial demand for slots offered no evidence of constraints. Ryanair said that the DAA/ACL's statements on runway congestion were misleading for the following reasons:

(a) DAA/ACL failed to mention that there were only a very limited number of summer 2012 slot requests that could not be accommodated. 98.9 per cent of summer

2012 slot requests were accommodated at the requested time and 99.9 per cent were accommodated within 15 minutes of the requested time.

(b) DAA's answers did not reflect the fact that airlines always overstated their slot requests. [✄] Therefore, looking at the first wave of slot requests was misleading.

53. We understand that the figure of 98.9 per cent given for the summer 2012 slot requests does not represent the number of initial slot request which were fulfilled. Instead the figure of 98.9 per cent is based on the position just prior to the start of the season after the majority of discussions with airlines have concluded. ACL said that at Heathrow (an airport widely considered to be capacity constrained) the figure was 95.6 per cent.

- *Changing runway utilization*

54. DAA said that the maximum number of departures in the 05:00–05:55 UTC period (06:00–06:55 local time) was 31. We considered whether the number of departures could be increased above the current limit of 31 for this period.

55. DAA said that departure capacity could not be increased in the short run during the 05:00–05:55 UTC period (06:00–06:55 local time) without creating undue congestion and unplanned delays. DAA said that in October NATS had assessed Dublin Airport's ability to accommodate one extra departure movement in the peak hour. The results showed that the extra movement could not be accommodated within the ten-minute delay criterion previously agreed by the Coordination Committee.

56. ACL said that the question of additional departures at Dublin had been looked at multiple times and every time the analysis had shown that increasing departures above 31 would result in a breach of the ten-minute average delay. ACL said that the ten-minute average delay was the standard applied at both Dublin and the UK level 3 coordinated airports.

57. We also compared Dublin's maximum departure limit of 31 with other single runway airports. The limits are 35 for Gatwick, 21 for Luton and 35 for Stansted.

58. DAA said that it was not always possible to make direct comparisons between airport runway capacities due to differences such as flight paths, airport infrastructure and air traffic control procedures. DAA said that at Gatwick aircraft could turn right or left after departure and this could be used to shorten the minimum times between departures. At Dublin Airport this option was not available because low altitude flying was restricted for noise abatement reasons. DAA said that currently at Dublin there was a 90-second gap between aircraft departures. In the longer-term, DAA were looking at reducing this time gap, this could add two or three extra departure slots in the 05:00–05:55 UTC period (06:00–06:55 local time).

59. ACL said that the number of departure routes following take-off did affect departure limits. ACL said that there were rules on the distances/times that must be left between aircraft to avoid vortex problems.[17] ACL explained that at an airport like Heathrow aeroplanes could head left, right, or straight after takeoff. This allowed the time between departures to be reduced as the aircraft would be in clearer air sooner.

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[17] When aircraft pass through air they create turbulence. This turbulence can be dangerous for following aircraft and rules, called wake vortex separation minima, are set down for safe distances/times between aircraft.

- *Adding extra runway capacity*

60. DAA said that both the Irish aviation authority and NATS had said that the second runway at Dublin Airport should not be taken into consideration when assessing capacity. This was because the second runway's availability was influenced by weather conditions and was only available for use approximately two-thirds of the time in summer and half of the time in winter.[18] DAA said that including this runway in the capacity calculations would lead to delays when the weather conditions did not allow its use.

61. Looking further into the future, DAA said that runway capacity was unlikely to increase; however, continuous efforts were being made to best utilize existing capacity. The Commission for Aviation Regulation in Ireland had set a trigger of 23.5 million passengers a year before DAA could begin to be remunerated for any capital expenditure on a second runway. The current forecasts suggested that such a trigger would not be met until around 2019.

62. Ryanair said that the next significant capacity addition at Dublin Airport would involve a second runway, but Ryanair understood this was prohibited until such time as traffic at Dublin Airport approached 30 million passengers a year.

- *Views of other parties*

63. The majority of respondents who expressed a view thought there were capacity constraints at Dublin in terms of slot availability:

    (a) Aer Arann said that from 05:20–06:30 UTC (06:20–07:30 local time) Dublin Airport was slot constrained and this was primarily due to a lack of runway capacity. Aer Arann said that for its new Dublin–Birmingham and Dublin–Manchester routes it was getting around this problem by not operating departures to these airports from Dublin during the 05:20–06:30 UTC period (06:20–07:30 local time) departure window, as Aer Lingus currently operated departures to these destinations during this window.

    (b) CityJet said that slots were a barrier to entry at Dublin, stating that there was only a limited availability of slots in the critical 05:00–07:00 UTC period (06:00–08:00 local time) and no slots available between 05:00–06:00 UTC (06:00 and 07:00 local time).

    (c) easyJet said that morning peak hour slots were critical to any short-haul operation as these allowed airlines to maximize aircraft utilization. While slots at peak times had become easier to acquire, they were still constraints on availability at peak times, so it would be harder for a new entrant to develop routes with slot times matched to passenger demand.

    (d) Cardiff International Airport said that there were slot constraints at peak times at Dublin. East Midlands and Manchester Airport said that the largest barrier to entry was slot constraints at Dublin in peak hours.

    (e) Flybe stated that prior to 2007 it was more difficult to obtain slots at Dublin Airport. Flybe said that it had a small presence at Dublin so had not investigated the scope for adding additional flights. Flybe said that it had problems in the past

[18] The precise figures are 62.7 per cent for summer 2012, 56.65 for winter 2011, 63.6 per cent for summer 2011 and 52.3 per cent for winter 2010.

trying to obtain a 07:00 UTC (08:00 local time) slot, but had fewer problems with a 17:00 UTC (18:00 local time) departure. Looking forward, Flybe believed that it would be possible to add additional frequencies at Dublin.

(f) Lufthansa said that there were no barriers to entry at Dublin.

(g) IAG stated that runway capacity was a constraining factor. There were slot constraints in the morning from 05:00–06:55 UTC (06:00–07:55 local time) during summer seasons and from 06:00–07:25 UTC (06:00–07:25 local time) in winter seasons. IAG also said that in high demand seasons, availability for arrival slots in the 21:00–22:00 UTC hour (22:00–23:00 local time) could be limited as aircraft based at Dublin returned after their final flight of the day.

Gatwick Airport

64. Gatwick Airport said that it had some runway capacity issues during the summer season, particularly during peak hours. This was supported by a number of third parties including Aer Lingus, Flybe, IAG, East Midlands Airport, Manchester Airport and Thomas Cook. ACL said that in addition to constraints relating to departures, it could also be difficult for airlines to find arrival slots at Gatwick.

65. Ryanair said that there was substantial off-peak capacity available at Gatwick and peak slots appeared regularly.

Heathrow Airport

66. Heathrow Airport said that slot availability and runway capacity were the main constraints on any expansion of services from Heathrow.

67. CityJet, Aer Lingus, easyJet, East Midlands Airport, Flybe, IAG, Manchester Airport, Stansted Airport and Thomas Cook said that there were capacity issues at Heathrow. Leeds Bradford Airport said it understood that at present Heathrow was a capacity-constrained London airport at certain times of the day where the availability of slots for new services was restricted. ACL said that any new entrant considering flying from the island of Ireland would not be able to obtain landing slots at Heathrow from the slot pool.

London City

68. Aer Lingus said that there was congestion during peak hours. Flybe and IAG said that there were capacity constraints in the morning and evening at London City Airport. ACL said that in addition to constraints relating to departures, it could also be difficult for airlines to find arrival slots at London City at peak times and there were also limited aircraft parking positions.

69. Ryanair said that there was substantial off-peak capacity available at London City.

Luton Airport

70. Luton Airport said there were terminal constraints in the morning peak.

71. Aer Lingus said that there was congestion during morning peak hours. Ryanair said that there were slots freely available. Ryanair said that there was substantial off-peak capacity available at Luton Airport.

Manchester Airport

72. Manchester Airport said that there were currently departure slot constraints between 05:00–07:00 UTC (06:00–08:00 local time) across all three terminals and arrival constraints from 10:30–12:00 UTC (11.30–13:00 local time).

73. Aer Lingus said that there was congestion during morning and evening peak hours. Flybe said that there were slot capacity issues at Manchester from 05:45–06:10 UTC (06.45–07.10 local time) for departures and 07:00–07:44 UTC (08:00–08:44 local time) for both departures and arrivals.

74. Ryanair said that there were slots freely available and in its OFT submission Ryanair said that there were competitors at Manchester which had slots at Manchester Airport that could be reallocated to UK–Republic of Ireland flights if the relative profitability of such services increased.

Stansted Airport

75. Stansted Airport said that there were no capacity constraints at any time of day, either in the summer or winter scheduling seasons.

76. Aer Lingus said that there was congestion during morning and evening peak hours. In its OFT submission, Ryanair said that there was substantial off-peak capacity available at Stansted and that peak slots appeared regularly.

77. ACL said that its capacity report for Stansted suggested there were slots available. However, the ACL report suggested there were terminal constraints for late evening international arrivals and early morning international departures.[19]

The importance of a well-known brand

Views of the European Commission

78. The European Commission concluded that brand recognition constituted a barrier to entry. It found that Aer Lingus and Ryanair had two of the strongest brands in Ireland and that it would take considerable time and investment for an entrant without a strong brand to upgrade its brand in Ireland. It found this entry barrier was equally relevant for routes from Dublin, Shannon, Cork and Knock. The European Commission's conclusions were based, inter alia, on the views of respondents and the fact that the many tickets were booked online and direct through the airlines' websites, increasing the importance of a well-known brand.

Importance of a well-known brand

79. Aer Lingus stated that Ryanair and Aer Lingus had well-established brands, particularly in the Irish and UK markets. This facilitated high levels of online sales and was a barrier to entry. Aer Lingus also highlighted the importance of the Aer Lingus brand to Aer Arann, which Aer Arann is allowed to use as part of their franchise agreement. This brand, along with other benefits from the franchise agreement, allowed Aer Arann to 'operate routes in competition with Ryanair which would otherwise not be possible'. Aer Arann told us that it had benefitted from operating under the Aer Lingus Regional brand and on those routes where it had rebranded

[19] www.acl-uk.org/UserFiles/File/STN%20S13%20START%20OF%20SEASON%20REPORT.pdf.

routes this alone had led to an uplift in volumes [✂]. Aer Arann said that under the old Aer Arann brand it would not have had the confidence to enter routes and compete with Ryanair.

80. CityJet said that brands played a significant role in the competitive process for short-haul routes to and from Ireland. CityJet said that Aer Lingus and Ryanair had strong brands, while CityJet's brand was mostly business focused.

81. DAA said that Aer Arann had re-emerged under the franchise agreement when it was rebranded as Aer Lingus Regional. This supported the view that Aer Lingus had a strong brand which was attractive to Irish customers. DAA said that prior to this Aer Arann was unable to compete with Ryanair under its own brand. DAA said that an effective competitor to Ryanair would need to have a strong brand and research showed that Ryanair and Aer Lingus were the most well-known transport brands in Ireland. DAA said that Aer Arann, which had been established for 25 years in Ireland, was still substantially behind Ryanair and Aer Lingus in brand recognition terms, as shown in Table 1.

TABLE 1 **Brand awareness for Irish airlines**

		per cent
Airline	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]

Source: [✂].

82. DAA said that this was particularly important in Ireland because the majority (79 per cent) of customers booked directly through airline websites. This evidence on bookings is consistent with Ryanair's 2012 Annual Report where it stated that Internet bookings accounted for over 99 per cent of all reservations. We found that both the Aer Lingus and the Ryanair site were in the top 100 Irish websites and no other airlines or travel aggregator websites like lastminute.com or Expedia were in the top 100.[20]

83. easyJet said that brands played a significant role in the competitive process for short-haul routes to and from Ireland. easyJet said that Aer Lingus, Ryanair and easyJet all had strong brands, although it noted that because easyJet did not operate in Ireland its brand was weaker there. easyJet thought that more than two years would be required to build up a strong brand in Ireland. Flybe said that brand recognition was a barrier to entry and that branding played a significant role in the competitive process for short-haul routes to and from Ireland. Lufthansa said that brand names were important in the competitive process. Lufthansa said that Aer Lingus and Ryanair had strong brands, whereas Lufthansa had weak brand in Ireland.

84. Knock Airport said that building a brand would be barrier to entry. Gatwick Airport said that marketing costs were a constraint on the ability of airlines to enter and expand. When asked to identify the barriers to entry or expansion for an airline seeking to operate services between Great Britain and the island of Ireland, Birmingham Airport said that for any for any existing airline building a brand presence and securing sufficient passenger volumes to become profitable would be the greatest challenge and that the lack of alternative carriers was evidence of how difficult this task could be.

[20] www.alexa.com/topsites/countries/IE. Tripadvisor.ie was in the top 100, but this is a review site rather than a booking site.

85. Ryanair said that marketing costs were not barriers to entry. It said that brand awareness was largely irrelevant in a market where consumers were price sensitive, and where they purchased tickets online.

Investment to establish a brand

86. Ryanair stated that little additional investment would be required by airlines entering routes to Ireland. Ryanair said that: *(a)* some of the potential entrants on UK–Dublin routes already operated routes into Ireland, including Flybe, Jet2 and Air France; *(b)* that a significant proportion of passengers on UK–Ireland routes originated from the UK (thus, if brand strength matters at all it matters both in the UK and Ireland); *(c)* since 2007 the use of comparison websites had increased; and *(d)* that marketing aimed at the UK also reached Irish consumers as some media was consumed in both countries. Ryanair said that when it opened a new base it spent approximately €[✂] in marketing.

87. Aer Arann said that being branded as Aer Lingus Regional had enabled Aer Arann to gain a wider reputation and stronger brand awareness that would otherwise have been prohibitively expensive to achieve particularly in the UK. CityJet said that one year would be needed to build a strong brand, but could not estimate the costs of this. DAA said marketing support was available to airlines to assist with promotional activities. easyJet said that it would expect to spend £[✂] on marketing if it entered on a new route between Great Britain and Ireland. Flybe thought that two years would be needed to create or upgrade to a strong brand on routes to and from Ireland. The amount spent would be approximately €200,000 a year per aircraft operated. IAG said that [✂]. Lufthansa said that it was not in a position to estimate the costs, but thought that it would take two years to build a strong brand.

Importance of bases and network effects

88. A more substantial form of entry is the establishment of a base at either the origin or destination airport (or both). Since both Ryanair and Aer Lingus operate bases from Dublin, Cork and Shannon we considered whether an airline would have to establish bases at these airports in order to be an effective competitor.

Views of the European Commission

89. The European Commission found that base operations provide significant advantages to Aer Lingus and Ryanair and this would constitute a barrier to entry at Dublin, Cork and Shannon airports. The European Commission also found that the costs of establishing a base were significant.

Airline bases

90. Ryanair defined a base as an airport at which Ryanair aircraft are permanently based and from which aircraft start their flying schedule in the morning, return periodically during the day, fly their last sector of each day into that airport, and remain there overnight. In addition, Ryanair flight crew, cabin crew, and engineers are based at that airport and will reside in the local area.

91. Table 2 shows the airlines which operate bases in the Republic of Ireland.

TABLE 2 **Base information for airlines based on Republic of Ireland**

Airline	*Base airport*	*Number of aircraft stationed overnight*
Aer Lingus*	Cork	4
Aer Lingus	Dublin	32†
Aer Lingus	Knock	0
Aer Lingus	Shannon	2
Ryanair	Cork	1
Ryanair	Dublin	15
Ryanair	Shannon	1
Aer Arann	Cork	2
Aer Arann	Dublin	10
Aer Arann	Shannon	1
CityJet	Dublin	3

Source: Aer Lingus, Ryanair, other parties.

*Aer Lingus figures do not include Aer Arann.
†Four of these 32 aircraft are long-haul aircraft which would not be used on flights between Great Britain and Ireland.

Views of parties on whether a base is required

92. Aer Lingus stated that bases were important as they gave airlines flexibility and made it easier for them to re-optimize their routes and enter new routes. Aer Lingus said that bases afforded airlines economies of scale and scope stemming from flexibility in redeploying assets at a base and the ability to spread fixed costs over many routes. Aer Lingus operated all of its flights from one of its bases (Dublin, Cork, Shannon, Belfast, and London Gatwick). Aer Lingus said the lack of airlines with a base in the Republic of Ireland constituted a strong barrier to entry from the Republic of Ireland end of any overlap route.

93. Aer Lingus also said that no airline could establish an efficient and viable base at Dublin Airport without a sufficient number of peak hour departure slots. Airlines attempted to start their operations as early as possible to maximize aircraft utilization and early-morning departures were key to attracting time-sensitive and business passengers.

94. Ryanair stated that Ryanair and Aer Lingus had no significant competitive advantage from having bases in Ireland. Ryanair presented data which it said showed that economies of scale were minimal as maintenance costs and crew costs per block hour did not change with the size of the base. Ryanair said that an airline with a large base would not get better prices for ground handling services. Ryanair said that aircraft utilization was not related to the number of aircraft stationed at a base.

95. We note, however, that there are some Ryanair statements which suggest that there are advantages to operating bases.

96. First, in its submissions to the European Commission Ryanair stated: ‘From a commercial perspective, an airline can negotiate a lower cost when traffic increases at each base as asset utilization increases and unit costs decline.’

97. Second, in the European Commission’s investigation into the Olympic/Aegean merger, Ryanair stated: ‘It is Ryanair’s policy to avoid routes that do not have a base

at either end of the route, given that such routes introduce complexity to operations and increase the risk of so-called knock-on delays to the system.'[21]

98. Third, Ryanair submitted a report to the CAA during its investigation into whether Stansted Airport has market power. The report states: 'There are significant costs to operating routes from airports where an aircraft is not based, with the result that Ryanair only operates such "W" routes in very exceptional circumstances (for example as part of a strategic decision to build up traffic at a potential new base). These routes account for less than 2% of Ryanair's total route network.'[22]

99. CityJet said that a base in Dublin, Cork and Shannon would not be required to constrain a merged Aer Lingus/Ryanair. Instead a competitor with a base at the non-Dublin end could compete with Aer Lingus and Ryanair on ex-Dublin routes.

100. easyJet said that to be an effective competitor an airline would need to open a base in Dublin. A base would be needed to serve the outbound market effectively and to spread the significant costs of establishing sufficient market presence across a large number of routes. easyJet said that one could operate from a base at the other end, but this would limit an airline's ability to capture the Dublin-based market.

101. Flybe stated that to compete with the parties on routes from Dublin one would need to nightstop the aircraft in Dublin so they would be ready for the early morning wave of departures. However, one would not necessarily need to base these aircraft at Dublin. Flybe stated an airline would need to base aircraft at Cork and Shannon if it wished to be an effective competitor for flights involving these airports. Flybe said that bases gave airlines more flexibility in dealing with fluctuations in demand and made it easier to open new routes. Flybe said that scale efficiencies increased with the size of the fleet, but there were diminishing returns after ten aircraft. If the aircraft were based at the airport then local crew would be needed and efficiency levels would improve as the number of aircraft reached five or six. Flybe estimated that the cost savings associated with a base of more than six aircraft would be £250–450,000 a year.

102. Flybe said that W flight patterns could work for flights to continental Europe from Irish airports; however, flights between Great Britain and Ireland would need to start or finish at Dublin.[23] The same was true for Cork, Knock and Shannon. Flybe said that it preferred not to fly W-pattern flights because these operations were less robust if there was a problem with the aircraft.

103. IAG said that it could successfully operate a route with or without a base at the airport and the need to establish a base at an airport would be derived from the type of schedule/customer that was targeted. For short-haul business schedules to Ireland an airline like British Airways would need to overnight the aircraft in Ireland. IAG said for leisure schedules overnighting would not be required as the customer was generally less sensitive as to the time of day the flights were scheduled and was more flexible in their travel plans. IAG said that it would aim to optimize its schedules for connecting passengers, who were very important on the Irish routes. IAG said that [✂].

[21] Commission Decision C(2011) 316 in Case No COMP/M.5830—Olympic/Aegean Airlines, paragraph 752. http://ec.europa.eu/competition/mergers/cases/decisions/m5830_20110126_20610_2509108_EN.pdf.
[22] Page 2, www.caa.co.uk/docs/5/rbb%20stansted%20final%20non-confidential%20version%2029%20Nov%2011.pdf.
[23] W flights are flights where the aircraft visits a different third airport after the second. An example would be Dublin–London–Rome–London–Dublin.

104. Lufthansa said that to compete effectively with a merged Aer Lingus and Ryanair on Dublin routes one would need to establish a base at Dublin. The same was true for Cork and Shannon.

105. DAA said that a competitor had to be based at Dublin if it was going to replicate the constraint Aer Lingus imposes on Ryanair and that any loss of competition would not be replaced by airlines operating routes to and from Dublin when their hub is elsewhere. DAA also highlighted the fact that Ryanair and Aer Lingus both operated bases at Dublin, Cork and Shannon. [✂]

Views of parties on costs of establishing a base

106. Ryanair said that the cost of establishing a new base was insignificant and that all that was required was some hangar space and a limited number of personnel. Generally, the only assets at Ryanair bases are aircraft, crew rooms, and minimal equipment (computers and spares). Based on Ryanair's experience, the sunk cost of establishing a base is less than €[✂], which is primarily comprised of new base marketing spend.

107. Flybe said that minimum investment required to establish a base would be £6 million a year, based on £3 million per aircraft a year and a minimum of two aircraft at the base.

Economic environment and Irish market

Views of the European Commission

108. The European Commission concluded the Irish market was unattractive and this acted as a barrier to entry. In addition to the poor economic climate, the European Commission noted that the small size of Ireland, the fact that it was not a pass-by destination and the lack of secondary airports all reduced its attractiveness.

Views of parties and other information reviewed

109. Aer Lingus thought that the economic environment made it less likely that there would be new entry on to routes between Ireland and Great Britain. CityJet said that the economic environment in Ireland had been extremely difficult. easyJet said that the worsened economic environment since 2007 had made entry less attractive. IAG said the general economic climate heavily affected airlines' strategies and that due to both weak demand and weak balance sheets the current climate was not conducive to route expansion by full-service carriers. If demand recovered, IAG said there would likely be a lag whilst carriers rebuilt their profitability and balance sheets before taking on the investment costs and risks of network expansion. Having said that British Airways through its acquisition of bmi had been able to expand its route network from London.

110. Ryanair said that additional new entry could be expected at any time when economic conditions improved. It said that in any event relatively weak economies had often served as springboards for low fare airlines to begin and grow operations as consumers became more price-sensitive, and gave the example of Ryanair's current plans for expansion in Greece and Ireland.

111. Flybe stated that there had been a 25 per cent reduction in traffic at Irish airports since the slowdown, but that the market was slowly improving. Flybe said that the Irish market was relatively small and pointed out that the number of people within an

hour of its base at Southampton Airport was roughly equivalent to the population of Ireland.

112. We also note that the IMF's recent report on Ireland shows expected growth of 1.1 per cent in 2013 and 2.2 per cent in 2014.[24] However, real domestic demand, which may be more closely linked to demand for flights, is expected to fall in 2013 by 1 per cent and grow by only 0.9 per cent in 2014. The IMF's current forecast is that the UK will grow by 0.7 per cent in 2013 and 1.5 per cent in 2014.[25] These low expected growth rates, combined with continued economic uncertainty are consistent with the view that this is not an attractive time to enter, although we recognize that the growth rates for the UK and Ireland are relatively higher than many other European countries.[26]

Aggressive response by existing operators

Views of the European Commission

113. The European Commission concluded that the fear of aggressive retaliation constituted a barrier to entry. In particular, Ryanair had a reputation for and the ability to engage in aggressive competition when airlines tried to enter routes where it operated. This entry barrier was equally relevant for routes to and from Dublin, Shannon, Cork and Knock.

Views of parties

114. Aer Lingus said that Ryanair had established a reputation for aggressive retaliation and there were numerous examples where Ryanair had 'attacked' new entrants.

115. Ryanair stated that an aggressive response should not be an issue when considering the minority shareholding. It noted that if one believed that Ryanair's Aer Lingus shareholding gave it an incentive to soft-pedal against Aer Lingus, this would create opportunities for new entrants and give Ryanair fewer incentives to respond aggressively.

116. We note that the material in [✂] is consistent with the view that Ryanair reacts aggressively to increased competition: [✂].

117. Ryanair said that Wizz Air entering should be seen as evidence that Ryanair's pro-competitive aggressive stance did not dissuade airlines from entering.[27]

118. Aer Arann said that it had carefully considered its decisions to enter new routes and compete with Ryanair, as Ryanair in the past had displayed aggressive competitive tactics on specific routes. Aer Arann gave an example of the Cork–Dublin route, where Aer Arann had profitably operated five or six turbo-prop services a day. Ryanair entered the route, adding significant jet capacity, coupled with extremely low fares and ultimately forced Aer Arann to exit the market. Ryanair then exited the market shortly after and Dublin to Cork had not been served by air since. Aer Arann acknowledged that a new motorway between Cork and Dublin had opened around this time, but thought the Ryanair competitive actions were very aggressive in

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[24] Page 12, www.imf.org/external/pubs/ft/scr/2013/cr1393.pdf.
[25] www.imf.org/external/country/GBR/index.htm.
[26] Page 48, www.imf.org/external/pubs/ft/weo/2013/01/pdf/text.pdf.
[27] We understand that Wizz Air has subsequently stopped operating from Modlin airport due to safety concerns. http://wizzair.com/en-GB/about_us/news/wizen135, consulted 17 May 2013.

relation to the low strategic importance of the route to Ryanair's expansive European network.

119. CityJet said that fear of retaliation by competitors was a barrier to entry and that Ryanair protected its position on its routes by being aggressive on prices and frequencies.

120. DAA stated that it expected that any entry by competitors would be met with aggressive pricing and referred to the European Commission's Statement of Objections that detailed evidence of Ryanair's aggressive response to entry by easyJet on Cork–Gatwick, Go on Dublin–Edinburgh and Wizz on routes from Cork to Poland. DAA said that Wizz was exiting the Cork to Poland routes following the entry of Ryanair.

121. easyJet said that in the past it had encountered significant responses from Ryanair when it had entered routes. [✄]

122. Flybe said that it would consider entering routes to compete with Ryanair, but this was not a question that regularly occurred.

123. Lufthansa said that Ryanair's reaction to new entry was very low prices and very aggressive marketing.

124. Blackpool Airport said that competing with Ryanair on price was likely to be a barrier to entry. [✄]

Taxes and airport fees

Views of the European Commission

125. The European Commission found that the level of charges at Dublin Airport was a barrier to entry that was likely to deter new entrants, particularly low cost airlines. The European Commission did not discuss the issue of taxes, but when summarizing its views it stated: 'The level of airport charges and taxes at Dublin airport is likely to deter new entrants.'

Views of parties and other information

126. A House of Commons report suggested that UK air passenger duties were much higher than other European countries, as shown in Table 3.

TABLE 3 **Rates of UK aviation tax per person compared with other EU countries**

€

Country	*Short haul rate—economy*	*Medium haul rate—economy*	*Max rate charged—any class*
UK	16.0	89.9	226.6
Austria	8.0	20.0	35.0
France	5.2	5.2	47.6
Germany	7.5	23.4	23.4
Ireland	3.0	3.0	3.0
Italy	4.5	4.5	5.5
Other EU Average	5.6	11.2	26.7
All EU Average	7.4	24.3	60.0

Source: House of Commons All Party Parliamentary Group for Aviation Inquiry into Aviation Policy and Air Passenger Duty August 2012. Available at www.bar-uk.org/docs/topics_docs/APPG_Aviation_Report_Aug_2012.pdf.

127. Aer Lingus also noted that there had been a significant increase in airport charges since 2007, with the average price cap set by the Irish Commission for Aviation Regulation increasing from €6.88 for the period 2006 to 2009 to €9.97 (an increase of 45 per cent) for the period 2010 to 2014. In addition, the Irish Government has imposed a tax of €3 per passenger in respect of all flights departing from the Republic of Ireland.

128. DAA provided material suggesting that its aeronautical revenues per passenger of €10.43 in 2011 and 2012 were below the average of €12.07 for important European airports.[28] DAA also provided material suggesting aeronautical revenues at Cork and Shannon were in line with the charges at secondary European airports. DAA also explained that it offered growth incentives for airlines on a non-discriminatory basis. Airlines which brought in additional volumes could have discounts up to 100 per cent (year 1), 75 per cent (year 2) and 50 per cent (year 3).

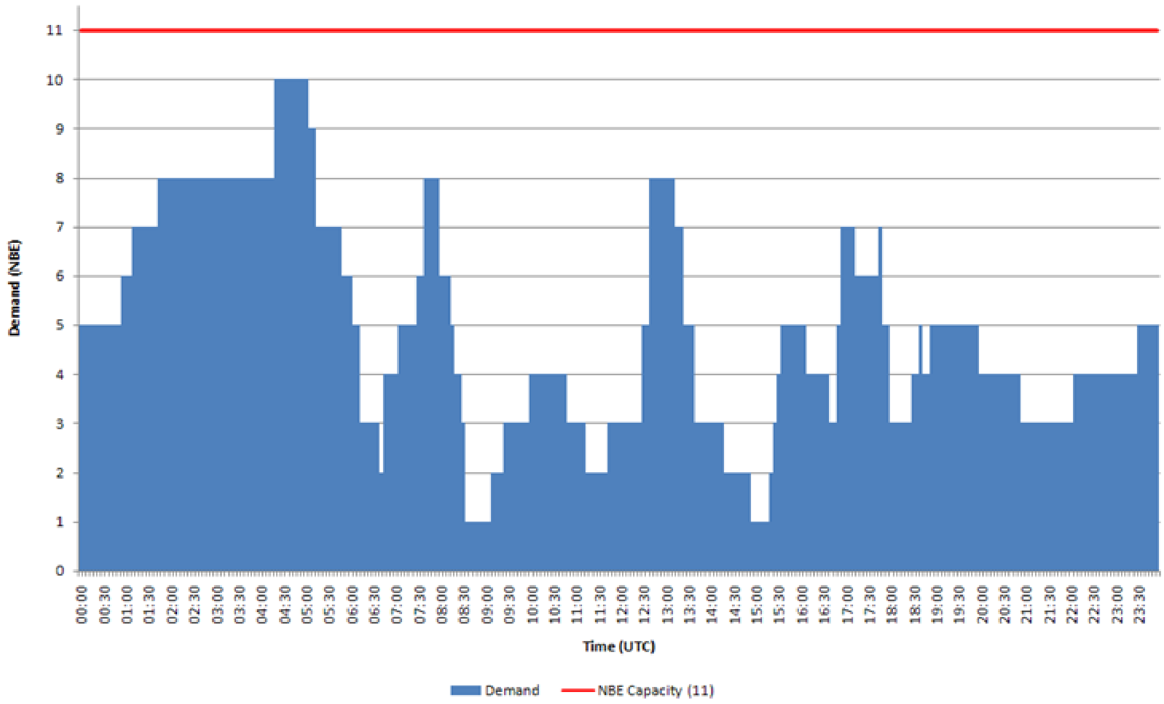
129. Our review of the Ryanair [✄] identified numerous references to the importance of airport charges [✄]. For example, [✄].

130. Flybe said that the charges at Dublin were above the average it paid to airports. However, Flybe said that the level of charges at Dublin, Cork, Knock and Shannon were conducive to entry. Liverpool Airport stated that Air Passenger Duty would affect the demand for air travel. Prestwick Airport saw Air Passenger Duty and the relatively high charges at Dublin as significant constraints on entry and expansion.

[28] Aeronautical revenues are defined as 'Aeronautical charges per passenger, measured over the course of a year, net of discount or fee waivers. Average of nautical revenues collected per passenger for use of airfield (landing fees, ramp/apron fees), gate charges, terminal space, passenger related charges. Excludes air traffic control fees and facility rentals for ancillary buildings, such as maintenance hangars and cargo buildings'. Source: www.Aci.aero/Media/aci/downloads/ACI_APM_Guidebook_2_2012.pdf.

FIGURE 1

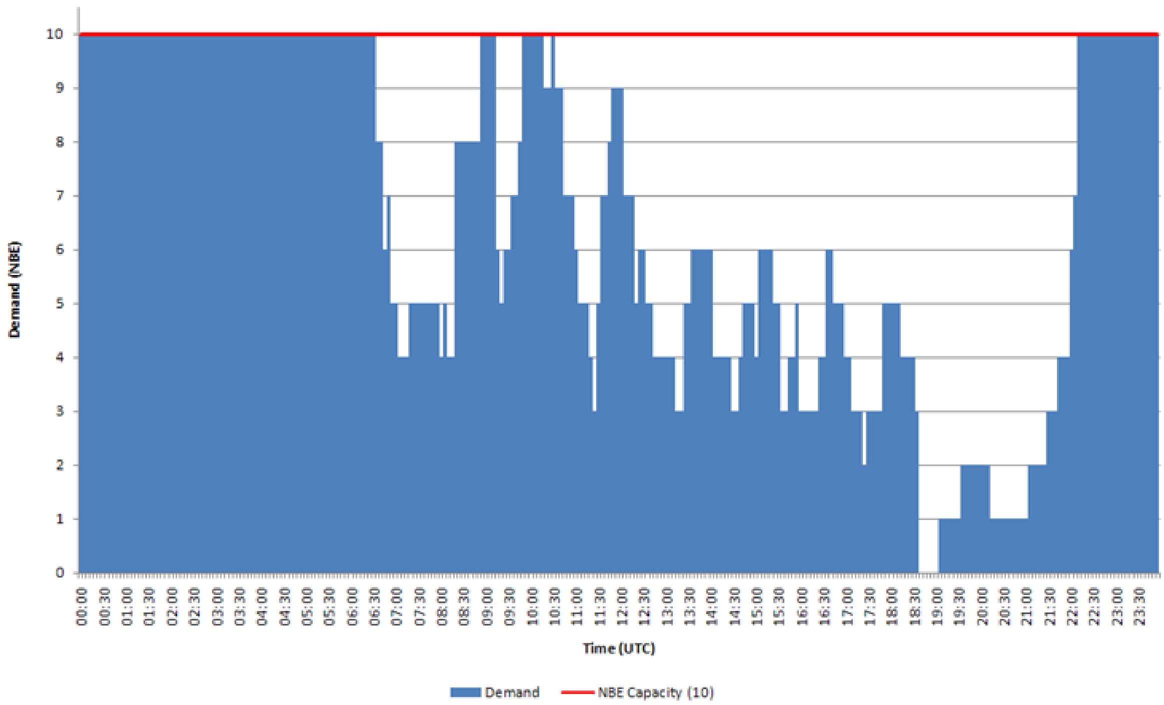
Pier A stand use



Source: DAA.

FIGURE 2

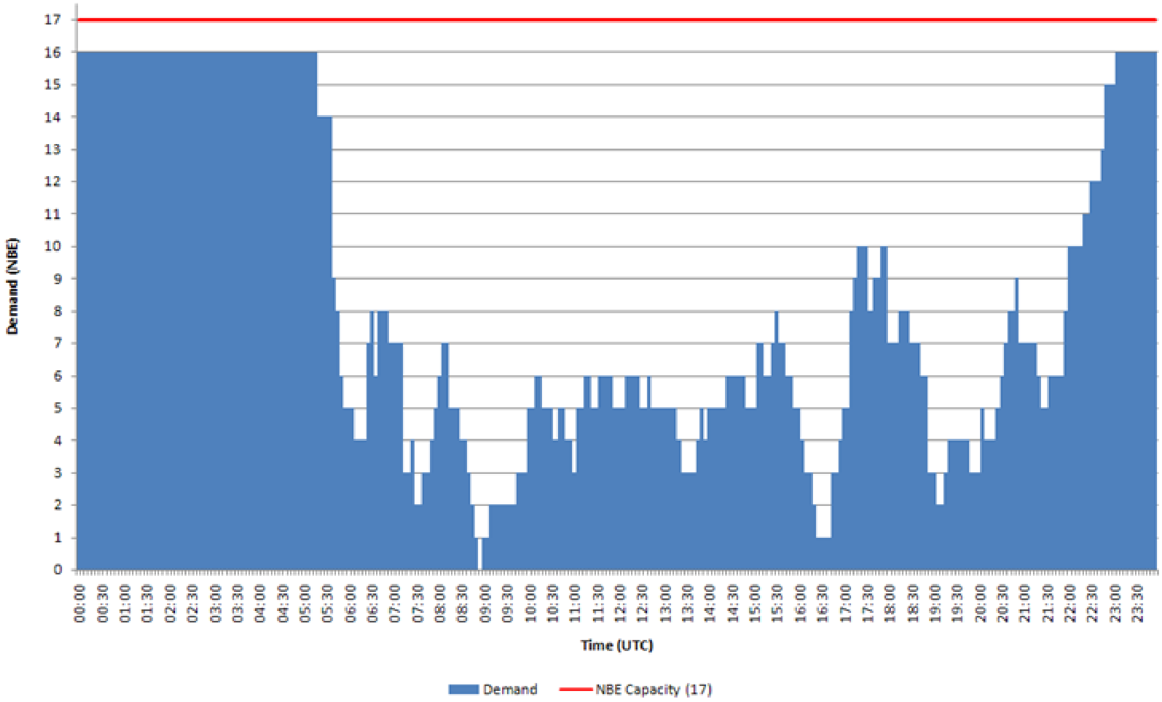
Pier B stand use



Source: DAA.

FIGURE 3

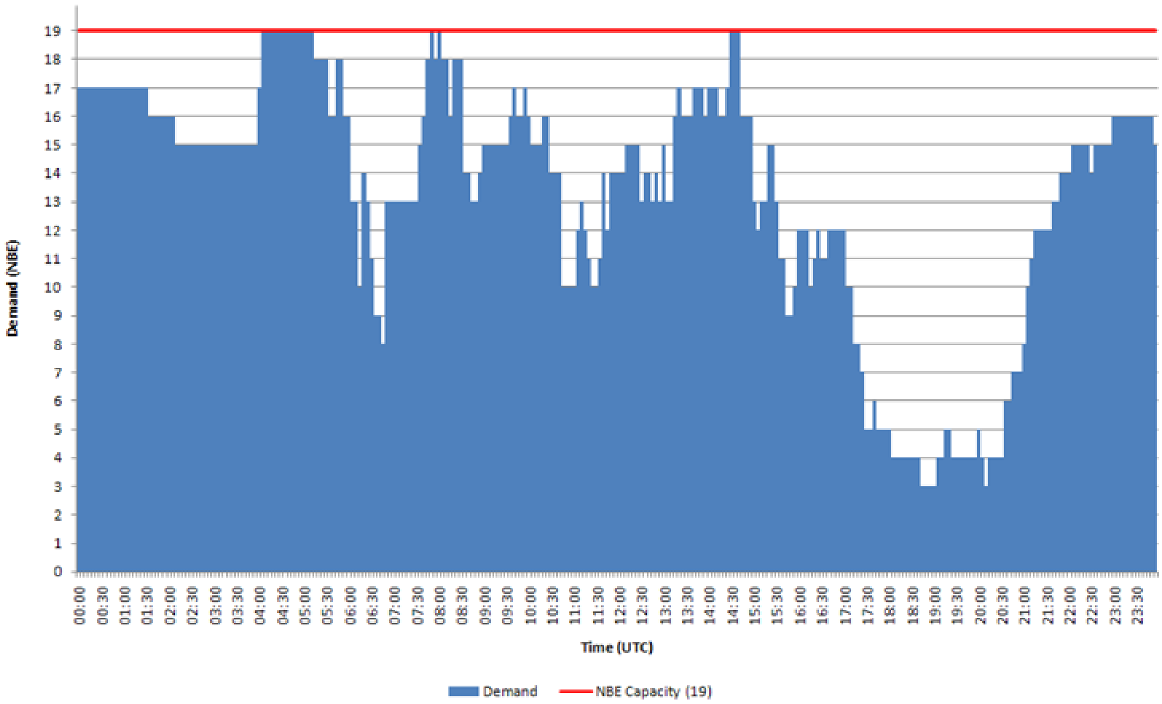
Pier D stand use



Source: DAA.

FIGURE 4

Pier E stand use



Source: DAA.

Remedies implementation

Introduction

1. In this appendix, we consider the implementation of the remedy that we identified in Section 8 of the main report. We start by describing the divestiture package and the risks associated with a disposal of that package. Against that background we consider the nature of an appropriate divestiture process and the identity of the party conducting that process. We then consider issues relating to purchaser suitability and the timescale that should be allowed for a divestiture to take place.

Description of the divestiture package

2. The divestiture package should be such that Ryanair's shareholding is reduced to 5 per cent of the issued share capital of Aer Lingus. As of the date of this report, that means that the divestiture package is 132,529,021 ordinary shares in Aer Lingus, representing 24.82 per cent of the issued share capital.

Divestiture risks

Description of divestiture risks

3. In our guidelines,[1] we identify a variety of risks that may be associated with a divestiture remedy:

   (a) Composition risk arises if the scope of a divestiture package is too constrained or not properly configured to attract a suitable purchaser or may not allow a purchaser to operate as an effective competitor.

   (b) Asset risk arises if the competitive capability of the asset to be divested will deteriorate before completion of divestiture.

   (c) Purchaser risk arises if a suitable purchaser is not available or if the merger parties dispose to a weak or otherwise inappropriate purchaser.

4. In this case, divestiture risks are likely to be somewhat different in nature from those encountered in a typical divestiture, in that the asset being disposed of consists of shares in a quoted company, rather than a trading business or collection of assets.

Views of the parties

5. Ryanair said that there were no asset risks or composition risks associated with a divestiture remedy because there was no prospect of the business being integrated or Aer Lingus being undermined. Ryanair also said that there would be few buyers for the divestiture package. It said that one of the concerns identified by the CC was that other airlines were currently dissuaded from acquiring Aer Lingus and in those circumstances it was unclear why any purchaser requirements would be justified

[1] *CC8*, paragraph 3.3.

given that the CC's objective and that of Aer Lingus was to ensure that Aer Lingus's shares could be acquired by another airline.[2]

6. Aer Lingus said that the universe of potential buyers for the stake as a whole was limited at present. It considered that part of the harm already inflicted by Ryanair was the exclusion of Aer Lingus from any prospect of participating in the recent round of consolidation in the industry such that major airlines were not, at present, likely to be actively interested in acquiring Aer Lingus because the most likely purchasers were currently absorbing previous acquisitions. It thought this situation could change over the medium term. It said that at the current date there would be interest from financial investors to acquire small parcels of shares which would result in the divestiture package being sold to a number of purchasers, and it expected this demand to remain strong in the foreseeable future.

Discussion of divestiture risks

7. We found composition risk to be low because the divestiture package could be sold as a single block of shares or subdivided into smaller parcels of shares without having an impact on the operation of the airline.

8. We found asset risk to be relatively low in the short term (ie over a period consistent with a normal CC divestiture period of around six months) because Aer Lingus is a stand-alone company with independent management. Asset risk could increase over time if the remedy implementation was delayed or took a significantly longer period because the SLC would continue to restrict Aer Lingus's ability to pursue an independent competitive strategy. As set out in Section 7, the airline may be expected to become a less effective competitor in the future if it is unable to maintain continued downward pressure on its costs through, for example, realizing cost synergies through a combination with another airline.

9. We found the scope for purchaser risk to be high for several reasons, including:

   (a) There may be a limited pool of suitable purchasers for the divestiture package in its entirety at the date of our final report, though the number of suitable purchasers and the strength of their interest in acquiring the whole divestiture package could change over time. The universe of potential purchasers would increase if the remedy permitted the sale of smaller parcels of shares to a number of different purchasers. In this scenario, purchaser risk would be low and relatively stable because buyers and a seller of Aer Lingus's shares can be matched via the stock market.

   (b) Ryanair may have an incentive to sell its shares to an unsuitable purchaser that is not independent of Ryanair, or which it has reason to believe will act in a way that would weaken Aer Lingus as a competitor to Ryanair, such that the SLC would not be remedied. Conversely, Aer Lingus is likely to have its own preferences regarding the identity of new shareholders in the airline, to find long-term supportive shareholders.

   (c) A potential purchaser might be otherwise unsuitable if it gave rise to further competition or regulatory concerns.

10. We can overcome these divestiture risks by specifying the characteristics of an effective divestiture process and setting out the criteria that we will apply to establish

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[2] Ryanair's response to the Remedies Notice, 11 June 2013, paragraph 20.

purchaser suitability for the shares included in the divestiture package. Based on this approach, we judged that purchaser risk is capable of being managed effectively.

Divestiture process

Description of the available options

11. We identified two potential divestiture processes that could be used to sell Ryanair's shares and which we would expect to address the divestiture risks identified:

(a) Process Option 1: sale of the divestiture package to an approved purchaser via an up-front buyer process (up-front buyer process).

(b) Process Option 2: sale of the divestiture package to a number of approved independent buyers via a stock market placement (stock market dispersal).

12. We also considered a slow dispersal of the shares into the market and a standard auction process for the entire divestiture package.

Views of the parties

13. Aer Lingus said that the most effective divestiture process was a return of the shares to a diverse public holding via the company's public listing (ie process option 2) rather than a sale of the entire divestiture package to any one individual purchaser (eg via process option 1). It said that if the divestiture were to take the form of process option 1, the single purchaser would have to be acceptable to Aer Lingus.

14. Ryanair initially said that in light of its view that the SLC decision was wrong, and that behavioural remedies would be effective, there was no reason for the CC to impose a divestiture remedy and no consideration should be given to the design of a divestiture remedy process. It later told us that there was no reason for the CC to particularize the specific ways in which a divestment could be carried out and that flexibility as to the method of divestiture would be required: *(a)* to obtain a reasonable value for the shares and prevent a distortion of trading activity; and *(b)* to account for the fact that there may be few prospective trade buyers for the entire stake at the present time.

Discussion of the choice of divestiture process

15. In principle, both process option 1 and process option 2 could be effective divestiture processes because, under either scenario, Ryanair's interest in Aer Lingus would be reduced in a timely manner to a level at which the SLC would be remedied.

16. Under process option 1, a potential purchaser (eg an airline) would be identified which, subject to prior approval by the CC, could enter into an agreement to acquire the divestiture package in its entirety. An up-front buyer process, as opposed to a conventional auction process, would be appropriate because it would reduce purchaser risk by resolving uncertainty about the existence of potential purchasers at an early stage without leading to delay in remedy implementation.

17. Under process option 2, market practice suggests that a technique known as book-building would be used to find buyers for the shares.[3] This process would typically aim to maximize proceeds for the seller by seeking to create excess demand for the shares offered, and then allocate to the highest bidder and potentially ration the shares below the number requested. The most likely outcome of stock market dispersal is that the ownership of Ryanair's shares would be dispersed among a number of financial institutions.

18. It may be appropriate for Aer Lingus management to participate in the marketing of shares to potential purchasers, as required by the person responsible for running the sale process. It is market practice for meetings to take place between investors and the management of a company seeking to place shares (generally known as an investor 'road show') to help investors decide whether to purchase shares.[4] Arrangements for any such road show would require careful consideration by the CC to ensure that it was appropriate and did not result in delay or disagreement between the parties that could jeopardize the remedy.

19. We concluded that a stock market placement would be an effective disposal process because there is a market for Aer Lingus shares and purchaser risk would be low because there would be available purchasers and their suitability could be established relatively quickly.

20. It may be possible to apply both process options 1 and 2 in a short time period during the divestiture period. For example, initial consideration could be given as to whether an up-front buyer was available and, if this were not the case, a stock market placement could be carried out without delay.

21. The choice between process options 1 and 2 could depend on a variety of factors, including market conditions, investor interest and the time available to complete the sale. An investment bank would arrange and implement a sale under the supervision of the CC. There could be a variety of external factors that could make one divestiture process more effective than another, or represent the parties' preferred process, at a given point in time. We do not consider it necessary to prescribe which of these alternatives needs to be followed and this will allow an element of flexibility for the implementation of the remedy to adapt to market conditions.

22. We also considered other possible disposal models (see paragraph 12). In our view, a slow dispersal of Ryanair's shares into the stock market would take too long to implement given the need to remedy the SLC, could place downward pressure on the share price and/or be unwelcome for existing shareholders and may hamper any capital raising that might be needed whilst the dispersal was under way. Based on historical trading volumes, it could take more than a year for the shares to be dispersed given the relatively low volume of Aer Lingus shares that are traded. An increase in trading activity would be needed to absorb a large block of shares into the

[3] Investment banks use a range of techniques to achieve the sale including, for example: block-trade, book-building and accelerated tender. The Financial Adviser may also be prepared to offer a guarantee to purchase any unsold shares on its own behalf (ie underwrite the transaction) to provide certainty that the entire process will be completed in a specified period of time. An underwriting agreement may result in the bank retaining the shares that it is unable to sell, with a view to subsequently selling them at a later date.

[4] Although such road shows are generally relevant when a company is seeking to raise new capital, it may be appropriate in the circumstances of a reduction in Ryanair's shareholding for new and existing shareholders to hear directly from Aer Lingus about how the business will proceed after the share sale.

market more quickly, and a stock market placement would be an appropriate process to achieve this.[5]

23. A full auction process to identify potential acquirers of the entire divestiture package may not lead to a successful outcome because both Ryanair and Aer Lingus told us that there were few trade buyers at the present time (ie purchaser risk associated with this option is substantial). The sale of a block of shares does not generally lend itself to a conventional auction process and there are stock-market-based processes available which would be more effective and take less time. An auction process that took a long time to implement could also create asset risk that may increase over time (see paragraph 8).

24. We therefore decided not to pursue either a slow dispersal of the shares into the market or a standard auction process for the entire divestiture package. However, we do not rule out the possibility that the investment bank arranging the sale may suggest an alternative process option to the CC which it believes, in the light of circumstances at the time, might be a more appropriate method of achieving the divestiture than process options 1 and 2, in terms of maximizing the returns to Ryanair, maintaining an orderly market in Aer Lingus shares, and timing. The CC would consider any such proposal at the time.

Responsibility for implementation of the divestiture process

Description of the available options

25. The identity of the party responsible for implementation of the divestiture process is an important consideration in this case. We identified three alternative parties who could, in principle, be responsible for implementation, under the CC's supervision:

(a) Aer Lingus;

(b) Ryanair; or

(c) a Divestiture Trustee.

26. In addition, the CC is able to require the appointment of a Monitoring Trustee to assist in the monitoring of the implementation of the remedy and assist the CC (eg in relation to the progress of the divestiture, assessing purchaser suitability or providing advice about other relevant factors, such as equity market conditions). The CC's merger remedies guidelines[6] state that, where divestiture undertakings are in place, the CC will normally require the appointment of an independent Monitoring Trustee to oversee the parties' compliance with the undertakings.

Views of the parties

27. Aer Lingus expressed concerns that allowing Ryanair to run the process or to have any involvement in the choice of who bought the shares would give rise to significant purchaser risk that could result in substantial detriment to Aer Lingus. Aer Lingus said that it alone should have responsibility for selection of the purchasers and it would seek out institutional shareholders interested in forming a long-term stable

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[5] In Appendix C (paragraph 44), we set out the daily trading volume and value for Aer Lingus shares since its IPO in October 2006, and the average number of trading days represented by stakes of 25 and 30 per cent. A 25 per cent stake in Aer Lingus is equivalent to the number of shares traded in 288 trading days based on the volumes traded over the last seven months.
[6] *CC8*, paragraph 3.23.

shareholder base. Aer Lingus considered that its long-term competitive capability would be best safeguarded in this way.

28. Aer Lingus said that a Divestiture Trustee should be appointed immediately. The Divestiture Trustee could be an investment bank, or a consultancy with experience of divestiture roles for competition agencies (assisted as necessary on pricing matters by an investment bank). It said the Divestiture Trustee should be under the direction of the CC and Aer Lingus, to the exclusion of Ryanair, preferably to place the shares with institutional investors quickly to return Aer Lingus to a widely-held public listing. Aer Lingus said that, in the case of a sale to a single purchaser, there should be a clear requirement on the Divestiture Trustee not only to consult with Aer Lingus, but to proceed only if such a single purchaser were acceptable to Aer Lingus. It said that there would otherwise be a risk of the stake ending up in the hands of an unsuitable purchaser who might take steps which would have the effect of reducing competition on the routes between Great Britain and Ireland (eg manoeuvring to reassign Heathrow slots for other purposes). It also said that, in the case of a sale to multiple financial institutions, it (and its advisers) had already extensively canvassed the universe of likely institutional buyers and could contribute positively on this topic, in which Aer Lingus had the strongest possible legitimate interest.[7]

29. Aer Lingus further suggested that an external Hold Separate Manager (HSM) should be appointed, who would be responsible for the exercise of all rights attaching to the shares. This would extend not only to voting rights (which the HSM would exercise in line with the advice of proxy advisers such as Institutional Shareholder Services) but also to the requisitioning of general meetings, the tabling of resolutions, attendance at general meetings, threatening and/or bringing litigation/regulatory complaints, seeking meetings with Aer Lingus management and access to Aer Lingus's commercial information, and public campaigning against Aer Lingus in a capacity as shareholder.

30. Aer Lingus said that a separate Monitoring Trustee was not needed at this juncture, and that the normal oversight role could be performed by the Divestiture Trustee once appointed. If there were a substantial delay in appointing a Divestiture Trustee, an interim Monitoring Trustee might be appropriate.

31. Ryanair considered that there was no basis for a divestiture remedy.

32. Ryanair said that there would be no need for a monitoring mechanism because it would be apparent to Aer Lingus whether or not Ryanair had complied with any order to divest shares.[8]

33. Ryanair told us that there was no basis for the appointment of a Divestiture Trustee or for any involvement of Aer Lingus in the sale process, beyond possibly participation in a road show if required. In its view, Aer Lingus should have no right to use the divestiture process to secure a veto over the identity of its shareholders and should have no input into the choice of potential purchasers of Ryanair's stake. Ryanair said that the CC's only legitimate concerns should be those based on competition grounds and that the usual CC purchaser approval process, as well as merger control law, already ensured that a divestment would not result in harm to competition and would be made to an independent purchaser.

[7] In a memorandum prepared by Goodbody Stockbrokers, a financial adviser to Aer Lingus, Goodbody Stockbrokers said that closer cooperation between Aer Lingus and the Divestiture Trustee was important in maintaining an orderly market in Aer Lingus shares. It said that it was in Aer Lingus's interests to have a share price that was well supported and on this matter at least its interests were closely aligned with those of Ryanair. It also said that the Divestiture Trustee's fee could be structured so as to incentivize it to maximize the price it obtained when selling Ryanair's shares.
[8] Ryanair's response to the Remedies Notice, 11 June 2013, paragraph 19.

34. Ryanair said that it should manage any sale process that was mandated (through a merchant bank or broker of its choosing) and that an immediate imposition of a Divestiture Trustee would be unjustified because:

(a) the appointment of a Divestiture Trustee would be inconsistent with CC and EU precedent;

(b) the CC's concerns about Ryanair's ability to run the process were unproven, unfounded, and did not justify the imposition of a Divestiture Trustee from the outset;

(c) the use of a Divestiture Trustee would make a book-building exercise unworkable, resulting in a significant adverse impact on stock market liquidity and orderly trading;[9] and

(d) the appointment of a Divestiture Trustee at an early stage of the procedure would be entirely disproportionate.

Discussion of the choice of party to manage the divestiture process

35. We noted that Ryanair and Aer Lingus both expressed concerns about the suitability of the other party to manage the implementation and that the other party may have incentives that could reduce the effectiveness of the implementation (eg to sell to an unsuitable purchaser, or sell below market price).

36. We considered that it would be highly unusual to allow Aer Lingus to be responsible for selling Ryanair's shares because the shares belong to Ryanair which has an interest in exchanging them for cash at a market price. There is a risk that Aer Lingus would not be sufficiently incentivized to maximize the proceeds for Ryanair if it were to place greater emphasis on its own preferred choice of purchasers. We therefore concluded that it would not be appropriate for Aer Lingus to manage the divestiture process.

37. We considered whether Ryanair should be given this role. Under the approach pursued in the majority of divestiture remedies overseen by the CC, Ryanair would be permitted to run a process to sell its shares to an approved purchaser in the first instance. If Ryanair were permitted to run the sale process it would have discretion in relation to the price and the allocation of shares between approved purchasers. Ryanair would also be allowed to determine the timing of the sale, provided that it completed within the divestiture period.

38. The appointment of a Divestiture Trustee is generally used by the CC as a fall-back option if a party has not completed the divestiture at the end of the divestiture period, or in other relevant circumstances where the CC has reason to be concerned that an effective divestiture would not be completed, eg within the permitted time. The possibility that a Divestiture Trustee may be appointed after an initial period creates an incentive for a party to take appropriate actions to implement the remedy promptly. The CC's guidelines[10] regarding Divestiture Trustees state that its mandate would be to dispose of the package within a specified period (the Trustee's

[9] In a memorandum prepared by Morgan Stanley, at the request of Ryanair, Morgan Stanley said that a Divestiture Trustee would have no incentive to maintain an orderly market (eg by taking balance sheet risk, acquiring the block upfront at a fixed discount, or because it had a long-term relationship with the seller) but would rather sell the shares as expeditiously as possible.

[10] *CC8*, paragraph 3.24.

Divestiture Period) at the best available price in the circumstances, subject to prior approval by the CC of the purchaser and the divestiture arrangements.

39. If Ryanair were to be permitted to manage a divestiture for an initial period, we were concerned that there would be a material risk that Ryanair would be incentivized to undermine the effective implementation of this remedy, for example by placing shares with unsuitable purchasers. We regarded this point as important, given the significance of competition between Ryanair and Aer Lingus. For example, Ryanair may seek to sell its share to parties who were not independent of it, or to a purchaser or purchasers whose intention, in purchasing the shares, was to break up Aer Lingus, sell off its Heathrow slots or use them for purposes other than flights between Great Britain and Ireland, and/or take some other action the effect of which would be to reduce competition between Ryanair and Aer Lingus on routes between Great Britain and Ireland.

40. We have considered whether the CC might oversee a sale process and appoint a Monitoring Trustee to assist in reviewing the conduct of the sales process and ensuring that there were no unnecessary delays in a process managed by Ryanair. However, the sale of a minority stake in a listed company raises particular difficulties for this type of monitoring arrangement. This risk would be very difficult to manage, particularly in the context of a stock market dispersal (ie Process Option 2). In addition, it would be hard for the CC or a Monitoring Trustee to distinguish between a legitimate delay in Ryanair’s process (eg to target an appropriate window for a stock market placement during the divestiture period) and an intentional delay to place the shares (eg to retain them without an intention to implement the remedy). This in turn restricts the ability of the CC to intervene before the end of the divestiture period (by appointing a Divestiture Trustee) if the latter were to be the case. Given this, the safest and most transparent way to manage this risk would be for the sale to be conducted by an independent party with no vested interest other than performing its mandate.

41. We also considered whether the appointment of a Divestiture Trustee at the outset of the process would result in material detriment to Ryanair. We note that this divestiture remedy does not involve the sale of a business, in which the vendor might be best placed to market it on the basis of its knowledge and understanding of it. A parcel of shares is being sold and the sale would most likely be conducted by a financial adviser. As the financial adviser would be mandated to achieve the best available price in the market, we did not consider that Ryanair would suffer material detriment in terms of the proceeds realized for its shares as a consequence of that adviser being mandated by the CC rather than Ryanair. Further, we would expect that the professional fees for a Divestiture Trustee would be broadly equivalent in magnitude to those that Ryanair would pay if it were to appoint its own financial adviser to run the sale process. There is therefore unlikely to be any material incremental cost to Ryanair of the CC’s decision to appoint a Divestiture Trustee.

42. For these reasons we decided to require a Divestiture Trustee from the outset of the divestiture process.

43. The appointment process and terms of engagement for the Divestiture Trustee would be set out in the Final Undertakings or Final Order implementing our remedies. Our views about what these should be are set out in further detail in Annex 1. The Divestiture Trustee would be obliged to bring about an effective disposal at the best available price in the market [✄]. The Divestiture Trustee would inform the CC about the process that would be undertaken (and would be free to suggest alternatives to the two process options outlined above, for consideration and approval by the CC, if it believed that such an alternative would result in a more effective sales process)

and implement it under supervision of the CC. Purchasers would be subject to prior approval by the CC, although if a book-build exercise (process option 2) is the chosen sales method, it would probably be impractical from the timing point of view for the CC to scrutinize and approve each potential purchaser and we would have to rely on the Divestiture Trustee's assessment of potential purchasers based on the purchaser suitability criteria provided by the CC to the Trustee in its mandate. While the Divestiture Trustee would have discretion in relation to the price accepted and the allocation of shares between suitable purchasers, given its mandate and its need to retain its professional reputation, we would expect it to act in a way that preserves an orderly market in Aer Lingus shares and secures a fair market value for the stake.

44. Given Aer Lingus's concerns about the identity of the potential purchaser, it may be appropriate for the Divestiture Trustee and/or the CC to consult with Aer Lingus during the divestiture period, especially if a trade sale to a single buyer (process option 1) is contemplated. The Divestiture Trustee would also be allowed to determine the timing of the sale, provided that it completed within the divestiture period. Given the specialist nature of the Divestiture Trustee's duties, we considered that an investment bank with extensive day-to-day involvement in Irish and London equity capital markets could have the requisite knowledge and expertise to perform these duties.

45. We discounted, for the time being, the appointment of an HSM, as suggested by Aer Lingus. An HSM is usually only appointed in order to operate a business that is to be divested and/or prepare it for sale, in a case where there has been substantial integration of the two businesses, or there is a high risk of deterioration of the business (for example, through loss of key customers or staff), or the pre-merger senior management of the acquired business is absent and/or strong incentives exist for the current senior management to operate the acquired business on behalf of the acquirer.[11] None of these considerations appears to us to be relevant here, where the asset to be divested is a parcel of shares in a listed company.

46. A Monitoring Trustee could provide support and advice during the remedy implementation phase in relation to equity market conditions and purchaser suitability. This remedy differs from several prior remedies involving the divestiture of a business unit or company, as opposed to a block of shares. Given the role of the Divestiture Trustee and our assessment of asset risk and composition risk for the divestiture package, we did not find that there was a pressing need for a Monitoring Trustee in relation to the preservation of the Aer Lingus business or the oversight of the sale process. The CC has kept this matter under review during the inquiry, and would continue to do so during remedy implementation.

47. Ryanair would be responsible for the remuneration of the Divestiture Trustee or for any Monitoring Trustee or HSM should this be required at a later stage.

Decision

48. We concluded that it would be necessary and appropriate to appoint a Divestiture Trustee as soon as practicable after agreement on final undertakings or the making of a final order to manage the sale of the divestiture package. The need for a Monitoring Trustee and/or HSM will be kept under review.

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[11] *CC8*, paragraph 14.

Purchaser suitability and CC information requirements

Description

49. The CC's guidelines[12] state that the identity and capability of a purchaser will be of major importance in ensuring the success of a divestiture remedy. At this stage it is too early to know who will express interest in acquiring Ryanair's shares in Aer Lingus.

50. Our interim order (see Section 8) requires Ryanair to obtain the CC's consent for the transfer of shares to another party. This safeguard is currently in place to preserve the CC's ability to take remedial action and would enable the CC to ensure that Ryanair does not sell its stake to an unsuitable purchaser during our investigation. As the interim measures would fall away on final determination of the investigation, we considered what safeguards would be necessary as part of the remedy implementation process.

51. We noted that given that this divestiture remedy relates to a block of shares in Aer Lingus as opposed to a business, it is possible that the shares may be purchased by one or more parties, and the resulting ownership structure of Aer Lingus could vary substantially depending on how many shares were purchased by which party.

52. As set out in the guidelines,[13] the CC considers four broad criteria for the suitability of purchasers:

(a) independence of purchaser from the main party (ie Ryanair);

(b) absence of further competitive or regulatory concerns;

(c) commitment to the relevant market; and

(d) appropriate capability and financial resources.

Views of the parties

53. Aer Lingus said that there would be significant purchaser risk if Ryanair had any involvement in the choice of purchasers. Aer Lingus considered that Ryanair would transfer Aer Lingus shares to shareholders whose motivations were aligned with Ryanair's interests. Aer Lingus considered that if Ryanair were allowed to choose the purchaser, it would sell to parties that would be inclined to vote in concert with Ryanair's remaining shares, would be inclined to tender their shares if Ryanair made another offer for Aer Lingus, and would not be willing to sell the shares to a party other than Ryanair. Aer Lingus also considered that there might be a category of shareholder that Ryanair would target who would sell off Aer Lingus's business in parts. Aer Lingus believed that the default instruction to the Divestiture Trustee, in the absence of a single purchaser acceptable to the CC and to Aer Lingus, should be the dispersal of Ryanair's shares to a diverse set of institutional investors, and that the Divestiture Trustee should be mandated to have regard to Aer Lingus's wishes as to the identity of such investors.

[12] *CC8*, paragraph 3.15.
[13] *CC8*, paragraph 3.15.

54. Ryanair said that it was unclear why any purchaser requirements would be justified as the CC's objective (and that of Aer Lingus) was to ensure that Aer Lingus's shares could be acquired by another airline.

Discussion of purchaser suitability

55. The CC's application of its general purchaser suitability criteria is adapted on a case-by-case basis in light of the nature and circumstances of the divestiture in question. In this inquiry the divestiture concerns a parcel of shares which are freely tradable on the stock market, and if the process involves a stock market placement (ie process option 2) the implementation will be undertaken in a very short time period.

56. The purchaser suitability assessment would need to focus on those where divestiture risks are highest, ie in relation to purchaser risk. In order to address the risk that unsuitable purchasers may emerge, all proposed purchasers of the Ryanair shares in Aer Lingus will be subject to review by the Divestiture Trustee and as necessary the CC. The CC would specify the general principles that would apply to the approval of purchasers and mechanism via which the Divestiture Trustee would consult with the CC. We noted that there is an inherent information asymmetry in relation to a purchaser's ultimate intentions for its shareholding and the CC would not generally seek to impose further obligations or requirements on the purchaser, beyond those that are necessary to remedy the SLC, in order not to deter parties from bidding for the shares.

57. In order to manage the purchaser suitability assessment so that it is compatible with the pace of a stock market placement, the CC would instruct the Divestiture Trustee and may delegate certain tasks and responsibilities to the Divestiture Trustee. It would be appropriate for the Divestiture Trustee to review the purchaser identity and consult with the CC as appropriate to ensure that the remedy implementation is effective. It may also be appropriate for the Divestiture Trustee to consult Aer Lingus and/or Ryanair during the process.

Independence of purchaser from Ryanair

58. In relation to the independence of the purchaser from Ryanair, the CC will need to be satisfied that a purchaser has or had no significant connection to Ryanair that may compromise Ryanair's incentives to compete with the merged entity. Examples of issues that would give rise to concerns about independence could include:

(a) Ryanair holding a financial interest in the purchaser.

(b) The purchaser holding a material financial interest in Ryanair.

(c) The purchaser and Ryanair having directors or management in common.

(d) Material commercial or financial relationships, or any side agreements between the purchaser and Ryanair.

Absence of further competitive or regulatory concerns

59. In relation to the absence of further competitive or regulatory concerns, divestiture to the purchaser should not create a realistic prospect of further competition or regulatory concerns. Moreover the CC's approval of a purchaser may be subject to clear-

ance by the Office of Fair Trading, European Commission or other regulatory authority.[14] This is most likely to be a relevant consideration in the event of an up-front buyer process to divest the whole of the stake to another airline (ie process option 1).

60. The CC may consult the relevant authorities in relation to international competition issues and public takeover issues during the purchaser suitability assessment on a case-by-case basis.

61. Any purchaser must take its own advice in relation to the possibility of competitive or regulatory concerns that might arise if it acquired a shareholding in Aer Lingus.

Commitment to the market, and appropriate capability and financial resources

62. Depending on the level of shareholding acquired, the CC may wish to review (or require the Divestiture Trustee to review) the two remaining general purchaser suitability criteria, to establish whether the purchaser has an appropriate business plan and capabilities for competing in the relevant market and/or to form an appreciation of its general intentions as a significant shareholder in Aer Lingus.

63. This is likely to be particularly relevant if the purchaser was acquiring the divestiture package in its entirety. There may be circumstances in which a financial investor may acquire a block of shares with a view to selling them in a subsequent transaction, eg as part of an underwriting agreement in a stock market placement. The CC will require details of the proposed divestiture process and would also review such purchasers on a case-by-case basis in accordance with the purchaser suitability criteria.

Divestiture period and timing considerations

Description

64. As set out in our guidelines,[15] when determining the initial divestiture period (ie the period in which the parties should achieve effective disposal of a divestiture package to a suitable purchaser) the CC will seek to balance factors which favour a shorter duration, such as minimizing asset risk and giving rapid effect to the remedy, with factors that favour a longer duration such as canvassing a sufficient selection of potential suitable purchasers (purchaser risk) and facilitating adequate due diligence.

Views of the parties

65. Ryanair said that there would be a significant cost to it if it were required to sell too quickly. It could also undermine orderly trading in Aer Lingus shares more generally if a significant volume of shares had to be sold quickly. Ryanair said that any required divestment period should be no less than [✄] months following the conclusion of the ongoing EU merger review. Ryanair said that a prospective purchaser had an incentive to game the disposal process to acquire the asset at an under value. Any sale deadline should be confidential and known only to Ryanair and the CC.

66. Ryanair sent us a memorandum from its financial adviser, Morgan Stanley, which said that our proposed divestiture period was too short and could result in a disorderly market for Aer Lingus shares, to the detriment of all shareholders. It said

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[14] If the identity of the purchaser (eg another airline) would itself raise regulatory concerns.
[15] *CC8*, paragraph 3.24.

that market practice was to size the offering relative to the free float and liquidity in the shares. Recent European precedents had averaged 35 to 40 days trading volume with an average discount of about 4 per cent. The Ryanair stake to be sold would be so large as to dislocate the market for a period of time and would be a liquidity event comparable to an Initial Public Offering, where investors typically required a discount of 15 to 20 per cent to absorb the supply. Morgan Stanley said the sale would need to be staggered over time across several transactions, with appropriate lock-up periods (of [✄] days) for Ryanair. With this in mind, and also considering the need to have flexibility to time the sales when market conditions were supportive, Morgan Stanley estimated that a disposal process would require [✄] months, assuming [✄] block sales spaced between [✄] day lock-up periods.

67. Aer Lingus said that the divestiture package could be sold in a stock market placement in very short period of time, eg one week, but that this process should take place at an appropriate point in time for the company and the stock market. Aer Lingus considered that a sale in the third quarter of 2013 would be appropriate.

68. Aer Lingus also sent us a memorandum from its financial adviser, Goodbody Stockbrokers, which said that while the placing of 24.82 per cent of Aer Lingus would be relatively large in Ireland, it was in no way unprecedented in terms of relative scale or absolute size. It said that, at the current share price of €1.70, the placing would be worth €225 million and this would not be a shock to the market but would, rather, be very well received by institutions. Goodbody Stockbrokers also said that there were investors who had been deterred from buying Aer Lingus stock because of the limited liquidity but they continued to keep a watching brief on the stock and engage with Aer Lingus management on investor road shows. It thought that, if market conditions were good, then there would be strong demand, minimizing any potential discount. It also said that a staggered share sale process would create a negative technical overhang on the share price, and that some institutional investors would not invest until such overhang was removed. It said that it would be more appropriate to complete the sale by means of a single placing (via an accelerated book build) as opposed to multiple tranches with lock-up periods in between. It said that lock-up periods would not alleviate investor concern about a staggered share sale but may deter institutional investors and have a negative impact on subsequent demand and pricing.

69. Aer Lingus said that the divestiture deadline should be made public, and the reasons for this flow from the character of the divestiture—it is not a situation where there is a risk of a fire sale. Rather the market for Aer Lingus is one in which the price is continuously quoted.

70. Aer Lingus also said that the CC should adopt an order carrying into effect the decisions in its final report without delay. This was on the basis that Ryanair would not be forthcoming with undertakings and would appeal the CC's decision.[16] An early adoption of an order, according to Aer Lingus, would compel Ryanair to make its application to the CAT without delay, where the appeals against the report's findings and the order could be dealt with together. Where such an order is not enforced pending appeal, Aer Lingus requested that the CC strengthen the existing interim order to require Ryanair to transfer its shares to a third party, for the exercise of all of its voting rights.

[16] Aer Lingus referred to comments contained in the *Sunday Telegraph* article titled 'Ryanair Row Over Aer Lingus? It's Like a Monty Python Script', dated 1 June 2013.

Discussion of the duration of the divestiture period

71. The CC's guidelines state that a divestiture period will normally be six months at a maximum. This period is generally relevant to a standard sell-side process for a whole company or business. In this case, we are considering the divestiture of a parcel of shares and it is likely that these could be sold more quickly than an entire company or business because a number of process steps would be unnecessary. However, we also recognize that there may be particular periods of time when a share placement was not possible (eg close to Aer Lingus's results announcements) or would be inadvisable (eg during summer or Christmas holiday periods when equity markets are quiet and availability of investors might be limited).[17]

72. We consider that potential purchasers would be able to complete valuations of small parcels of shares in a listed company more easily than if the transaction involved an entire company or privately-held shares because the market value of the shares is observable on the Stock Exchange. The process of price discovery in Aer Lingus shares is a continuous process in the stock market, and the process of book-building can take place very quickly over the telephone or by electronic communication. On this basis, there is no need to allow additional time in the divestiture process for valuation appraisals or negotiations about price.

73. The extent of due diligence that a potential purchaser may require for a transaction involving a parcel of shares in a listed company, such as Aer Lingus, is very little (if any) and is generally much less than for a transaction involving an entire company because there is a substantial volume of public information available to all interested parties and there are no changes to the operation or management of the business.

74. There is an established process for buying and selling shares in listed companies (eg via a trading desk of an investment bank or broker). There would be no need for a share purchase agreement or extensive documentation. Purchasers will need to have funds available to complete the share purchase and their stockbroker or dealer will confirm this before accepting their instructions to purchase shares. Clearing and settlement of share sales is a routine process which takes three days. This can be accommodated in a relatively short divestiture period.

75. We also noted that Ryanair was able to purchase a substantial block of Aer Lingus shares (19 per cent) less than one week following the initial public offering in October 2006, preceding its first bid.[18]

76. We noted that there is a possibility of a mandatory public offer for Aer Lingus stemming from the implementation of the divestiture. A mandatory public offer for Aer Lingus would be required under Irish takeover rules if a potential purchaser already owned more than 0.18 per cent of Aer Lingus's shares outstanding, and sought to purchase the divestiture package in its entirety because it would result in a holding of 30 per cent. In such circumstances an offeror would be required to circulate an offer document to shareholders within 28 days of the triggering and announcement of the offer and allow an offer period of at least 21 days (total 49 days). If the offeror is unable to secure acceptances for a minimum of 50 per cent of Aer Lingus then this bid would lapse. The public offer period could be longer than 21 days, and may be

[17] A number of factors are relevant to the time that would be required to sell a business, including: the preparation of marketing materials such as an information memorandum; the time needed to approach bidders; the number of bidding rounds that were offered in an auction process; and the time needed for due diligence, documentation and financing to be arranged.
[18] As set out in Appendix B. Aer Lingus's shares were admitted for trading on 2 October 2006. By 5 October 2006 Ryanair had purchased a shareholding of 19.1 per cent. By 28 November 2006 it had purchased a shareholding of 25.2 per cent. By 20 August 2007 its shareholding had increased to 29.4 per cent and by 2 July 2008 its shareholding had increased to 29.82 per cent.

extended (eg if there was a counterbid by another party). In general, due diligence is completed during the period between the announcement of an offer and the posting of the offer document (ie 28 days).

77. We also noted that a voluntary offer for Aer Lingus might also be relevant in some circumstances (eg if a purchaser did not already own shares in Aer Lingus but wanted to acquire the whole company). This would have the same timetable implications as a mandatory offer.

78. We recognized the need to ensure that the divestiture process, and in particular the timing, should be structured in a way which minimized the negative impact on an orderly market for shares in Aer Lingus. Once the market knows the stake will be for sale, the share price is likely to weaken as investors wait for the placing. We took the view that a long divestiture period, such as that requested by Ryanair, to place a known amount of shares could cause greater overall disruption to the market than a book building within a shorter disposal period. However, although we note in paragraphs 72 to 75 that the sales process, once launched, can generally be completed within a relatively short time frame, we considered that it was appropriate to allow the Divestiture Trustee some flexibility in choosing the most appropriate time window in which to launch the transaction, in the interests of maximizing the price achieved for the shares.

Decision on divestiture period

79. We concluded that the divestiture must be completed within a period of [✂] months from the date of the final undertakings (or final order). If the Divestiture Trustee approaches the CC during the divestiture period with a reasoned argument as to why it believes that it will not be possible to divest all of the shares during this period (in a manner which preserves, as far as reasonably possible, an orderly market in Aer Lingus shares), the CC can consider at that point whether an extension to the deadline might be appropriate.

Summary of decisions regarding implementation of a divestiture remedy

80. In summary, we decided that:

(a) The divestiture may be implemented via an upfront buyer process to a single purchaser or via a stock market placement of the shares, or by another process identified by the Divestiture Trustee and agreed by the CC.

(b) A Divestiture Trustee should be appointed from the outset to sell the divestiture package to suitable purchasers.

(c) The Divestiture Trustee will review whether a purchaser satisfies the suitability criteria set out in this report, and will consult with the CC as appropriate.

(d) Ryanair may nominate parties to act as Divestiture Trustee for approval by the CC. The CC may appoint its own choice of Divestiture Trustee if Ryanair is unable to identify appropriate candidates. Ryanair is responsible for remuneration of the Divestiture Trustee.

(e) The divestiture period is [✂] months from the date of the final undertakings (or final order).

Further details of Divestiture Trustee appointment

1. In this annex, we set out the types of provisions regarding the appointment of the Divestiture Trustee that we would expect to see in any final undertakings or order.[19]

The Trustee Obligation

2. The Trustee Obligation means bringing about Effective Disposal at the best available price in the market [✂] and the performance of all ancillary tasks as are necessary or desirable for the purposes of Effective Disposal promptly and in any event within the Trustee Divestiture Period.

3. The Divestiture Trustee shall fulfil the Trustee Obligation and shall undertake such matters preparatory to giving effect to the Trustee Obligation or part thereof as the CC may specify in the written Direction.

Nomination and appointment

4. Ryanair would be required within a period of four working days from the date of the final undertakings (or final order) to submit to the CC for approval a list of two or more persons whom it proposes to appoint as Divestiture Trustee.

5. The proposal shall contain sufficient information for the CC to verify that each proposed person is independent of and unconnected to Ryanair and Aer Lingus and the Group of Interconnected Bodies Corporate to which either of them belongs, possess the qualifications necessary for the performance of the mandate and shall on appointment and thereafter be free of any conflict of interest including any conflict of interest that might arise by virtue of the terms of remuneration.

6. Ryanair shall also provide the full terms of the proposed mandate, which shall include all provisions necessary to enable the Divestiture Trustee to fulfil the Trustee Obligation and a schedule of the steps to be taken to give effect to the mandate.

7. The CC may approve or reject any or all of the proposed persons (such approval not to be unreasonably withheld) and may approve the proposed mandate subject to any modifications it deems necessary for the Divestiture Trustee to fulfil the Trustee Obligation. If only one proposed person is approved, Ryanair shall use its best endeavours to appoint, or cause to be appointed, the individual or institution concerned as Divestiture Trustee in accordance with the mandate approved by the CC. If more than one proposed person is approved, Ryanair shall be free to choose the Divestiture Trustee to be appointed from among the approved persons.

8. Ryanair would be required to appoint the Divestiture Trustee within two working days from the CC's Direction under paragraph 7 and on the terms of the mandate approved by the CC.

9. If all the proposed Divestiture Trustees are rejected by the CC, Ryanair shall submit the names of at least two further persons within five working days from being

[19] The actual terms in any final undertakings or order will, in line with usual practice, be subject to consultation.

informed of the rejection, in accordance with the requirements and the procedure set out above.

10. If Ryanair fails to submit for approval persons whom it proposes to appoint as Divestiture Trustee in accordance paragraph 4, or Ryanair fails to submit the names of further persons in accordance with paragraph 9; or those further persons whose names were submitted by Ryanair in accordance with paragraph 9 are rejected by the CC (acting reasonably); or Ryanair is unable for any reason to conclude the appointment of the Divestiture Trustee within the time limit specified by the CC, the CC shall give written Directions for the appointment of one or more persons to act as Divestiture Trustee after informing Ryanair at least one working day before the written Directions are issued of the name of the proposed Divestiture Trustee, and Ryanair shall appoint or cause to be appointed such Divestiture Trustee within two working days from the CC's Direction under the terms of a Divestiture Trustee mandate approved by the CC.

Functions of the Divestiture Trustee

11. The Divestiture Trustee shall fulfil the Trustee Obligation.

12. The Divestiture Trustee shall take such steps and measures it considers necessary to discharge the Trustee Obligation and to that end the Divestiture Trustee may give written directions to Ryanair and/or Aer Lingus, and Ryanair and Aer Lingus each undertakes to comply with such directions or to procure compliance with such directions as are within its powers and to take such steps within its competence as the Divestiture Trustee may reasonably specify.

13. Ryanair and Aer Lingus would each undertake to enable the Divestiture Trustee to carry out the Trustee Obligation.

14. Ryanair and Aer Lingus would each recognize and acknowledge that:

    (a) the CC may, on its own initiative or at the request of the Divestiture Trustee or Ryanair or Aer Lingus, give written Directions or instructions to the Divestiture Trustee in order to assist it in the discharge of the Trustee Obligation;

    (b) the Divestiture Trustee may include in such agreements, deeds, instruments of transfer and other instruments and documents as are necessary for the performance of the Trustee Obligation such terms and conditions as it considers appropriate; and

    (c) the Divestiture Trustee shall protect the legitimate financial interests of Ryanair and Aer Lingus subject to the Divestiture Trustee's overriding obligations to give effect to the Trustee Obligation.

15. Ryanair and Aer Lingus would each recognize and acknowledge that in the performance of the Trustee Obligation the Divestiture Trustee shall act solely on the instructions of the CC and shall not be bound by any instruction of Ryanair or Aer Lingus. Ryanair and Aer Lingus would each be required not to seek to create or vary the obligations and duties of the Divestiture Trustee except with the CC's prior written consent.

Duties and obligations of Ryanair and Aer Lingus with respect to Divestiture Trustee

16. Ryanair and Aer Lingus would each be required to provide the Divestiture Trustee with all such cooperation, assistance and information (including by the production of financial or other information whether or not such information is in existence at the time of the request, but excluding any material properly the subject of legal privilege) as the Divestiture Trustee may reasonably require in the discharge of the Trustee Obligation.

17. Ryanair and Aer Lingus would each recognize and acknowledge that the Divestiture Trustee shall be entitled, subject to the duty of confidentiality, to full and complete access to the books, records, documents, management or other personnel, facilities, sites and technical information necessary for the fulfilment of the Trustee Obligation (save where material is properly the subject of legal privilege) and Ryanair and Aer Lingus would each be required to provide the Divestiture Trustee upon request with copies of any such document. On the request of the Divestiture Trustee, Ryanair and Aer Lingus would each be required to make available to the Divestiture Trustee one or more offices on its premises, for meetings in order to provide the Divestiture Trustee with all information necessary for the performance of the Trustee Obligation.

18. Ryanair and Aer Lingus would each be required to grant reasonable comprehensive powers of attorney on terms approved by the CC, duly executed, to the Divestiture Trustee to enable it to discharge the Trustee Obligation including by the appointment of advisers to assist with the disposal process. Ryanair and Aer Lingus would each be required, upon the reasonable request of the Divestiture Trustee, to execute the documents required to give effect to the Trustee Obligation.

19. Ryanair and Aer Lingus would each be required to hold the Divestiture Trustee, its employees, agents or advisers harmless against any liabilities arising out of the proper performance of the Trustee Obligation and Ryanair and Aer Lingus each recognizes and acknowledges that the Divestiture Trustee, its employees, agents or advisers shall have no liability to Ryanair or Aer Lingus or any of their respective subsidiaries for any liabilities arising out of the proper performance of the Trustee Obligation, except to the extent that such liabilities result from the negligence or bad faith of the Divestiture Trustee, its employees, agents or advisers.

20. Ryanair and Aer Lingus would each undertake that at its expense the Divestiture Trustee may appoint advisers (in particular for corporate finance or legal advice) if the Divestiture Trustee considers the appointment of such advisers reasonably necessary or appropriate in the discharge of the Trustee Obligation, provided that any fees and other expenses incurred by the Divestiture Trustee are reasonably incurred. Should Ryanair or Aer Lingus refuse to approve the advisers proposed by the Divestiture Trustee, the CC may, after consulting with Ryanair and Aer Lingus, approve and direct the appointment of such advisers at the expense of Ryanair and Aer Lingus.

21. If Ryanair or Aer Lingus wished to make an objection to any disposal on the grounds of bad faith or failure of the Divestiture Trustee to protect the legitimate financial interests of Ryanair and/or Aer Lingus, subject to the Trustee Obligation, it should submit a Notice setting out its objections within seven working days from the day on which it became aware of the fact or facts giving rise to its objection.

Replacement, discharge and reappointment of Divestiture Trustee

22. Ryanair and Aer Lingus would each acknowledge that if the Divestiture Trustee ceased to perform the Trustee Obligation, or for any other good cause, including the exposure of the Divestiture Trustee to a conflict of interest, the CC may, after consulting the Divestiture Trustee, require Ryanair to replace the Divestiture Trustee.

23. If the Divestiture Trustee is removed, the Divestiture Trustee may be required to continue in its post until a new Divestiture Trustee is in place to whom the Divestiture Trustee has affected a full handover of all relevant information. The new Divestiture Trustee shall be appointed in accordance with the foregoing procedures.

24. Ryanair and Aer Lingus would each recognize and acknowledge that, other than in accordance with paragraph 22, the Divestiture Trustee shall cease to act as Divestiture Trustee only after the CC has discharged it from its duties at a time at which all the functions with which the Divestiture Trustee has been entrusted have been met.

Modelling Ryanair's ability to block a special resolution

Introduction

1. In this appendix, we set out a model relating the extent of Ryanair's shareholding to its ability to block a special resolution under different scenarios.

Overview and rationale for the model

2. A special resolution may be blocked with 25 per cent of the votes cast. Ryanair's ability to block a special resolution will therefore be affected by the size of its own shareholding as well as:

   (a) whether or not the Irish Government and the other shareholders in Aer Lingus participate in any such vote;

   (b) whether the Irish Government retains its stake; and

   (c) whether or not other shareholders vote with Ryanair on the resolution. We describe such shareholders as 'allies' of Ryanair.

3. The model identifies critical values of Ryanair's shareholding, above which it would be able to block a special resolution, depending on assumptions made about these other factors.

4. This critical value r may be calculated by reference to the following formula

$$\text{Effective voting power} = \frac{\text{Votes cast by Ryanair plus 'allies'}}{\text{Total votes cast}} = 0.25 \qquad (1)$$

5. To enable us to identify the implications of different assumptions about the factors set out in paragraph 2, and to reflect the different position of Ryanair, the Irish Government and other shareholders in Aer Lingus we define the following terms.

Definitions

	Description	*Value*
r	Proportion of shares held by Ryanair	Output of the model
S	Total number of shares in Aer Lingus	534,040,090
R	Number of shares held by Ryanair	Equals r×S
G	Number of shares held by Irish Government	Currently 134,109,026
O	Number of shares held by 'others'	Equals S-R-G
t	Turnout of 'others'	Assumption needed for model
A	Number of other shareholders voting with Ryanair	Assumption needed for model

6. The application of equation (1) differs depending on whether the Irish Government votes in support of any special resolution or abstains. We consider each of these cases in turn.

Irish Government votes in support of a special resolution

7. We look first at scenarios in which the Irish Government votes its shares in support of any special resolution. The model acknowledges the possibility that not all other shareholders may vote, and that some may vote with Ryanair against the special resolution. As the total number of shares in Aer Lingus is fixed, we assume that any

reduction in Ryanair's or the Irish Government's current shareholding results in an increase in the number of shares held by other shareholders.

8. Under this scenario, equation (1) becomes

$$\text{Effective voting power} = \frac{R + A}{R + G + tO} = 0.25 \qquad (2)$$

9. Substituting for the definitions of R and O in Table 1, this becomes:

$$\text{Effective voting power} = \frac{rS + A}{rS + G + t(S - rS - G)} = 0.25 \qquad (3)$$

10. Rearranging and solving for the critical value r gives:

$$\text{Critical value of shareholding} = r = \frac{tS + G(1-t) - 4A}{S(3+t)} \qquad (4)$$

11. As would be expected, the critical value of Ryanair's shareholding (r) decreases with the number of allies (A) and increases with the level of turnout of other voters. Equation (4) may be used to consider scenarios in which Ryanair is the only shareholder to vote against a special resolution (A = 0) and in which the Irish Government sells its stake (G = 0).

Irish Government abstains on special resolution

12. If the Irish Government abstains on a special resolution, this reduces the total number of votes cast, as only Ryanair and a proportion of 'other' shareholders will vote. Under this scenario, equation (1) becomes:

$$\text{Effective voting power} = \frac{R + A}{R + tO} = 0.25 \qquad (5)$$

13. This results in the following critical value for the shareholding, r

$$\text{Critical value of shareholding} = r = \frac{tS - tG - 4A}{S(3+t)} \qquad (6)$$

14. This is lower than the critical value when the Irish Government votes in support of the special resolution in equation (4), as Ryanair's shareholding will represent a larger proportion of total votes cast.

Glossary

ACL	Airport Coordination Limited.
Act	The Enterprise Act 2002.
Aer Arann	Operates flights between the Republic of Ireland and the UK as Aer Lingus Regional, under a franchise agreement with **Aer Lingus**.
Aer Lingus	Aer Lingus Group plc.
CAA	Civil Aviation Authority.
CC	Competition Commission.
DAA	Dublin Airport Authority.
EC	European Community.
ESOT	The Employee Share Ownership Trust of **Aer Lingus**.
EU	European Union.
The Guidelines	CC and OFT *Merger Assessment Guidelines, CC2 (revised),* September 2012.
IAG	International Airlines Group SA.
IPO	Initial Public Offering.
Ireland	The island of Ireland, including both the Republic of Ireland and Northern Ireland.
M&A	Mergers and acquisitions.
OFT	Office of Fair Trading.
Ryanair	Ryanair Holdings plc.
SLC	Substantial lessening of competition.
Slot	The time of arrival or departure allocated to an airline.