

Completed acquisition by Air France finance S.A.S / City Jet Ltd of VLM Airlines N.V.

ME/3535/08

The OFT's decision on reference under section 33(1) given on 9 May 2008. Full text of decision published 10 June 2008.

PARTIES

1. **Air France KLM S.A. (AFKL)** is active principally in air transportation (passengers and freight) but also in ground services (for example, passenger handling). AFKL owns over 92 per cent of the economic rights in **KLM Royal Dutch Airlines (KLM)**, a Dutch registered international carrier operating scheduled cargo and passenger services to more than 90 destinations principally from Amsterdam. AFKL is a founding member of the SkyTeam Alliance and has two international hubs at Amsterdam Schiphol and Paris CDG airports. AFKL's vehicles for this acquisition are its wholly-owned subsidiaries, **Air France Finance S.A.S.**, and the latter's subsidiary, **City Jet Ltd (City Jet)**, a regional European airline serving ten of its current seventeen routes from its hub at London City Airport.
2. **VLM Airlines N.V. (VLM)** is a Belgian-registered regional airline. VLM is active in the supply of scheduled short-haul point-to-point passenger air transport services, primarily focused on business customers. For the IATA summer 2008 season, VLM operates eight routes on a reverse-hub basis at London City Airport, with most of its aircraft and personnel based in The Netherlands and in Belgium.

TRANSACTION

3. The transaction comprises the acquisition by Air France Finance S.A.S. ([...]) of the entire issued share capital of VLM together with [...] Fokker 50 aircraft for €[...].

4. The transaction was completed on 14 February 2008. The OFT's statutory deadline in the present case is therefore 14 June 2008. The parties submitted an informal merger notification on 22 February 2008. The OFT's extended administrative deadline expires on 9 May 2008.

JURISDICTION

5. As a result of this transaction, AFKL and VLM have ceased to be distinct. In the year ended 31 December 2006 (last financial year for which audited financial information is available), VLM generated a UK turnover of £[...], which, accordingly, does not satisfy the turnover threshold set out in Section 23(1)(b) of the Enterprise Act (the Act).
6. However, the transaction qualifies as a relevant merger situation on the share of supply test set out in Section 23(4) of the Act as the parties' combined share of supply in the UK for scheduled air transport services between Amsterdam and LCY (in which both parties are active) exceeds the 25 per cent threshold.
7. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

MARKET DEFINITION

8. As will be detailed below, the focus of this transaction are routes between various London airports and Dutch airports, as follows:

London City (LCY)	Amsterdam Schiphol (AMS)
London Heathrow (LHR)	Rotterdam (RTM)
London Gatwick (LGW)	
London Stansted (STN)	
London Luton (LTN)	
All London airports (LON)	

9. The parties overlap in the provision of direct business and leisure passenger air transport services on LON—AMS and LON—RTM.

10. For passenger air transport services, definition of the relevant product and geographic markets is inextricably linked. Past decisional practice¹ has considered the relevant starting point for market definition of scheduled passenger air transport services to be origin and destination (O&D) pairs (that is, city-to-city pairs).
11. In line with recent OFT, Competition Commission (CC) and European Commission (EC) decisions, the OFT considers below whether it is appropriate to narrow or widen the market definition from the starting point of a particular O&D pair (that is, LON—AMS and LON—RTM).
12. In this respect, the OFT considers the following distinctions in relation to LON—AMS and LON—RTM: (i) direct and indirect services (ii) scheduled and charter services, (iii) business and leisure passengers and (iv) LCY versus other London airports.

Direct vs. indirect flights

13. In the light of previous OFT² and EC³ decisions and in accordance with third party responses, the OFT takes a cautious view and excludes indirect flights from the present analysis. The OFT has received no evidence that suggests that it should deviate in this case from the approach taken in previous cases.

Scheduled vs. charter flights

14. In accordance with EC and CC reasoning in previous cases,⁴ the parties submit that charter passenger air transport services are a separate relevant market from scheduled passenger air transport services. The OFT has not received any evidence in the course of the present case to depart from

¹ Competition Commission: British Airways plc and Cityflyer Express Limited: *A report on the proposed merger* (July 1999); ME/2795/06: Anticipated acquisition by Flybe Group Limited of the BA Connect business of British Airways plc (OFT decision of 20 June 2007); ME/3399/07 Anticipated acquisition by easyJet Airline Company Limited of GB Airways Limited (OFT decision of 24 January 2008); Case COMP/M.3280 Air France/KLM (11 February 2004).

² ME/2795/06: Anticipated acquisition by Flybe Group Limited of the BA Connect business of British Airways plc (OFT decision of 20 June 2007); ME/3399/07 Anticipated acquisition by easyJet Airline Company Limited of GB Airways Limited (OFT decision of 24 January 2008).

³ Case COMP/M4439 Ryanair/Aer Lingus (27 June 2007); Case COMP/M.3280 Air France/KLM (11 February 2004).

previous decisional practice of treating charter and scheduled passenger air transport services separately. Given the parties' minimal overlap in the supply of charter passenger air transport services, this type of service is not considered further.

Business vs. leisure passengers

15. In line with previous decisional practice,⁵ the parties submit that business and leisure passenger air transport services form two separate markets (business passengers being defined as time-sensitive passengers travelling on flexible economy or business class tickets, and leisure passengers being defined as non-time sensitive passengers travelling on non-flexible economy tickets).⁶ The OFT notes that four large business customers ([...]) contacted in the context of the present analysis suggest that they do not see business and leisure passenger air transport services as being substitutable.
16. In this regard, the parties further submit that the overlap routes predominantly serve business passengers. In support of this, they refer to a recently-conducted survey of VLM passengers (the VLM survey)⁷ stating that [70-80] per cent of VLM passengers flying between LCY and AMS, and [80-90] per cent flying between LCY and RTM, are business passengers.
17. For present purposes, the OFT therefore assesses the transaction separately for both business and leisure air passenger transport services.

O&D pairs at LCY vs. other London airports

18. The parties submit that the correct approach in the present case is to decide on a route-by-route basis whether services flown from LCY and the other London airports (LHR, LGW, STN and LTN) are substitutable, and not to consider whether, over all routes, services from LCY compete with those from other London airports. In this context, the parties further submit that in

⁴ Respectively Case COMP/M.2008 – AOM/Air Liberte/Air Littoral (27 July 2000) and Competition Commission: British Airways plc and CityFlyer Express Limited: *A report on the proposed merger* (July 1999).

⁵ Competition Commission: British Airways plc and CityFlyer Express Limited: *A report on the proposed merger* (July 1999); Case COMP/M.3280 Air France/KLM (11 February 2004).

⁶ Flexible economy and business class tickets are those that allow passengers to 'turn up and go' on any flight that day (sometimes for a fee), whereas non-flexible economy tickets restrict passengers to travelling on specified flights.

⁷ VLM commissioned a survey from a market research organisation called d-sense that surveyed 1,088 customers on VLM's (then) 11 routes between 23 January 2007 and 10 April 2007.

line with previous decisional practice on airport substitutability and according to the VLM survey evidence, the relevant market in terms of business passenger services is limited to LCY—AMS, whereas the relevant market in terms of leisure passenger services covers all London airports.

Previous decisional practice

19. In *Flybe/BA Connect*,⁸ the OFT stated that the extent to which flights from neighbouring airports may impose a competitive constraint on services between airport pairs will depend on a number of factors including the extent to which the catchments of potentially competing airports overlap and the sensitivity of passengers to time travelled to and from the airport. On this occasion, the OFT noted that certain flights (early morning, late afternoon and evening flights) are likely to be predominantly used by business passengers and are therefore likely to be priced accordingly. It was found that, while business passengers may have become more sensitive to price, there was no evidence to suggest that journey time or frequency had become significantly less important to business passengers such that they would be likely to either travel to neighbouring airports or fly with airlines operating a less convenient schedule. Thus, the OFT formed the view that business travellers are less likely than leisure passengers to travel to neighbouring airports.
20. In *easyJet/GB Airways*⁹ the OFT reiterated that the extent to which passenger air transport services from neighbouring airports (albeit predominantly leisure passenger air transport services) may impose a competitive constraint on each other depended upon factors such as catchment area overlap and the time sensitivity of passengers.
21. In its 1999 report on the *British Airways plc and Cityflyer Express Limited*¹⁰ merger, the CC assessed the relevant market for London airports. While adopting an initial O&D approach, the CC distinguished three main market segments: the service for point-to-point leisure passengers, the service for point-to-point business passengers and the service for connecting passengers. With regard to point-to-point leisure passengers, the CC

⁸ ME/2795/06: Anticipated acquisition by Flybe Group Limited of the BA Connect business of British Airways plc (OFT decision of 20 June 2007).

⁹ ME/3399/07 Anticipated acquisition by easyJet Airline Company Limited of GB Airways Limited (OFT decision of 24 January 2008).

¹⁰ Competition Commission: *British Airways plc and CityFlyer Express Limited: A report on the proposed merger* (July 1999); Case COMP/M.3280 Air France/KLM (11 February 2004).

declared itself satisfied that services to a single destination from any or all of the London airports were operating in the same market. For point-to-point business passengers, it took the view that LCY was well placed to offer an alternative to LHR or LGW for business travellers starting their journey in central London. The CC took into account the following factors when assessing demand side substitutability between London airports for business passengers: (i) high frequencies and service standards, (ii) early morning departure and late evening return for short haul services, (iii) minimal travel time and (iv) the quality of rail and road links.

22. In *Ryanair/Aer Lingus*¹¹ the EC focussed its analysis on leisure/non-time sensitive passengers flying to and from Dublin, and concluded that scheduled point-to-point passenger air transport services between Dublin and LHR, LGW, LTN and LCY belonged in the same market.

The OFT's approach

23. Below, the OFT considers whether LCY and other London airports are substitutable for direct, scheduled business and leisure passenger air transport services to AMS and RTM from both demand- and supply-side perspectives.

Demand side substitution

Business passengers

24. The OFT has regard to the previous decisional practice presented above, and also considers the following set of evidence gathered in the course of the investigation in relation to (i) the type of passengers travelling via LCY, (ii) their sensitivity to time travelled, (iii) catchment areas in London, AMS and RTM. The OFT also takes into account (iv) the model relied upon by British Airways (BA) to measure the impact of its newly launched LCY—AMS service on its currently operated LHR—AMS service and finally, (v) other third party comments relating to the present transaction.

(i) Type of passengers travelling via LCY airport

25. The OFT notes that LCY was designed to cater primarily for business passengers travelling from and to London's financial districts, Canary Wharf and the City. In that respect, figures from the Civil Aviation Authority (CAA)

¹¹ Case No. COMP/M.4439 27 June 2007.

indicate that the percentage of time-sensitive business passengers using LCY is significantly higher—around 64 per cent of all passengers using LCY—than it is at other London airports. Furthermore, these figures show that all other London airports cater for more leisure than business passengers. However, as recognised by the parties in absolute terms, significant numbers of business passengers also fly to and from LHR.

26. The survey evidence provided by the parties corroborates the proposition that a majority of passengers flying via LCY are time-sensitive business passengers: in a sample of more than 1,000 VLM passengers, when asked the purpose of their flight with VLM, [80-90] per cent overall stated that they were flying on business and in particular [70-80] per cent on LCY—AMS and [80-90] per cent on LCY—RTM.

(ii) Passengers' sensitivity to time travelled

27. The parties submit that business passengers are more time sensitive and therefore will prefer a service that enables them to reach their destination more quickly even if that service is more expensive. In this regard, the parties provide shortest total travel times from central London to AMS and RTM airports for services via each of the five London airports, which show that:¹²

- the overall travel time taken to fly through LCY to AMS compared with the overall travel times taken to fly from other London airports to AMS is 54 to 60 minutes shorter, and
- the overall travel time taken to fly through LCY to RTM compared with the overall travel times taken to fly from other London airports to RTM is 76 to 80 minutes shorter.

28. The OFT finds that the high proportion of business passengers characterising LCY's customer base combined with the relatively short travel time taken to fly from LCY to AMS or RTM appears consistent with the proposition that a significant number of time sensitive business passengers located in or close to central London, when offered similar schedules, would be likely to choose the LCY—AMS or LCY—RTM service in preference to a service flown from another London airport.

¹² Travel time includes average flight time plus average check-in and security clearance time plus the shorter of the average journey time to central London by car or taxi and the minimum journey time to central London by public transport.

(iii) Catchment areas in London, Amsterdam and Rotterdam

29. The parties submit that the catchment areas for business passengers in the present case are smaller than the 100 km radius used by the CC and the EC in their decisional practice. In this respect, the VLM survey data establishes that:
- for passengers beginning their journey in London: [80-90] per cent begin their journey within 50 km of LCY, and [50-60] per cent travel less than 20 km to reach LCY
 - for passengers beginning their journey at AMS, [80-90] per cent travel less than 50 km, and
 - for passengers beginning their journey at RTM, [80-90] per cent travel less than 50 km.
30. The parties acknowledge that business passengers travelling out from and back to London within the same day would be likely to prefer to start their outward journey from home in the morning, rather than from their work place in the City or central London. However, the VLM survey evidence reveals that only [20-30] per cent of respondents returned the same evening to LCY whereas the rest, approximately [...] of VLM passengers, spent at least one night away from home on business. The parties submit that, accordingly, it is likely that a number of these passengers start and end their business journey from their work place in the City or central London.
31. In light of the above, the OFT acknowledges that the survey data presented above suggest a narrow approach to airport catchment areas in London, Amsterdam and Rotterdam, when considering business passengers.
32. However, the OFT also takes into consideration the CC study on '*catchment areas of BAA and other main airports in Scotland and South-east England*'¹³, which suggests that LCY's and LHR's catchments areas overlap to a certain extent. In particular, the most important London borough catchments for LCY are the City of London (with 15 per cent of passengers originating there), Westminster (13 per cent) and Tower Hamlets (11 per cent), and the most important London borough catchments for LHR are Westminster (11 per cent) and Kensington and Chelsea (6 per cent). Therefore the catchments of LCY and LHR overlap in the London borough of Westminster,

which suggests that LCY and LHR compete with each other to a certain extent. A third party response to OFT questions confirms this.

(iv) BA's cannibalisation model

33. Anticipating the likely impact of the new LCY—AMS services based on the number of LHR—AMS bookings, BA indicates to the OFT that it expected its LCY—AMS service to gain 40 per cent of its passengers from its LHR—AMS service. BA also indicates that its two current LON—AMS routes (that is, LHR—AMS and LGW—AMS) compete with the parties' LCY—AMS services. In this respect, the OFT believes that LCY does place some constraint on LHR.

(v) Other third party comments

34. Four other airlines' responses to OFT questions indicate that they view LCY as a business airport. Out of four large customers (accounting for [...] of AFKL's business on LCY—AMS and [...] of VLM's) who responded to the OFT's questionnaire, three do not think that flights to AMS and RTM from London airports other than LCY imposed a constraint on LCY—AMS or LCY—RTM.
35. Other evidence from customers is somewhat mixed, with some saying that—although they may be forced to accept a 10 per cent price increase by the merged entity—they would also try to switch some business to other London airports. Finally, in response to the OFT's questionnaire, LCY indicates that it sees all London airports and in particular LHR as competing with LCY.
36. In light of the above, the OFT acknowledges that LHR certainly is LCY's closest competitor and in that respect does allow for some competitive constraint to be placed on routes served out of LCY.

Leisure passengers

37. The parties submit that leisure passengers are more readily prepared to travel to an airport for a flight so that the relevant market in relation to leisure air transport services to AMS and RTM includes all London airports.

¹³ See Appendix D of CC's emerging thinking report on BAA Airports (published on 22 April 2008).

38. Given that LCY—AMS and LCY—RTM are predominantly business routes, information and evidence provided to the OFT on leisure passengers are lacking. However, a third party focussing predominantly on leisure passengers indicates to the OFT that alternative routes (from other London airports) would be viewed by passengers as substitutes for LCY—AMS and LCY—RTM to the extent that routes to the same destination are available. In addition, OFT econometric analysis of data provided by the same third party shows that the third party's average monthly yields on its routes to AMS from one London airport are statistically significantly affected by its yields and load factors at the other London airports, consistent with all London airports being in the same relevant market.
39. Finally, the OFT has not received any evidence to depart from its previous decisional practice of treating the market for air transport services to leisure passengers as London-wide.

Supply side substitution

40. The OFT considers below the ability of airlines not operating on routes from LCY to AMS and RTM, to use existing slot [Endnote 1] holdings and aircrafts to switch from one route to another when prices on a route rise (slot flexing).
41. The parties submit that BA, bmi, and easyJet could flex their existing capacity at London airports, although technical barriers would limit the extent of such a practice (specifically, the short runway at LCY means only turboprop or small jets with specially trained pilots can use the airport).¹⁴
42. On this point, the OFT has received a mixed set of responses from third party airlines present at LCY: two airlines consider it easy to enter/expand on LCY—AMS and LCY—RTM by re-deploying slots at LCY. Another airline says that re-deploying slots to be used across different routes is relatively easy but that its aircraft cannot operate from LCY. Another airline comments that re-deploying slots at LCY is difficult and re-deploying them at other London airports essentially is impossible.
43. In terms of examples of supply-side substitution through slot flexing, the OFT notes that Air France stopped flying LGW—Strasbourg and started flying LCY—Strasbourg. In the same vein, Airport Coordination Ltd (ACL)

¹⁴ This presumably presupposes that they can obtain slots at LCY.

confirms that airlines occasionally use this flexibility to optimise their use of slots.

44. However, for supply-side substitution to broaden the relevant market in response to a change in relative yields between two routes, it would need to be (near-) instantaneous and (near-) costless. Overall, the OFT has not seen evidence showing that slots at LCY or at all London airports could be used in such a way to provide passenger air transport services to and from different destinations in order to arbitrage profitable differences in yields. On the contrary, the OFT notes that slot flexing for an airline appears to require a minimum time period of six months (to plan the route at the relevant bi-annual IATA slot conference), and involves major opportunity costs given the current scarcity of slots at London airports (in particular at LHR and LCY during peak times). In conclusion, although slot flexing seems plausible, the OFT does not believe that very short-term slot flexing responses may be feasible enough or profitable enough to affect competition in a manner consistent with interpreting slot flexing as supply side substitution.
45. It follows that supply side substitution in the form of slot flexing may not be considered in the present case as widening the relevant market to include all London airports. However, the OFT notes that slot flexing—as considered later in the decision—may be characterised as expansion by existing players.

Conclusion on LCY vs. other London airports

46. The OFT considers that for **business** passenger air transport services operated between LCY and respectively AMS and RTM, there is some evidence to support the view that the relevant market may extend more widely than LCY, in respect of which the OFT considers that LHR is LCY's closest competitor. However, the best view of the evidence available at this stage is to consider that, for the purposes of the AMS route, LCY—AMS is a separate O&D-pair market.
47. In any event, unilateral effects concerns arise on the AMS route even on the basis of a market comprising both LCY and LHR as points of origin. The duty to refer in this case is therefore insensitive to the other most plausible candidate market considered.

48. The OFT is of the view that **leisure** passenger air transport services operated between LCY and AMS and RTM respectively form part of wider market which embraces all London airports.

Conclusion on market definition

49. On the basis of the above, the OFT's analysis focuses on: (i) direct, scheduled leisure passenger air transport services on LON—AMS; (ii) direct, scheduled business passenger air transport services on LCY—AMS; (iii) direct, scheduled leisure passenger air transport services on LON—RTM; and (iv) direct, scheduled business passenger air transport services on LCY—RTM.

HORIZONTAL ISSUES

50. VLM operates to RTM from LCY, whereas AFKL operates to RTM from LHR and STN. Accordingly, the transaction does not result in any horizontal overlaps for direct, scheduled business passenger air transport services to RTM. Overlaps for the other three relevant markets are considered below, as well as the issue of potential competition on the non-overlap LCY—RTM (business) route.
51. For the three relevant overlap markets (i, ii and iii above), the parties provide market share figures on the basis of bookings data from MIDT (Marketing Information Data Transfer). These data have three advantages: firstly, they report bookings on specific O&D pairs carrier-by-carrier; secondly, they capture and make a distinction between passengers on the O&D pair and passengers travelling from and to other destinations (that is, connecting passengers); and thirdly, MIDT bookings data can identify passengers with business class or fully flexible economy tickets in contrast to those travelling with a less flexible economy ticket (assumed to be leisure/non-time sensitive passengers). Notwithstanding this, the parties identify two limitations of MIDT bookings data: firstly, these data record bookings, not the number of passengers actually flying (passenger numbers are, however, available from other sources); and, secondly, MIDT data does not record the bookings of several low cost airlines (although the parties have imputed low cost airlines' shares of bookings on the basis of their shares of passengers and estimates of their split between leisure and business passengers). The OFT acknowledges that, although MIDT data are less reliable where low cost airlines operate on a route, they have the particular merit in this case of

showing the balance between time sensitive (business) and non-time sensitive (leisure) passengers.

LON—AMS (leisure)

52. LON—AMS is currently served by five airlines of which: two are traditional network carriers (AFKL and BA); one (bmi) is a network carrier that has reconfigured its operations over the last few years to include a low cost subsidiary (bmi Baby); another (VLM) is a regional airline; and one is a low cost or no-frills airline (easyJet). In that context, the parties estimate their combined shares of supply for leisure passengers on LON—AMS to be just [20-30] per cent with a [0-10] per cent increment.
53. The OFT considers that the merged entity faces sufficient competitive constraints post merger given the number of alternative airlines serving LON-AMS (leisure) for the transaction not to give rise for concerns over unilateral effects on this route.

LCY—AMS (business)

The merger reduces the number of competitors from 3 to 2

54. When the merger completed in February 2008, it effectively created an AFKL monopoly for business travel on the LCY—AMS route - with a post-merger share of [90-100] per cent (increment [30-40] per cent) based on MIDT bookings data. Clearly, on this *prima facie* basis, the merger combines closest competitors and raises very serious unilateral effects concerns. (The merger also raises *prima facie* concerns over unilateral effects on the basis of a wider LHR/LCY—AMS market, where the post-merger share is [50-60] per cent with an increment of [0-10] per cent, on the basis of MIDT bookings.)
55. However, the pre-merger counterfactual should be adjusted to take account of imminent entry, in May 2008, by BA. BA's decision to enter LCY—AMS was made public in November 2007 and would have involved some pre-planning (for example, IATA slot conference). The merger was not announced until 24 December 2007. On the basis of the evidence available,

the OFT considers that BA is a new entrant on the route going forward, and did so independently of—rather than in response to—the merger.¹⁵

56. By including BA as a competitor, the merger might therefore best be viewed as reducing the number of competing airlines on LCY—AMS from 3 to 2, rather than from 2 to 1. The parties relied on the fact of the new BA service to argue that BA will provide sufficient competitive constraint on AFKL post-transaction, mitigating the possibility of unilateral effects post-merger.
57. Nevertheless, all else equal, and assuming significant entry barriers, a merger reducing the number of competitors from 3 to 2, rather than 2 to 1, still raises very serious *prima facie* unilateral effects concerns because of the assumption that the merger between any two of only three rivals combines *close* competitors, if not the *closest* competitors. Elimination of close competition in a differentiated market ordinarily suggests a *prima facie* post-merger incentive to raise price or reduce service.¹⁶
58. The table below gives an indication of the relative position of each of VLM, KLM and BA based on the latter's entry schedule and aircraft employed, and each merging party's pre-merger position, shown combined on a pro forma basis (see further, efficiencies, below).

LCY to AMS	VLM	KLM	BA	KLM + VLM pre merger	Total
Weekly frequencies	68	40	21	108	129
Seats per frequency	48*	48*	85-102†	-	-
Weekly capacity (seats)	3,264	1,920	1,955	5,184	7,139
Share of weekly frequencies	52.7	31.0	16.3	83.7	100
Share of weekly capacity	45.7	26.9	27.4	72.6	100

Source: airlines' websites. *Notes:* *Fokker 50 †Avro RJ85, RJ100

59. It is apparent that while BA on these data matches — and indeed, slight exceeds — KLM's pre-merger weekly capacity, BA has only around 50 per

¹⁵ Had BA's entry been in response to the merger, this would not have changed the analysis below, *ie.* the merger would still have raised unilateral concerns at peak periods on the LCY-AMS route.

¹⁶ In other words, by combining the first and second choices for a substantial proportion of customers, this suggests high diversion ratios between the merging firms, which means that the merged firm would retain (recoup) enough of the passengers that it would have lost—in response to a pre-merger price increase or frequency reduction—to make such action profitable post-merger. This would hold true even if some passengers did switch to the remaining rival, who may also have the incentive to raise price.

cent of KLM's weekly frequencies. Even allowing for BA, therefore, the merger raises unilateral effects concerns because the merged entity will account for over 70 per cent of frequencies and capacity, with a substantial (around 25-30 per cent) increment. (A similar story emerges considering a wider LCY/LHR—AMS market where post-merger and after BA's entry the parties will account for 44 per cent of capacity, with an increment of 10 per cent, and 57 per cent of frequencies, with an increment of 22 per cent.)

The parties remain the only two serious alternatives for peak-time business travel

60. Notwithstanding the 3 to 2 characterisation given entry by BA, this appears substantially to *understate* the closeness of competition lost between the merging parties, seen through the lens of peak time travel (that is, between 06:00 and 10:00, and 16:00 and 20:00 according to ACL).
61. The opportunity to fly at peak times—indeed, to have the flexibility to chose from more than one flight at peak (for example, to arrive at the airport with a flexible ticket to catch the next flight, perhaps as a result of wishing to travel earlier or later than intended)—would appear to be a factor material, if not decisive, for much business travel by air, and the OFT has no reason to consider business travel on LCY—AMS as an exception.
62. The peak time schedules of each of the three competitors is as follows:
 - VLM – ten daily weekday services at peak times, comprising five departures between 07:45 and 09:45 and five departures between 16:40 and 20:00.
 - KLM—seven daily weekday services at peak times, comprising three departures between 07:45 and 09:25, and four departures between 16:55 and 19:45.
 - BA—two daily weekday services at peak times, comprising a single departure towards the end of morning and a single departure towards the end of evening peak (at 08:55 and 18:55), respectively.
63. As is apparent, BA's marginal peak-time presence suggests that it can at best be a very modest competitive constraint on VLM and KLM's pre-merger pricing at peak times, and therefore on AFKL post-merger. Its relative competitive insignificance for peak-time travel is reinforced by customer views. The responses of corporate customers contacted in the course of the investigation indicate they do not attribute much weight to

BA's entry on LCY—AMS. One customer expressly reports that BA's first service at 08:55 will not be sufficient to satisfy its demand for early morning departures and flexibility.

64. The merger is therefore best understood as eliminating closest competitors for peak-time travel and creating a near-monopoly at these times on the LCY—AMS route.

Peak-time slot constraints seriously limit BA's expansion and third-party entry

65. The first relevant question on countervailing constraints, therefore, is whether BA could replace the close competition between KLM and VLM by expanding its offer and increase its presence at peak times to replicate the seven daily schedules that KLM offered pre-merger (representing the increment in measures of concentration).
66. Although LCY, unlike for example LHR, is not a fully slot-coordinated airport (level 3) but rather is a schedule-facilitated airport (level two) in terms of its overall capacity (slot) utilisation across all times of the day/week, ACL told the OFT that the airport operates at full capacity at peak times, that is, between 06:00 and 10:00 and between 16:00 and 20:00, meaning that slots are no longer available at LCY at those times.
67. This entry barrier suggests that BA cannot credibly challenge AFKL's near-monopoly in peak times, **by acquiring additional slots for an expanded peak time schedule. Assuming therefore that BA retains the same overall number of peak slots at LCY, it is unlikely to be able to challenge AFKL** unless it were to slot-flex and sacrifice a significant number of slots it currently deploys to serve existing destinations from LCY other than AMS, such as Barcelona, Edinburgh, Frankfurt, Glasgow, Nice, Warsaw and Zurich.
68. However, the opportunity cost of slot-flexing would appear to be prohibitively high, explaining why BA chose to enter AMS with relatively small scale at peak times (one service in the late morning and one service in the evening)¹⁷ and use a greater number of peak-time slots to serve other important business destinations. At present, the OFT has no evidence that BA would forego any flights to other destinations in favour of increasing its peak presence to AMS in response to a post-merger price increase or

¹⁷ BA operates four services a day on LCY-AMS. Only two of these services are flown at peak times.

frequency reduction, let alone to the degree required to replicate the competitive constraint (seven peak daily services) that KLM imposed on VLM.

69. Third party airlines' responses to OFT questions reinforce the information received from ACL, suggesting that obtaining new slots at LCY is difficult due to capacity constraints. One third party indicates that slot availability is the key issue for airlines wanting to enter LCY—AMS and LCY—RTM and that successful routes for business passengers generally involve high frequency, so that the minimum scale of entry to compete on a business-orientated route is high.
70. Accordingly, neither slot-flexing nor expansion by BA, nor entry by another third party airline, can be expected to be timely, likely and on a sufficient scale to replicate the competition lost between the merging parties. This conclusion stands even if the market were to be considered to comprise LCY and LHR, as the latter is the most congested of London airports, and is no less slot-constrained at peak periods than is LCY.

Existing BA and bmi services at LHR are insufficient to resolve concerns

71. While the OFT considers that services by BA and bmi from LHR—AMS are likely to impose a certain degree of competitive constraint on AFKL post-merger, the OFT has insufficient evidence to conclude that this, even in conjunction with other constraints, would be sufficient to challenge AFKL's near-monopoly at peak times from LCY and so to discipline AFKL's pricing and frequency plans on LCY—AMS post-merger. Indeed, although the OFT does not need to decide on this issue, the better view may be that constraints on business services between LCY and a destination such as AMS are asymmetric, in the sense that flights from LCY constrain flights from LHR without the reverse necessarily being true, or true to the same degree.

Buyer power is insufficient to discipline the merged firm

72. The parties indicate that a small number of large customers (the OFT understands three) account for [...] per cent of the parties' revenues on LCY—AMS and that these customers usually trade airlines off against each other, exercising a degree of buyer power, along with travel agents.

73. However, AFKL's near monopoly at peak times, insulated by the strength of the entry barriers posed by slot constraints, suggests limited prospects that buyer power by corporate customers, even in the form of annual corporate deals, would discipline the merged firm. Buyer power could not be wielded in the form of sponsoring peak-time entry onto the route, nor is self-supply an issue here. Rather, the mechanism would have to be one of leveraging multi-market buyer power across several routes which the customer used and which were more competitive than the LCY—AMS route post-merger.
74. In this regard, two corporate customers indicate to the OFT that they would be able to resist a 10 per cent price increase or equivalent worsening in non-price factors by the parties on LCY—AMS and LCY—RTM on account of the volume of air travel business they do with the parties on these and other routes. Conversely, two other customers say they could not resist such a price increase (but would switch some or all of their business elsewhere). One of these customers also tells the OFT, that until AFKL began operating on LCY—AMS, VLM was the only operator on two of its key routes (LCY—AMS and LCY—RTM) [Endnote 2]. It is reported that whilst VLM gave some discounts, they were not in line with the customer's expectations for a competitive route given the volume of its business with VLM.
75. Additionally, based on information provided by the parties and on customer responses to an OFT questionnaire, it appears that the parties' largest customers on LCY—AMS rely on the parties at least as much as the parties rely on them on other routes. That is, based on a comparison between (i) large corporate customers' share of the parties' revenue on LCY—AMS and (ii) the parties' share of these large customers' global travel expenditure, the parties' reliance on their large corporate customers on LCY—AMS seems proportionate to their large corporate customers' reliance on them elsewhere. Consequently, the basis of any power on the part of large customers is not clear—their threat not to use the parties on LCY—AMS seems no more credible than the parties' threat to increase fares on customers' other routes, given their apparent equi-proportional reliance on each other.
76. Overall, the OFT is not satisfied that the parties' main customers have buyer power to the extent that unilateral effect concerns could be mitigated. Further, four large customers indicate that they bi-laterally negotiate fares with the parties following periodic competitive tenders (annual or bi-annual).

Therefore, it is not clear to the OFT how, to the extent that large customers were to have any buyer power, it would protect smaller-volume customers, given such bi-laterally negotiated fares would not constitute a publicly available fare tariff from which smaller-volume customers could equally benefit.

77. Accordingly, buyer power alone and in conjunction with other countervailing constraints, does not resolve the OFT's unilateral effects concerns.

AFKL's efficiency claims do not resolve the OFT's concerns

78. AFKL submits that the transaction is likely to bring about material benefits to UK passengers: while AFKL does plan to rationalise frequencies on LCY—AMS to [...] per day, thus [...], it will however use larger aircraft (that is, [...]), such that overall capacity on the route (even during the peak time windows) is not necessarily affected. The parties further submit that AFKL expects to use the slots at LCY that are freed up by such rationalisation to enter new routes, though substantiated details of these were not given.

79. The OFT notes that on the most favourable basis claimed, the parties plan to operate no more than [...] daily frequencies between LCY and AMS. The OFT estimates that the parties therefore plan to operate at most [...] seats daily on LCY—AMS, whereas they currently operate [...] seats daily on this route. These plans therefore qualify not only as a reduction in pre-merger daily weekday frequencies from 19 to at most [...], but also at least a capacity reduction of [...] seats per day, on the most favourable estimate of the parties. These figures reinforce the OFT's concerns that the merger will give AFKL the incentive to reduce frequency and restrict capacity as a result of the merger. A contraction in capacity will very likely result in higher ticket prices due to the yield management systems employed in the airline sector, which automatically adjust prices upward as seats on a given flight become more scarce. Even for flexible tickets that do not apply to particular flights, AFKL can be expected to have the incentive to raise price because the merger combines, as noted, the only two providers with a substantial presence at peak times on this route.

80. In the absence of quantified and verifiable efficiency claims in terms of increased competition or the opening of entirely new destinations from LCY with the freed-up slots, both of which may be considered to benefit

passengers, the OFT has no basis to consider whether the substantial expected harm to business customers on LCY—AMS would be outweighed by benefits to customers on other routes. This approach is in line with the OFT's stated position in its *Substantive Assessment Guidance*, which states at paragraph 7.9 that '... to show that benefits in one market outweigh an expected substantial lessening of competition in another [the OFT] will require clear and compelling evidence.'

Conclusion

81. Accordingly, the OFT believes that the merger may be expected to substantially lessen competition on the LCY—AMS route, with the potential for price increases and/or frequency reductions or other adverse impact on service quality for business travellers as a result of the merger. This conclusion does not change if, contrary to the OFT's indications on market definition, both LHR and LCY were considered on an aggregated basis at the London end of the O&D pair with AMS.

LON—RTM

The parties' activities pre-merger

82. Pre-merger, VLM operated a service from LCY—RTM and would have continued to do so, had the merger not gone ahead. Pre-merger, AFKL had not operated a service from LCY to Rotterdam. It had, however, historically operated two different services from London airports to RTM, namely:

- a service from STN to RTM through its subsidiary Transavia, and
- a service from LHR to RTM operated by KLM.

83. AFKL argues that the appropriate counterfactual to the merger is that it has decided independently of the merger to exit its services to RTM from each of STN and LHR, with the result that it should be treated as having no actual service competing with VLM's service on LCY—RTM. The question of the appropriate counterfactual to be applied is discussed below in detail in relation to the LON—RTM (leisure) overlap although the conclusions reached are also taken into account in the analysis of the LCY—RTM (business) route.

LON—RTM (leisure)

84. Consistent with the OFT's approach to market definition in this case, as explained in paragraphs 37 - 39 above, the OFT has considered all London airports to be in the same market for leisure passengers.
85. Pre-merger, AFKL operated services from two London airports to RTM: Transavia from STN and KLM from LHR. VLM operated flights from LCY to RTM. Given that no other carriers operate direct services to RTM from any other London airport, the merger prima facie (and subject to the correct counterfactual analysis, as discussed below) leads to a merger to monopoly on the LON—RTM route.
86. It is possible that the loss of a competitive constraint through actual competition could, in any event, be adequately balanced by the likelihood of new entry.¹⁸ However, there are a number of reasons why, in relation to LON—RTM, entry may not be regarded as likely, timely and sufficient such as to mitigate concerns. First, only [...] per cent of KLM's LHR—RTM traffic actually comprised leisure passengers, such that entry at one of the other London airports (STN, LTN or GTW) intended to serve leisure passengers may appear less viable. Second, it is reasonable to consider, given the precise nature of the route, that the significant majority of VLM's passengers on its LCY—RTM route will be business, rather than leisure, passengers. Third, it is notable that Transavia, which was previously operating leisure services from STN—RTM, decided to exit the market (see paragraphs 92 - 94 below).
87. The above considerations raise significant questions about whether entry targeted specifically at leisure passengers would be likely given the demand profile on the LON—RTM route. Although it has not needed to conclude on this point, the OFT considers that entry would be unlikely to constrain the merging parties post-merger on LON—RTM when testing against pre-merger conditions, and hence it is appropriate to examine the parties' arguments on the correct counterfactual.

Counterfactual

88. The OFT's general approach is that it relies on pre-merger conditions as the appropriate proxy for the counterfactual and will test the competitive impact of any transaction against such a standard before proceeding to consider whether another counterfactual should be substituted. In general, where the merger raises no concerns relative to pre-merger conditions, nothing will turn on the OFT's adoption of its default counterfactual of pre-merger conditions¹⁹ and there will be no need to consider the detailed factual questions that arise under substitute counterfactuals that, for example, the failing firm defence engages.
89. However, where the merger does raise concerns relative to the pre-merger situation, the OFT is slow to clear a transaction based on the 'inevitability' of exit of the target (or indeed, as in this case, the acquiring) business. That is why, where a seller wishes to exit a market because the relevant business is failing or distressed, the OFT will not lightly depart from judging the impact of such a sale as against pre-merger conditions, and will only do so when it has sufficient compelling evidence that exit is inevitable, in line with the first two criteria of the failing firm defence.
90. When applying its counterfactual analysis, the OFT is mindful not merely of whether the target firm (or, where relevant, the acquirer) would exit the market, but also of whether it had any plans to re-enter the market in the foreseeable future. To the extent that there is evidence that the exit from the market may be temporary,²⁰ this will not result in a change to the pre-merger counterfactual.
91. As discussed above, in this case the pre-merger position clearly does raise competition concerns given that VLM will become the only carrier flying

¹⁸ See in this respect the OFT's analysis of the competition impact of new entry in its decision on the anticipated acquisition by easyJet Airline Company Limited of GB Airways Limited.

¹⁹ A rare exception to this will be where the OFT has concerns that the merger eliminates an important potential entrant—including entry by acquisition of the unique assets of target—but for the merger. The evidentiary cautions expressed by the OFT in BSkyB/ITV would apply in such cases. See further paragraphs 108 to 109 in relation to the analysis of potential competition in relation to LCY—RTM.

²⁰ In the case of a retail merger, for example, a temporary absence from the market might arise where there was a gap between the time at which a party surrendered a lease or closed an outlet either for refurbishment or permanently, and the time at which it intended to recommence trading—potentially from a new location—within the same geographic market.

direct from a London airport to RTM and entry barriers are significant given the likely demand profile on the route. The OFT has therefore considered carefully the arguments on the correct counterfactual presented by the parties. The factual position differs for each of the two services historically operated by AFKL to RTM.

STN—RTM

92. In relation to the Transavia service from STN to RTM, Transavia operated one or two daily flights between RTM and STN during the IATA Winter 2007/08 season. However, the parties state that this service has been cancelled as of 30 March 2008 as a result of decisions taken in January 2007, that is, significantly prior to, and independently of, the merger.
93. The OFT was provided with compelling internal evidence from the parties that demonstrate that the decision to terminate the STN—RTM service significantly pre-dated the merger and could in no way be said to be connected to the merger. On this basis, it would be inappropriate to treat Transavia's STN—RTM service as providing an ongoing competitive constraint absent the merger.
94. The OFT notes that there is no evidence to suggest that AFKL/Transavia had considered reinstating a service from STN to RTM.

LHR—RTM

95. KLM has previously flown three frequencies per day from LHR to RTM, targeting business customers. KLM has used Fokker 50 aircraft for these services, each capable of seating 48 passengers.
96. AFKL argues, substantiated by a number of internal business documents, that it was commercially inefficient to continue using such small aircraft from LHR given the very high economic value of LHR slots to AFKL and to its SkyTeam alliance partners (Delta and Northwest). In particular, the so-called Open-Skies agreement of 2007,²¹ allowing carriers other than the existing four operators²² to fly between London and the US, accentuated

²¹ The agreement was signed on 30 April 2007 and came into force on 30 March 2008.

²² British Airways, Virgin Atlantic, American Airlines and United Airlines.

pressure on incumbent carriers to optimise slot use at LHR in favour of larger aircraft and more profitable trans-Atlantic routes.

97. The parties provide a detailed set of documents to demonstrate to the OFT the nature and progression of the internal reasoning that has led AFKL between June 2007 and November 2007 to decide to move from three daily frequencies on LHR—RTM to two in the short term and to phase out this service completely by October 2008.
98. AFKL accepts that there have been market rumours that VLM was likely to be put for sale that have originated around spring 2007 and that it was known in September 2007 that VLM's owners had instructed a merchant bank to look for potential bidders. However, AFKL also argues that the VLM sale process did not start properly until [...], that AFKL did not assume that it would be successful in any bid for VLM and that a possible acquisition of VLM was not reflected in AFKL's planning in any way. Although the acquisition of VLM has been noted as a potential area of discussion in an internal AFKL [...] management presentation provided to the OFT, it does not seem rational for AFKL to have been making concrete planning decisions at the time based on a speculative belief that it would emerge as the acquirer of VLM, and nor is there any evidence that an AFKL acquisition of VLM was in actual fact being factored into AFKL's existing route planning.
99. On the basis of all the evidence provided, the OFT is satisfied that there is compelling documentary evidence that the rationale for the LHR—RTM exit decision was clearly the Open-Skies development and that the crystallisation of this decision on or around [...], following the IATA slot conference earlier in November, was wholly independent of AFKL's purchase of VLM. The temporal proximity of these decisions to the VLM sale process has meant that the OFT has required particularly robust evidence of the absence of any causation between the merger and the route termination.
100. The OFT notes that there was no evidence to suggest that AFKL would consider reinstating its service from LHR—RTM in the foreseeable future. The rationale for the closure of the existing LHR—RTM service is based on the importance of efficient use of slots at LHR. There is no evidence to suggest that this pressure on airlines to make use of LHR slots for large aircraft will lessen in the foreseeable future. As such, any suggestion that

AFKL might have been incentivised to reverse its exit decision at LHR is both speculative and implausible.

Conclusion on LON-RTM (leisure)

101. In order to depart from pre-merger conditions as the appropriate counterfactual for assessment of the merger situation, the OFT considers that sufficient compelling evidence is required. In effect, AFKL is arguing that, to the extent competitive harm may arise given the fact that VLM will be the only carrier operating from LON to RTM, the merger is not the cause of that harm as it would occur in any event.
102. Where this type of absence of causation between the merger and the lessening of competition is argued, the OFT will as a matter of policy seek a high level of supporting evidence (within the parameters of its belief relevant to the reference test of the Act, which entails a comparison of the outcomes with and without the merger).
103. In this case, the OFT believes that the parties have met the high evidentiary threshold required to demonstrate that AFKL would have exited the STN—RTM and LHR—RTM routes with or without the merger. As such, there can be no lessening of competition caused by the merger between existing, actual services.
104. In this case, some documentary evidence suggests that AFKL has considered re-entering the LON—RTM route through the provision of services from LCY—RTM. Therefore, the OFT also considers whether the merger could be regarded as resulting in a loss of potential competition to the extent that AFKL should be considered as a potential entrant onto the LCY—RTM route. This issue is discussed below in the context of LCY—RTM (business).²³

LCY—RTM (business)

105. Pre-merger, VLM was the only operator providing a direct service from LCY to RTM, and there is therefore no direct overlap brought about by the

²³ To the extent that the removal of AFKL as a potential competitor on the LCY—RTM route does not result in a realistic prospect of a substantial lessening of competition, then it will follow that competition problems would not arise from the removal of potential competition on the wider LON-RTM market.

merger. The OFT therefore considers whether AFKL should be considered as an actual or perceived potential competitor to VLM on this route.

Evidentiary thresholds in applying potential competition theories of harm

106. There are two ways in which a potential entrant could constrain an incumbent supplier.
- The first is through actual entry that would, or could, absent the merger, **increase** competition above pre-merger levels and that would be eliminated in a merger between an incumbent and the entrant. This is sometimes referred to as **actual potential competition**. Actual potential competition constrains the merging firm only if and when entry actually occurs.
 - The second is the merger's removal of the constraint on the incumbent imposed by the mere threat of entry, which is sometimes referred to as **perceived potential competition**. Unlike the constraint from actual entry, which by definition has not arisen under pre-merger conditions, a constraint from perceived potential entry that gives incentive to the incumbent to respond to this threat—for example, by offering materially lower prices (also known as limit pricing) or more favourable non-price terms, partially to deter actual entry—does exist in the pre-merger environment.
107. Both theories of potential competition may apply in an individual case: in other words, a merger could in principle eliminate both the existing constraint posed by the threat of entry (perceived potential entry) and the potential for increased actual competition post-entry (actual potential entry).
108. When applying theories of harm based on either form of potential competition, the OFT is mindful that it should apply evidentiary checks and balances because loss of potential—as opposed to actual—competition could easily be alleged and might be difficult to rebut in the large range of scenarios in which the parties did not overlap pre-merger. The risk that a non-incumbent firm that is not in fact a potential entrant might be incorrectly judged to be one is serious unless a sufficiently careful approach is taken to the correct evidential standard. Unduly lax evidentiary standards

could result in speculative over-intervention and arguably triggers analogous cautions to those routinely expressed in relation to enforcement action based on non-horizontal—and especially conglomerate—theories of harm (including by the CFI in *Tetra Laval*²⁴ and *General Electric*²⁵ cases in discussing evidentiary thresholds applicable in such cases).

109. Accordingly, in *Tesco/Kwik Save*,²⁶ in articulating its general policy position on the counterfactual, the OFT observed that a rare exception to the proposition that the pre-merger competition is the appropriate benchmark for merger analysis 'will be where the OFT has concerns that the merger eliminates an important potential entrant ... but for the merger' and cautioned that 'the evidentiary cautions expressed by the OFT in BSkyB/ITV would apply in such cases'—in other words, in circumstances where the OFT had no concerns relative to pre-merger conditions, the OFT would not lightly substitute a substantially more competitive counterfactual than the status quo ante and intervene on this basis.

Removal of AFKL as an actual potential entrant

110. The theory of harm in this context is that AFKL entering on LCY-RTM absent the merger would have substituted a monopoly (VLM) for a duopoly (AFKL and VLM). To the extent that the merger could be said to have prevented such actual entry, the merger substantially lessens competition by eliminating the realistic prospect that, without it, VLM's monopoly would be eroded and replaced by a substantially more competitive outcome.
111. To determine whether AFKL should be considered as an actual potential entrant whose removal might create competition concerns, the OFT assesses below, first, the likelihood of entry by AFKL (in absolute terms) and, second, the extent to which AFKL could be said to be uniquely positioned to enter (that is how much more likely was AFKL to enter than any other carrier).

²⁴ See Case C-12/03P *Commission v Tetra Laval* [2005] ECR I-987, paragraph 155.

²⁵ See Case T-210/01 *General Electric v Commission* [2005] ECR II-5575, paragraph 295.

²⁶ Anticipated acquisition by Tesco Stores Limited of five former Kwik Save stores (Handforth, Coventry, Liverpool, Barrow-in-Furness and Nelson).

112. The OFT is mindful of the recent analysis of potential entry by the EC in the Ryanair/Aer Lingus case.²⁷ The EC examined, on a 'prudent and conservative basis', the impact of the loss of potential competition on Dublin routes in which only one of the merging parties was present. In carrying out this analysis, they identified routes where:²⁸

- the likelihood of entry was high
- there was an attractive airport in the route for the potential entrant without any significant congestion hindering entry
- the route had growth potential
- there was no other carrier currently active on the route, and
- entry by another competitor was relatively unlikely and not imminent.

113. In terms of the above criteria, in the case of LCY—RTM, no carrier other than VLM was active on the route, but there was significant congestion during peak time at LCY that would hinder entry. The OFT considers below the likelihood of entry by AFKL and AFKL's position as a potential competitor relative to other potential entrants.

Likelihood of entry by AFKL

114. The OFT considers several factors in this case that point towards AFKL having an incentive to enter the LCY—RTM route.

- AFKL (until October 2008) serves passengers wishing to travel from London to RTM, albeit from LHR. There is no evidence presented to the OFT to suggest that the closure of the LHR—RTM route was because it was not profitable in absolute terms; rather, the parties' explanation for its closure is that a slot at LHR was more efficiently used for trans-Atlantic services. To this extent, it is reasonable to consider that the parties may have wanted to continue to serve existing passengers of the LHR—RTM service by starting up a new

²⁷ Case No. COMP/M.4439 27 June 2007.

²⁸ Ibid. Paragraph 522.

service from LCY—RTM, a point accepted to some degree by the parties at the issues meeting.²⁹ Further, the fact that the LHR—RTM route was closing would mean that, henceforth, KLM would no longer be disincentivised from commencing LCY—RTM by concerns about cannibalising demand from its existing LHR services. In other words, whilst the parties' evidence on the counterfactual removes concerns about the loss of pre-merger competition from LHR, it makes the connected premise of an intent on KLM's part to enter LCY—RTM absent the merger significantly more plausible.

- There is one piece of documentary evidence presented to the OFT by AFKL to show that [the prospect of starting a service from LCY to RTM was raised within KLM].
- As the Dutch national flag carrier, KLM (as part of AFKL) has an obvious interest in flying to the largest port in Europe and the second largest city in the Netherlands.

115. In relation to the considerations discussed above, the OFT is aware of only one piece of documentary evidence highlighting AFKL's interest as a potential entrant into LCY—RTM. AFKL argues that the email quoted in paragraph 114 above reflects the working suggestion of one employee [...] and that any decision to enter LCY—RTM would require a considerable degree of planning and internal agreement prior to being determined. To draw conclusions about its intention on the basis of that single piece of documentary evidence would, they argue, be overly speculative. At the issues meeting, the parties accepted that they were committed to maintaining services to their clients and would therefore explore ways to re-open a LON—RTM service in the future. However, they made clear that such a view was in no way a firm commitment, and that it was subject to slots becoming available and to the normal range of commercial factors that would have been relevant to the finalisation of such a decision.

116. Most significantly, however, although the above factors might suggest an incentive on the part of AFKL, they are not probative of the extent to which AFKL has the ability to enter LCY—RTM in the foreseeable future.

²⁹ The OFT notes that BA indicates that it expects, with the launch of its services from LCY to AMS, 40 per cent of its business from LHR to be transferred to LCY. To the extent that AFKL started up a LCY service (after the existing LHR service had terminated) it might be expected that the volume of business 'transferring' would be similar.

There are a range of different factors strongly supporting the proposition that, although AFKL might have considered entry potentially attractive, their ability to do so in practice is extremely limited.

- The OFT notes already in paragraph 66 that LCY is capacity constrained during the peak periods that are needed to operate business services. The entry barriers in the form of peak time slot constraints bind KLM as for any other potential entrant, and are sufficiently tight to make entry inherently unlikely in the short term. Indeed, the suggestion within the email quoted in paragraph 114 above is expressly made conditional on additional morning slots becoming available at LCY (rather than on slot-flexing) which, on the evidence before the OFT, appears unlikely. There is no positive evidence available to the OFT that KLM would enter the LCY–RTM route by slot-flexing at LCY given the opportunity cost of reducing its LCY–AMS service (which already offered a less frequent service than KLM's closest competitor on the route, VLM, offered).
- The documentary evidence referred to above, to the extent that it may be attributed to AFKL, suggests that LCY–RTM would be implemented only after a service to [...] had been established. To the extent that the reasoning in the document is relied on, KLM would have had to obtain sufficient morning slots at LCY to launch services first to [...] and then to RTM.
- To the extent that AFKL was likely to enter the LCY–RTM route, it may be noted that it had not chosen to do so to date. Although launching a LCY–RTM service would have been likely to cannibalise to some extent traffic on AFKL's existing LHR–RTM service, it is clear that at least one other operator (BA) considered it commercially efficient to operate services from both LHR and LCY to the same destination – but AFKL had not done so in relation to RTM. Further, the OFT is informed by a large customer of VLM on the LCY–RTM route that it has tried unsuccessfully to sponsor entry (including by KLM) over the last two years, but has been unable to do so.

117. On the basis of the evidence taken as a whole, the OFT concludes that although there is some evidence of an incentive on the part of AFKL to enter onto LCY–RTM, it remains very unlikely that they would have been

able to do so in the foreseeable future. In particular, the difficulty in obtaining additional peak-time slots at LCY appears a significant barrier to AFKL being successful in this regard, and it would be speculative to conclude that this constraint would lessen materially in the future. The OFT does not consider it appropriate to place an artificially specific figure on the overall probability of AFKL's entry. To the extent that it is greater than fanciful, it is very significantly less than likely and could certainly not be characterised as high (in contrast to the position in *Ryanair/Aer Lingus*³⁰).

AFKL's relative position as a potential entrant

118. For the sake of completeness, and notwithstanding the fact that it considers the likelihood of entry by AFKL to be low, the OFT considers in any event whether AFKL could be said to be uniquely well placed as a potential entrant into the LCY—RTM route in comparison to other potential entrants such that its loss might be particularly significant in terms of competitive impact.

119. The OFT considers that KLM as the Dutch flag carrier would have had an incentive to operate a service to RTM (as discussed above). Further, AFKL is to some extent distinguished from other carriers by the fact that it has historically served passengers from London to RTM from STN and (most relevantly and recently) business passengers from LHR.³¹

120. Given that the principal constraint actually preventing carriers from serving new routes at peak times from LCY is lack of spare slot capacity, an important question in this respect is whether AFKL's position differs advantageously from that of other carriers (in particular BA as the UK flag carrier). In particular, it is relevant to consider to what extent operators already have services from LCY such that they could slot flex to the extent they wished to do so.³² On this measure, KLM (as the Dutch flag carrier) is less well positioned to commence new routes from LCY than BA. In

³⁰ See note 11 above.

³¹ Given the inevitable delay in between the decision to launch a route and the actual commencement of operations on the route, AFKL would not in any event have been able realistically to start running services from LCY to RTM (even if slots had become available) before the IATA Summer 2009 season. To some extent this break means that any goodwill towards AFKL from existing LON—RTM customers would potentially have been lost in any event.

³² Even if existing operators did not slot flex in order to launch a route, there are clearly operational reasons why it would be easier for a carrier already operating from LCY to launch a new LCY—RTM service.

addition, City Jet is no better positioned than BA. Evidence from ACL states that for summer 2008, KLM has only 18 peak slots at LCY, compared to BA with 53 peak slots (including BA Cityflyer). City Jet has 29 peak slots at LCY [Endnote 3]. BA has increased its range of services operating from LCY to European destinations and is now, according to ACL, by far the largest operator from LCY in terms of number of slots after VLM.

121. On the basis of the evidence overall, the OFT considers that AFKL cannot be regarded as uniquely well placed to enter the LCY—RTM route. Indeed, on the basis of slot flexing ability, AFKL appears less well positioned than BA to enter [Endnote 4]. AFKL's existing position at LHR and its status as the Dutch flag carrier do not compensate for its comparatively weak position at LCY and the existence of slot constraints at peak time.

Removal of AFKL as a perceived potential entrant

122. The OFT considers whether, even if AFKL should not be considered as a particularly well-placed actual potential competitor, VLM's actions absent the merger would have been constrained by the mere threat of entry by AFKL. To the extent that this was the case, AFKL might have acted as a competitive constraint on VLM, even if it never entered the route, such that its removal as a perceived potential entrant might create competition concerns.
123. In this case, however, VLM would have been fully aware pre-merger that the slot constraints at LCY meant that its monopoly position was relatively insulated from likely potential entry. On this basis, it would not have been profit-maximising for VLM to limit price (or take equivalent actions on service levels or quality). In short, its incentive would have been to exploit that monopoly position whilst it lasted. This proposition is supported in this case by evidence from a large customer of VLM on the LCY—RTM route that has tried unsuccessfully to sponsor entry into this route for two years. To the extent this customer regards it as important to try to encourage an actual new entrant, this evidence demonstrates that it does not regard potential competition as sufficient to constrain prices.
124. For the above reasons, the OFT considers that, in the circumstances of this case, any constraint from AFKL as a perceived potential competitor is

sufficiently weak that its removal could not be said to result in a realistic prospect of a substantial lessening of competition.

Conclusion on LCY—RTM (business)

125. In this case, the parties provide compelling evidence that they have exited the wider LON—RTM market through decisions taken independently of the merger to end their services from STN and LHR.
126. However, consistent with its general approach to counterfactual or failing firm defences, the OFT has been careful to assess whether there is a realistic prospect that the merging firm, whilst exiting one part of the market, would re-enter in an alternative form. To this extent, the OFT has considered carefully whether it could be said that AFKL was particularly well placed as a potential entrant into the LCY—RTM route.
127. In this case, although the possibility of entry onto LCY—RTM has clearly been raised within AFKL, the OFT considers that the capacity constraint at LCY during peak times means that the likelihood of entry by AFKL was low. Further, AFKL was no better placed (and potentially less well placed) than BA to be able to obtain the necessary additional slots to commence a new LCY—RTM service or to flex its existing slot portfolio at LCY. As a result, the OFT does not believe that the removal of AFKL as a potential entrant (actual or perceived) gives rise to a realistic prospect of a substantial lessening of competition on LCY—RTM.
128. Finally, the OFT has no reason to believe KLM is withholding documentary evidence of probative of entry plans on LCY—RTM absent the merger. The board presentation materials we do have do not mention such a prospect, and refer instead to other potential destinations from LCY. Indeed, at this level of speculation, it is equally plausible—but equally unsubstantiated in the evidence before us—that the merger's slot rationalisation will generate more competition on some previous monopoly routes that AFKL will enter, or open entirely new routes from LCY.

VERTICAL ISSUES

129. The OFT also considers whether the transaction may give rise to vertical customer-foreclosure issues in the provision of passenger handling services at LCY.

130. Passenger handling at LCY is undertaken by Air France (self-handling), KLM Ground Services (KGS) and Menzies Aviation (part of John Menzies plc) and encompasses ground side operations such as:

- passenger check-in and assistance
- ticket desk facilities, and
- flight operation services (for example, aircraft turnaround).

131. Passenger handling does not, however, involve air side operations such as:

- ground handling, for example, baggage handling and ramp services, which LCY does itself, and
- aircraft refuelling, which BP does on behalf of LCY.

132. The OFT notes that post-merger, the parties will operate the majority of slots at LCY, with AFKL and VLM operating respectively 29 and 26 per cent of the slots at LCY according to one third party.

133. In this respect, another third party expresses the view that the merged entity will be handling the majority of throughput at LCY, which will raise barriers to entry for other handling agents. The same third party also considers it unlikely that Menzies will be left with a viable operation at LCY: the main concern being essentially that the merged entity will remove VLM (with 26 per cent of slots) as a customer of Menzies for the provision of passenger handling services. Therefore, Menzies will lack the necessary scale to compete with Air France and KGS and will exit the upstream passenger handling market, according to this third party. (Although contacted by the OFT in the course of the investigation, Menzies has not voiced any concern in relation to the present transaction.)

134. To assess this issue, the OFT considers whether the merged entity would have the ability and the incentive to foreclose Menzies, upstream, from the provision of passenger handling services by leveraging its power downstream in the provision of passenger air transport services.

135. The parties submit that the provision of passenger handling services at LCY is open and contestable. In support of this, the parties argue that barriers to entry are low, consisting principally of the need for experienced staff. The parties further point to the absence of infrastructure requirements and regulatory barriers to entry.³³
136. The OFT notes that contracts for the provision of passenger handling services are granted by the airline companies in the context of open tendering processes based on standard IATA passenger-handling agreements. The parties submit that a number of passenger handlers present at other London airports can and do bid for passenger handling contracts at LCY: ASIG, Aviance (currently operating at LHR, STN and LTN); Globeground, Plane Handling, SGS, SAS Ground Service, Servisair and Swissport (currently present at LHR, LGW and STN).
137. Consistent with this, the parties provide five examples of airlines switching providers: VLM switched from KGS to Menzies at LCY in 2006, Scot Airways switched from Servisair to Menzies at Edinburgh in 2003, AFKL switched from Servisair to SAS Ground services at Aberdeen in 2007, easyJet switched from Servisair to Menzies at LGW in 2007, and Air Malta switched from KGS to Alitalia at LHR in 2007.
138. In addition, the OFT notes that contractual terms entered into by airlines companies and handlers are transparent: passenger handling contracts at LCY, copies of which entered into by KGS have been provided by the parties, are based upon an IATA standard agreement. The IATA standard agreement provides for the right for each party to terminate the agreement unilaterally with a 60 day notice. On average, contract durations are of three years.
139. In that context, the parties indicate that KGS' passenger-handling contracts with [...] and [...] terminate in October 2008, prior to the expiry date of Menzies' contract with VLM which is due in June 2009. The parties submit that these contract renewals will be a chance for Menzies to strengthen its position at LCY. In this respect, the parties make the argument that Menzies has sufficient scale to bid credibly for new contracts as they come

³³ Given annual passenger numbers at LCY exceed 2m, EC Council Directive 96/97 applies, which means (i) airlines have the right to self-handle and (ii) third parties have the right to provide passenger handling services unless London City Airport applies to restrict the number (under Article 6 of the Directive), which it has not.

up for renegotiation at LCY: it is already present at four London airports and is the largest independent handler operating at LHR; it has achieved a significant client list (BA, Lufthansa for example, which could be potential customers at LCY); the parent company, John Menzies plc, is reported to be 'one of the UK's leading suppliers of ground handling services and ... one of the country's largest independent handlers of air cargo'³⁴.

140. In assessing the contract terms entered into by KGS with its different customers and those of Menzies entered into with VLM, the OFT notes the following:

- the financial terms achieved by KGS with [...] and [...] do not differ from other KGS contracts despite the fact that Menzies—the parties believe—unsuccessfully bid against KGS for these two contracts, suggesting that KGS does not see Menzies as a particularly close competitor that it would want to foreclose
- although KGS is the largest operator at LCY, the financial terms of KGS' contract with KLM do not appear to be more favourable than its contractual terms with KLM's competitors—suggesting that it is not favouring its own airline in a manner consistent with an incentive and ability to foreclose, and
- the financial terms of Menzies' contract with VLM appear comparable to KGS' contracts with its airline customers—suggesting Menzies does not appear beholden to VLM in a way that would prejudice Menzies ability to provide passenger handling services were it to lose VLM as a customer.

141. Finally, the parties submit that KGS would have no economic incentive to seek to foreclose Menzies. They make the argument that, were KGS to threaten to increase its prices to supra-competitive level post Menzies' exit, the airlines operating at LCY would react by self-handling, by sponsoring entry (that is, inviting passenger handlers active at other airports to bid for the contract) and by setting up a rival business to compete with KGS.

142. On the basis of the above, and given the absence of concern expressed by Menzies, the OFT forms the view that KGS is unlikely, post merger, to

³⁴ Extract of Menzies' internet website.

have the ability or the incentive to foreclose Menzies, not least given LCY's bottleneck on complementary air-side ground handling.

THIRD PARTY VIEWS

143. From twelve questionnaires sent to competing airlines, eight responded to the OFT. One other airline sent unsolicited comments. Five respondents express concerns essentially about the merged entity servicing over half the slots operated at LCY which is capacity constrained at peak times.
144. Another respondent, not active at LCY but operating services to AMS from LHR, reports not having any meaningful views on the merger. It confirms however that LCY might be constraining LHR.
145. Two other unconcerned respondents form the view that the London market is sufficiently competitive and that passengers have enough alternatives to turn to. One of them notes that increasingly, airlines are using all the London airports to provide services.
146. The OFT also contacted 21 of the parties' customers: their largest corporate customers and the major travel agencies working with the parties. From the four responses collected by the OFT, one agency, unconcerned, indicates that customers might accept a price rise implemented by the merged entity as a price for convenience of location.
147. Two other respondents say that they would be in a position to react to a price rise, due to length of relationship and volume spent with the merged entity. Nevertheless, one of them indicates that the monopoly position arising as a result of the merger will inevitably affect its negotiation position.
148. Finally, another respondent expresses its concern mainly driven by the expected price increase due to the monopoly situation arising as a result of the merger.

ASSESSMENT

149. The OFT's competitive assessment in this case focuses on (i) direct, scheduled leisure passenger air transport services on LON-AMS, (ii) direct,

scheduled business passenger air transport services on LCY–AMS, (iii) direct, scheduled leisure passenger air transport services on LON–RTM. The transaction does not give rise to any horizontal overlap for direct, scheduled business passenger air transport services to RTM, however, the OFT also evaluates (iv) the issue of potential competition on the non-overlap LCY–RTM (business) route.

150. On LON–AMS (leisure), the OFT considers that the merged entity, whose combined share of supply ([0-10] per cent increment) amounts to [20-30] per cent, faces sufficient competitive constraints not to give rise for concerns over unilateral effects on this route.
151. On LCY–AMS (business), the transaction creates very high combined shares of weekly capacity and frequency in excess of 70 per cent. Notwithstanding BA's recent entry, the merging parties are closest competitors on LCY–AMS: KLM and VLM remain by a large margin the top two choices for business passengers requiring morning and evening peak outbound and inbound flights between LCY and AMS; they will uniquely provide UK business passengers with a schedule of multiple peak-time departures and arrivals and the schedule flexibility that such time-sensitive customers require.
152. Furthermore, the OFT has seen insufficient evidence to suggest that competitive responses by BA (from LCY and LHR), bmi (from LHR), or new entrants, could replicate the lost competition between the parties, because all such players would face the binding airport capacity constraints that limit the addition of flights at peak times from LCY (or indeed from LHR). Nor is the available evidence on buyer power or efficiencies such as to resolve these concerns.
153. Accordingly, the OFT is under a duty to refer on the basis of the serious unilateral effects concerns arising on the LCY–AMS route (business) as a result of the transaction.
154. On LON–RTM (leisure), pre-merger the parties were the only airlines operating services between LON and RTM (VLM operated a service from LCY, AFKL operated a service from STN via its subsidiary Transavia and KLM operated a service from LHR). Accordingly, the merger *prima facie* leads to a monopoly on LON–RTM. When testing against the pre-merger conditions, the OFT considers that entry would be unlikely to constrain the

merging parties post-merger. However, the OFT believes that the parties arguments on the correct counterfactual meet the high evidentiary threshold required to demonstrate that AFKL would have exited the STN—RTM and LHR—RTM routes with or without the merger. Consequently, the OFT finds no lessening of competition between existing, actual services caused by the merger on LON—RTM (leisure).

155. On LCY—RTM (business), the OFT considers whether AFKL could have been regarded as well or best placed as a potential entrant onto a new LCY—RTM route. Although the possibility of entry onto LCY—RTM has been raised within AFKL, the OFT however considers that the capacity constraint at LCY during peak times renders the likelihood of entry by AFKL low. In addition, the OFT finds AFKL to be no better placed than BA to obtain the necessary additional slots to commence a new service or flex its existing slot portfolio at LCY. Consequently, the OFT concludes that the removal of AFKL as a potential entrant (actual or perceived) does not give rise to a realistic prospect of a substantial lessening of competition on LCY—RTM.

UNDERTAKINGS IN LIEU

156. Where the duty to make a reference under section 22(1) of the Act is met, pursuant to section 73(2) of the Act, the OFT may, instead of making such a reference, accept from such of the parties concerned undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it.
157. Pursuant to section 73(3) of the Act, in considering whether to exercise its discretion to accept such undertakings, the OFT is required, in particular, to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it.
158. The OFT's guidance states that in order to accept undertakings in lieu of reference 'the OFT must be confident that the competition concerns identified can be resolved by means of undertakings without the need for further investigation. Undertakings in lieu of reference are therefore

appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation.³⁵

AFKL's offer of undertakings in lieu of reference

159. AFKL has indicated during the course of the OFT's investigation that, notwithstanding its arguments as to why the test for reference is not met, to the extent that the OFT did find competition concerns on the LCY—AMS route, AFKL is prepared to resolve these by means of the provision of suitable undertakings in lieu. Given AFKL's constructive approach to this question, the case team has been able to give AFKL its view as to what undertakings in lieu would be likely to be acceptable (or not acceptable) in the event that the decision maker ultimately concluded that the test for reference was met.

160. AFKL submits the following undertakings in lieu to resolve the OFT's concerns in respect of the overlap on LCY—AMS by allowing a purchaser to replicate the constraint provided pre-merger by AFKL on the LCY—AMS route:

- to the extent that the purchaser is unable to secure the appropriate slots at LCY from LCY's slot coordinator ACL, divestment [Endnote 5] of up to three slots at LCY during the morning peak period³⁶ and up to four slots at LCY during the peak evening period³⁷ to be used by the purchaser for LCY—AMS
- divestment of a parking stand for an early flight at LCY to the extent ACL was not able to make an overnight parking stand available to the purchaser, and
- to the extent that the purchaser is unable to secure the appropriate slots at AMS from the slot co-ordinator, divestment of the necessary corresponding slots at AMS.

161. In line with guidance from the case team, AFKL offers to make the required slot divestments to an up-front buyer, that is to a purchaser approved by

³⁵ See paragraph 8.3 of OFT *Mergers Substantive Assessment Guidance*.

³⁶ This was defined as being 06:30-10:00.

the OFT in advance of the acceptance of undertakings in lieu. However, AFKL specifies that the number of slots offered for divestment will be reduced to the extent that the identified purchaser already operates a service between LCY—AMS in the relevant time periods (that is, effectively, where BA was the relevant purchaser³⁸).

Assessment of the undertakings in lieu

162. The OFT's starting point in approaching undertakings in lieu is that it will seek to ensure that competition is restored to pre-merger levels. This straightforward approach is consistent with the broad margin of assessment bestowed upon the OFT by sections 73(2) and 72(3) of the Act. It is incumbent on the merging parties to satisfy the OFT (without requiring the OFT to conduct a detailed investigation) that any alternative proposed remedy clearly and comprehensively removes the substantial lessening of competition even though it does not restore competition to pre-merger levels.³⁹
163. In this case, the OFT's starting position is therefore that the undertakings in lieu should replicate the competitive constraint lost through the merger. In this case, the substantial lessening of competition in question is derived from the importance to business passengers of being able to rely on a frequent LCY—AMS service operating at peak times of the day. Given that, pre-merger, KLM operated a fewer number of services during peak times than VLM did, the constraint lost by the merger is therefore most clearly resolved by a remedy in which a carrier other than the merging parties provided the same number of daily services from LCY—AMS, operating at times equivalent to those operated pre-merger by KLM.
164. The parties' offer to divest up to three slots during the morning peak and up to four slots during the evening period is therefore, in principle, a clear-cut solution to the competition concern identified. To the extent that the required number of slots are divested to an existing carrier that is already present during the early morning and early evening peak (that is, in this case, to BA), it is clear that AFKL would need to divest one less slot in each time period to replicate KLM's pre-merger frequency.

³⁷ This was defined as being 16:00-20:00.

³⁸ In the IATA summer season 2008, BA operates a service to AMS at 08:55 during the morning peak period and at 18:55 during the evening peak period.

³⁹ See *Co-operative Group (CWS) v OFT* [2007] CAT 24.

165. The OFT does not have information on the availability of free slots at corresponding times of the day at AMS. However, the undertakings in lieu offer provides that, to the extent that free slots are not available from the AMS slot co-ordinator, AFKL is also prepared to divest suitable slots in order for the purchaser in question viably to operate an equivalent LCY—AMS service to that operated pre-merger by AFKL.
166. The OFT has considered carefully whether it would be sufficient for AFKL to make the relevant number of peak-time slots at LCY available to a carrier that wished to operate on the LCY—AMS route, without actually requiring that those slots be immediately transferred. Holding the slots open in this manner would address the issue of capacity constraints at LCY during the peak periods, thereby removing the principal entry barrier for any carrier that wished to enter the LCY—AMS route. However, KLM provided direct actual competition on the route and the OFT seeks to restore that constraint *via* undertakings in lieu by safeguarding that there will be actual competition on the route post-divestment, not merely perceived potential competition.
167. In the circumstances of this case, the OFT considers that a necessary requirement to suspend the duty to refer and consider undertakings in lieu is that divestment of the slots described above should be to a suitable purchaser provisionally approved by the OFT before the OFT publicly consults on the undertakings prior to acceptance.
168. Given the nature of slot divestments remedies, and the need for a prospective purchaser to plan its future timetable and to advertise its future new services sufficiently far in advance, the OFT recognises that a carrier acquiring the divested slots from AFKL will not be able to begin its services immediately. However, the OFT considers that such an operational delay does not undermine the importance of AFKL securing a contractual agreement with an up-front buyer such that the buyer will commit to acquire the slots before the OFT accepts undertakings in lieu. In this regard, the OFT can be certain that, notwithstanding any operational delay, competition will be restored on the LCY—AMS route to pre-merger levels within the short term.
169. On the basis that AFKL offers to divest the number of slots necessary to restore the pre-merger competitive constraint provided by KLM to an

upfront buyer, the OFT is currently of the view that the proposed undertakings in lieu—assuming they are capable of being implemented—will restore competition to pre-merger levels. It considers that the undertaking offered is sufficiently clear cut to remedy the concerns identified, namely the substantial lessening of competition in the supply of airline services for business passengers on the LCY—AMS route.

170. Therefore, the OFT has decided to exercise its discretion under section 73(2) of the Act to suspend its duty to refer to consider whether to accept undertakings in lieu of a reference.

DECISION

171. The OFT's duty to refer the completed acquisition by Air France Finance / City Jet of VLM Airlines to the Competition Commission pursuant to section 22 of the Act is suspended because the OFT is considering whether to accept undertakings in lieu of reference from the AFKL group pursuant to section 73 of the Act.

END NOTES

1. For the purposes of the EU Slot Regulation 793/2004 (Article 2a), slots exist only at co-ordinated airports (whereas LCY is a non-co-ordinated airport). However, given that capacity is in fact scarce at LCY during peak times, the OFT has used the term slot for ease of exposition in the present decision to mean timings of flights at LCY during peak times.
2. The parties have informed the OFT that KLM UK was already flying LCY-AMS in IATA summer 1997, before VLM launched its LCY-AMS service in April 2005.
3. Correction: subsequently to the decision, the OFT was informed that City Jet holds 54 peak slots at LCY rather than 29.
4. Given the correction in endnote 3, the statements that 'BA is by far the largest operator from LCY in terms of number of slots after VLM' and that 'on the basis of slot flexing ability, AFKL appears less well positioned than BA to enter' might no longer be appropriate given that, using this measure, AFKL has more peak slots at LCY than BA.

However, the OFT does not consider that this number of peak slots makes AFKL significantly better positioned than BA to enter, and therefore this does not alter the OFT's overall conclusion that AFKL is not uniquely well placed to enter the LCY – RTM route.

5. Given that slots in the sense of the EU slot regulation do not exist at LCY, AFKL may have to seek permission from LCY to be able to divest slots held at LCY to another carrier.