

## Compecon - Competition Economics Newsletter.

### Issue No.13 Spring 2008 – Special Topic Airline Mergers and Airport Competition.

In this issue:

A Tale of Two Airline Mergers – Contrasting Decisions from the OFT.....	Page 1
Airport Competition - UK Competition Commission Publishes “Emerging Thinking” Report.....	Page 4
Grounded – Analysis of EU Commission Decision in Ryanair/Aer Lingus.....	Page 7

### Comment

---

The current issue focuses on the issue of competition in air transport with articles on two recent decisions by the UK’s Office of Fair Trading (OFT) in respect of airline mergers, along with an assessment of the UK Competition Commission’s “Emerging Thinking” report published as part of its investigation into competition between UK airports. In addition we have an article looking at the EU Commission’s

economic analysis in respect of Ryanair’s proposed acquisition of Aer Lingus. The question of market definition was important in all of the cases, in particular, whether different airports and, consequently, services between different airports, were substitutes for one another. There are a number of similarities between all three cases but also some significant contrasts.

---

### A Tale of Two Airline Mergers – Contrasting Decisions from the OFT.

---

#### **Introduction.**

On 9<sup>th</sup> May the UK Office of Fair Trading (OFT) announced that it was considering whether an offer of airport slot divestments was sufficient to overcome competition concerns resulting from the proposed acquisition by Air France-KLM (AFKLM) of VLM Airlines NV (VLM). This follows an earlier decision in January clearing the acquisition by easyJet Airline Company Limited (“easyJet”) of GB Airways Limited (“GB”) even though the

merging parties had combined market shares of between 40% and 80% on certain routes.

#### **The easyJet/GB Case**

The OFT published its decision in this case on 24<sup>th</sup> January. easyJet is a major low cost airline, which, according to the OFT decision, operated 339 routes between airports in Europe and to some destinations in North Africa. GB owned 16 aircraft and operated scheduled flights to 32 destinations from London’s

Gatwick and Heathrow airports and a further six routes from Manchester Airport. The majority of services were to Europe and North African destinations.

Since 1995 GB had operated as a franchisee of British Airways plc (BA), pursuant to a licence agreement. GB's flights were marketed by BA under the BA brand as BA scheduled flights. The service provided (travel classes, onboard service, aircraft livery, flight attendants' uniforms, etc.) was the same as for any other BA flight. Seats were sold primarily using BA's distribution channels.

In airline mergers each individual route is normally regarded as constituting a relevant market. The issue is whether a route should be defined in terms of flights between two specific airports ("airport pairs") or between specific cities ("city pairs"). There appear to be much stronger grounds for defining markets on the basis of city pairs rather than airport pairs.

As in the EU decision in *Ryanair/Aer Lingus*, the OFT concluded that the relevant markets consisted of routes defined on the basis of "city pairs". Like the EU Commission, the OFT concluded that the London airports were substitutes for one another, while the Spanish airports of Alicante and Murcia were also substitutes. The OFT went on to state, however, that it considered airlines operating to/from the same airports to be closer competitors than airlines operating to/from different airports.

Again as in the EU Commission decision in *Ryanair/Aer Lingus*, the OFT considered that "low cost/no frills" airlines and "full service" airlines were part of the same market. In *Ryanair/Aer Lingus*, the EU Commission supported this view by arguing that Aer Lingus had re-positioned itself and moved away

from being a traditional full service airline toward a low cost operating model and had adapted many of the operating practices of low cost airlines. Thus arguably, even if the Commission had found that low cost airlines were in a separate market to full service airlines, it could reasonably have argued that Aer Lingus and Ryanair were nevertheless in the same market. In this case BA would appear to operate as a more traditional full service airline and GB operated as a franchisee of BA essentially offering the same standard of service. Thus the grounds for arguing that the merging parties were in the same market might not have been as strong as in *Ryanair/Aer Lingus*.

As the overlapping routes essentially involved sun and ski holiday destinations, the OFT accepted that "seat only" sales by charter airlines were part of the same market.<sup>1</sup> It rejected the parties' contention that flights to other sun holiday destinations should be considered to be in the same market as those offered by the merging parties.

The OFT found that the merger would potentially affect competition on 9 routes from London where the parties' services overlapped. The parties' combined market shares on those routes varied from over 40% (London-Alicante) to over 80% (London-Innsbruck). The OFT concluded that there was a significant degree of competition between the parties pre-merger and that the remaining competitors did not provide a sufficient competitive constraint to allow it to dismiss any competition concerns.

The parties argued that barriers to entry and expansion on the relevant routes were low. According to the decision, the OFT received mixed views from third parties on whether

entry/expansion on the overlap routes was likely to remedy any competition concerns that might arise from the merger. In particular, a number of third parties cited concerns about congestion at London airports as a barrier to entry. Despite this, the OFT found evidence of recent entry and, in many cases, significant entry and/or expansion on each of the overlap routes. On a majority of routes, entry and/or expansion had occurred since the announcement of the merger.

Shortly after the merger announcement (and termination of GB's Franchise Agreement with BA), BA announced that it would enter five of the overlap routes. BA told the OFT that it was able to provide these services through flexing their current slot holdings at Gatwick (either reducing or removing existing services). Ryanair announced that it would commence services on one route, and subsequently launched services on two other overlap routes. Monarch announced that it would commence services on a further overlap route and launched services on a second overlap route in the summer of 2007.

The remaining two overlap routes had seen recent entry and expansion by easyJet itself within the previous six months. easyJet also provided the OFT with a number of examples of entry by competitors onto existing easyJet routes, and in particular onto routes serving the overlap destinations.

The OFT concluded that the extent of entry was significant when compared to the small number of overlaps. It noted that the low frequency on some of the affected routes meant that new entrants would need only a small number of slots. It therefore concluded:

“Given the actual entry on the overlap routes in the short period since the

announcement of the merger, and the evidence of entry and expansion prior to the announcement of the merger, the OFT considers that this, together with the likelihood of further entry and/or expansion on the overlap routes is sufficient to constrain the parties post-merger.”

#### **The Air France KLM/VLM Case.**

This case involves the acquisition by AFKLM of VLM. In a statement issued on 9<sup>th</sup> May, the OFT said that it had concerns that the merger would substantially lessen competition in the provision of scheduled flights for business travel between London City Airport and Amsterdam's Schipol airport.<sup>2</sup> The OFT statement said its concerns arose for three reasons:

- There were good grounds for considering that London City to Schipol was a separate market, because enough business passengers on the route valued its speed and convenience compared to Heathrow or other London airports.
- The merging parties were each other's closest competitors on the route. Even allowing for entry by British Airways on the route in May 2008, the parties would remain the principal choices for business travellers on the route, with a combined share in the 70-80% range of both seat capacity and flights.
- There was insufficient evidence that competitive responses by other carriers could replicate the lost competition between the parties, because rival airlines would face capacity constraints that limited the addition of flights at peak times.

The OFT has suspended a referral of the merger to the Competition Commission as AFKL has offered to

divest a sufficient number of take-off and landing slots at both airports to an up-front buyer. According to the statement the OFT “considers that this remedy, in principle, appears clear-cut and would restore competition on the LCY to AMS route.” The OFT is to consider AFKL’s proposal further.

#### **Comment.**

In contrast to the earlier decision in *easyJet/GB*, the OFT in *AFKLM/VLM* appears to have defined the market as comprising a specific airport pair, i.e. London City-Schipol, although the OFT’s statement quotes its Senior Mergers Director as stating that both London City and Heathrow were severely congested thus hindering other airlines from adding peak-time flights. It would appear that a key factor in the *AFKLM/VLM* case is the fact that many of the passengers on the route are business passengers flying at peak times. The OFT would appear to be of the view that such passengers are less likely to switch to flights from other London airports and that the congestion at peak

times means that new entry is unlikely to occur without the divestments proposed by the parties.

The decision in *easyJet/GB* was based on the grounds that, despite the parties’ high combined market shares and the fact that they were close competitors, there was substantial evidence of new entry offsetting any likely threat to competition. This is in contrast to the EU Commission findings in *Ryanair/Aer Lingus* that entry was unlikely due to the fact that in that case there were numerous examples of unsuccessful entry. (See below). It is also interesting that the OFT found that entry by BA on the London City to Schipol route would be inadequate to prevent the *AFKLM/VLM* merger substantially lessening competition.

---

<sup>1</sup> In *Ryanair/Aer Lingus* the EU Commission indicated that seat only sales on charter flights might be part of the relevant market but noted that such sales only constituted a tiny proportion of total seats on any of the overlapping routes and so was unlikely to affect the outcome either way.

<sup>2</sup> The full decision is not currently available.

---

## **Airport Competition - UK Competition Commission Publishes Emerging Thinking Report.**

---

#### **Introduction.**

On 22<sup>nd</sup> April, the UK Competition Commission published a report outlining its emerging thinking regarding its investigation of the British Airports Authority (BAA). The investigation began in March 2007 following a referral to the Commission by the OFT. The OFT reference requires the Commission to investigate whether there is an adverse effect on competition in the market or markets for airport services in

the UK arising from the supply of airport services by BAA. The Report finds that BAA’s ownership of three London airports (Heathrow, Gatwick and Stansted) along with Southampton Airport and its ownership of three Scottish airports (Glasgow, Edinburgh and Aberdeen) reduced competition between airports. In March the House of Commons Transport Committee published a report on the future of BAA which concluded that BAA’s ownership

of a number of major UK airports had stifled competition.

The Competition Commission's analysis of actual and potential competition between airports is of interest in light of the decision by the Irish Government to break-up Aer Rianta and in the context of the EU Commission's findings in *Ryanair/Aer Lingus* which is addressed in a separate article below.

### **Background.**

BAA owns and operates seven UK airports namely Heathrow, Gatwick, Stansted and Southampton all in the South East of England, and three Scottish airports – Glasgow, Edinburgh and Aberdeen. Its airports account for 60% of all UK airport passengers while the three London airports plus Southampton account for 91% of airport passengers in the South East of England. BAA's three Scottish airports account for 84% of Scottish airport passengers. The three London airports are defined as "designated airports" which means landing and other charges in those airports are regulated by the Civil Aviation Authority (CAA). As in the case of a number of other former state monopolies, BAA was successful in persuading the Government to privatise it as a single entity rather than break it up into a series of competing businesses.

The Commission's "Emerging Thinking" report identifies four key issues that need to be addressed:

- (a) Is there currently competition—for both airlines and for passengers—between the BAA airports and other airports?
- (b) Is there scope for competition to develop between BAA airports?

- (c) What are the constraints preventing the development of competition currently?

- (d) Can any aspects of BAA's performance be attributed to a lack of competition?

### **The London Airports.**

The Competition Commission report states that its findings to date indicate that BAA's London airports face very little competition from other airports, although there is some evidence that Southampton faces competition from Bournemouth. It further states that the evidence it has seen so far suggests significant substitutability of passenger demand between the three London airports (Heathrow, Gatwick and Stansted), with significant overlaps in their catchment areas, although this varies to some extent between different categories of passenger. It also considered that there was the potential for some competition between the three London airports and Southampton. It therefore concluded that BAA's ownership of all four airports adversely affected competition between them.

### **The Scottish Airports.**

In the case of airport services in Scotland, the Commission found that there was an overlap in catchment areas between Edinburgh and Glasgow, particularly for leisure passengers. It cited consumer survey results which indicated that Edinburgh was the best alternative to Glasgow while Glasgow and the non-BAA owned Prestwick were the best alternatives to Edinburgh. It found that, apart from Prestwick, there was no effective competition to BAA airports in Scotland.

The Commission expressed the view that there was therefore potential for

competition between Glasgow and Edinburgh airports and that BAA's common ownership of the two airports thus had an adverse effect on competition. The Report also suggested that there was scope for potential competition between BAA's Aberdeen airport and the other two airports, although it conceded that the evidence in that instance was less strong.

#### **Comment.**

The finding that the three London airports are substitutes from a passenger perspective is consistent with the EU Commission decision in *Ryanair/Aer Lingus*. Specifically it supports the EU Commission view that airline routes should be defined on the basis of city pairs rather than airport pairs (see below). The Competition Commission also cited evidence of competition between airports in the case of Birmingham and East Midlands, Liverpool and Manchester, and Leeds/Bradford and Doncaster suggesting that these airport pairs are also substitutes. The EU Commission reached similar conclusions regarding the first two of these pairs although it also considered Leeds/Bradford to be a substitute for Liverpool and Manchester. The Competition Commission analysis, however, suggests that Glasgow, Prestwick and Edinburgh are in the same market, while the EU considered only Glasgow and Prestwick to be substitutes.<sup>1</sup>

The Irish Government's decision to split up Aer Rianta into three separate airport authorities was premised on a view that competition between airports would be more beneficial than the former monopoly. There would certainly appear to be scope for competition between Cork and Shannon and other

regional airports, notably Kerry and Galway. Neither Cork nor Shannon would appear likely to exercise a significant competitive constraint on Dublin.

#### **Next Steps.**

The next stage of the investigation will involve the Competition Commission publishing its provisional findings. If at this stage it believed there was an adverse effect on competition, the Commission would consider possible remedies. Its provisional findings report will also have to address whether regulation and common ownership ultimately benefit passengers despite any restriction on competition that they may entail. BAA, for example, has claimed that concentration of ownership concentrate planning expertise in a single airport operator while also claiming that there are economies of scale from joint ownership of airports in a particular area. The decision not to separate the three London airports at the time of their privatisation was seen by some as denying passengers the benefits that might accrue from increased airport competition. Whether such competition might be belatedly on the way will not be known until the Competition Commission completes its investigation.

---

<sup>1</sup> The Competition Commission reported that Glasgow and Edinburgh Airports are 78km apart which it suggests is not much greater than the distance between Liverpool and Manchester (50km), Birmingham-East Midlands (58km) and Glasgow-Prestwick (59km). Interestingly the distance between Glasgow and Edinburgh airports (78km) is less than the 100km used by the EU Commission in the *Ryanair* case. The Competition Commission also notes that the distance from Glasgow city centre to Edinburgh airport is less than the distance between the two airports.

---

## **Grounded – Analysis of EU Commission Decision in *Ryanair/Aer Lingus*.**

---

### **Introduction.<sup>1</sup>**

The EU Commission decision blocking Ryanair's bid for Aer Lingus illustrates how the economic analysis of mergers by the Commission has evolved. In the past the quality of the Commission's merger analysis has been criticised. For example, the Court of First Instance was highly critical of the Commission's analysis in *Air Tours/First Choice*.<sup>2</sup> Several commentators criticised the Commission's merger analysis for emphasising factors such as market shares, entry barriers and buyer power but failing to apply analytical tools designed to analyse the impact on competition directly. The *Ryanair/Aer Lingus* decision indicates that such criticisms have been taken on board by the Commission.

### **Community Dimension.**

The combined worldwide turnover of the merging parties was below the €5bn threshold but exceeded the lower €2.5bn threshold. This meant that the issue of whether or not the merger had a Community dimension depended upon whether or not the merging parties each had a turnover of more than €25m in at least three Member States. The answer to that question ultimately depended on how revenue from ticket sales was allocated. The majority of each airline's ticket sales are made via the internet. According to the Commission decision neither airline had records that allowed the location of customers to be identified when they purchased tickets, although

somewhat bizarrely later on the Decision states "...on most routes affected by the merger, a majority of customers buy their ticket in Ireland." (Para 595)

In the case of return flights Aer Lingus argued that revenues for the return trip should be allocated to the outward bound country of departure. If this approach had been adopted Aer Lingus would only have exceeded the €25m turnover threshold in two member States, Ireland and the UK. The transaction would then have fallen to be considered under national law by the Irish Competition Authority (and possibly also by the UK OFT). Ryanair, in contrast, argued that revenues for all tickets should be allocated on a 50/50 basis between the originating and terminating country which would have resulted in the €25m threshold being exceeded in three Member States.

Given that Aer Lingus was publicly opposed to the bid it presumably believed that it would have a better chance of the merger being prohibited under national law, perhaps because the transaction might not be seen to raise significant competition issues at an EU level. Similar reasoning might explain why Ryanair argued that the transaction had a Community dimension.

The Commission rejected the Aer Lingus submissions on the grounds that neither airline sold what it described as "traditional return tickets". Rather it argued that both sold the tickets for each leg of a return trip separately. It suggested that one feature of

“traditional” return ticket was that the cost of the return trip was generally cheaper than the cost of purchasing a ticket for each leg separately, which it said was not true of Ryanair and Aer Lingus. The Commission also observed that passengers could buy the two legs of a return trip separately and could even purchase a ticket for one leg of the journey with one airline and the other leg with another. While true the relevance of these observations is hard to fathom. The issue of how revenues for return trips should be allocated, by definition, only arises in those cases where passengers had actually booked the outward and return leg of the trip at the same time in a single transaction. Other passengers may well have chosen to purchase tickets for each leg separately but this does not appear to be a valid reason for not allocating total revenue for a return trip to the original point of departure in those cases where passengers had clearly chosen to book a return flight. The Commission also ignored the fact that the default option on both websites is to purchase a return ticket.

The effect of allocating revenues from return bookings to the country of departure for the return leg was to bring Aer Lingus revenue above the €25m threshold in a third Member State – Spain - thus ensuring that the transaction was deemed to have a Community dimension and came within the scope of the Merger Regulation.

### **Market Definition.**

In newspaper reports around the time that Ryanair had announced its bid, its spokespersons were cited as claiming that overlaps between the two airlines were confined to around 16 routes. This figure was clearly based on routes being

defined on the basis of airport pairs (see first article above).

The Commission found that the relevant routes comprised city pairs based on a number of different factors.

- Whether both airports were within 100km/1 hour driving time of a city.
- Views of the airport operators.
- Views of other airlines.
- Views of passengers as indicated in response to consumer surveys on 12 of 35 overlap routes.
- Internal documents of the merging parties.
- Price correlations on services between a number of the relevant airports.
- Ryanair’s own marketing and advertising.<sup>3</sup>

The Commission noted that Ryanair’s advertising and marketing indicated that it viewed routes from Dublin to secondary airports as competing with Aer Lingus services to primary airports in the same city. For example, it pointed out that Ryanair marketed its Dublin-Beauvais as being to Paris (Beauvais) denoting that it viewed it as competing with Aer Lingus’ Dublin-Paris service. It also noted that in the case of such routes, Ryanair’s website included tourist information on the relevant city, indicating that the service was aimed at passengers wishing to visit the city in question. Thus the Commission in its decision notes:

“Ryanair has consistently positioned its routes as substitutes for routes to adjacent city destination airports. For example Aer Lingus flies to Bologna. On the establishment of its Dublin to Forlì (Bologna) route, Ryanair announced that: *“[this] will end Aer Lingus’ high fare monopoly...Bologna. Irish customers previously had no alternative to Aer*

*Lingus*”. This shows that Ryanair clearly positions Forlì airport vis-à-vis its customers as a substitute for Bologna main airport as regards passenger air transport services to/from Dublin. Similarly Ryanair makes direct price comparisons between routes that fly to adjacent airports (catchment area).” (Para 90).

### **Competition Analysis.**

The Commission stated that the case differed from a number of airline mergers that it had considered previously. It pointed out that all previous cases concerned mainly mergers of two carriers which had their main centres of operations at different airports, often in different countries and raised concerns on a relatively limited number of overlapping routes. This contrasted with the present case which “concerns the two main airlines in Ireland with a significant base at the same airport, namely Dublin Airport.” Thus it found that merger raised concerns on a significant number of overlap routes, all with a common point of origin. All the affected routes were from or to Ireland.

In analysing the potential effect on competition the Commission focused on a number of factors:

- Market shares;
- Closeness of competition between the two airlines;
- Whether both actually competed with each other in practice;
- Impact of the merger on actual competition;
- Consequences for routes where they are potential competitors;
- Switching possibility and buyer power of customers;

- Barriers to entry and potential for existing competitors to offset anti-competitive effects.
- The effects of the merger on each individual route-pair; and
- Whether efficiencies were likely to outweigh any competitive harm.

According to the Commission, Ryanair operated 400 routes across 24 different countries. 75 of these routes were to/from Ireland with most of these being to/from Dublin. It had 20 bases throughout Europe of which Stansted and Dublin were the most important. Aer Lingus operated 70 routes between Ireland and European destinations. Aer Lingus had 23 of aircraft based at Dublin compared with 20 for Ryanair. Despite the significant difference in size of the two airlines, the Commission noted that, according to the Association of European Airlines, Ryanair and Aer Lingus ranked number one and number three respectively in terms of weekly “no-frills” seats sold in summer 2006.

The Decision notes that those routes where the Merging Parties’ activities overlap included 8 out of the 10 most important routes to/from Dublin (one of the remaining two most important routes was the long-haul route to New York). The parties combined market shares were very high in all those eight markets. It also pointed to the fact that passenger numbers in 2006 on the 32 “overlap routes” to/from Dublin accounted for around 70% of all passengers carried on intra-European routes to/from Dublin.

According to the Decision Ryanair and Aer Lingus accounted for the largest share of passenger traffic at the airports of Dublin, Shannon and Cork. Ryanair and Aer Lingus each accounted for [30-40]% of all passengers ex-Dublin in 2005, whereas British Midlands and

Lufthansa accounted for [less than 5]%. Taking into account only intra-European traffic, the market shares of Ryanair and Aer Lingus amount to [40-50]% and [30-40]% respectively. Ryanair and Aer Lingus serve the largest number of destinations ex-Dublin with a combined total of over 110 destination airports in Europe and 80% of all intra-European traffic. The combined entity would also be the largest short-haul carrier at Cork and Shannon airports.

The Commission found that the two airlines overlapped on 35 routes. In the case of 22 of those routes, Ryanair and Aer Lingus were the only operators giving them a combined market share of 100%. The Commission found therefore that the merger would create a monopoly on those routes. In the case of the remaining 13 routes, Aer Lingus and Ryanair had a combined market share in excess of 60%.

Ryanair argued strongly that it did not compete with Aer Lingus.

“On the contrary, Ryanair argues that it behaves independently of Aer Lingus (and any other competitor) when setting prices and deciding on frequencies for its routes and does not consider the prices of its competitors. Ryanair claims that it is constrained only by the price sensitivity of its customers and not by the pricing behaviour of its competitors.” (Para 432).

These claims were strongly refuted by the Commission. In particular, the Commission noted that both Aer Lingus and Ryanair monitored each other's fares and reacted regularly to changes in fares. It noted that both airlines used specific software to adjust their capacities and prices on a daily basis in response to competitive actions by the other. It also found that the advertising

strategy pursued by the two airlines indicated that each considered the other to be its closest competitor noting that they both routinely published advertisements comparing their respective fares and services. Both carefully monitor and seek to react to each other's promotional fares.

The Commission Decision found that any anti-competitive effects of the merger on routes to and from Ireland were unlikely to be offset by new entry or expansion by existing operators. It accepted that there were no significant regulatory barriers in the market but, according to the Commission, “the strength of both airlines at the same airports combined with their low frills/low cost business model would increase the already high barriers to entry or expansion for actual and potential competitors.”

The Decision noted that there had been numerous unsuccessful attempts at entry on routes, and numerous examples of other airlines pulling out of routes, in and out of Ireland. It also highlighted the fact that there was no example of entry by a third carrier on a Dublin route where Ryanair already operated. The Commission also pointed out that:

“In contrast to other competitors, Aer Lingus has “survived” on a number of routes against Ryanair.” (Para 512).

The Commission's conclusions regarding the impact of the proposed merger on competition are summarised in para 491.

“The proposed merger would eliminate this actual competition between the Merging Parties, giving the merged entity significantly increased market power with the likely consequence of increased fares and/or a reduction of the number flights for passengers wishing to

travel to or from Ireland..In particular, the merged entity would have the incentive to set higher fares for Aer Lingus since most of the customers lost would be captured by Ryanair.”

In addition the Commission found that the merger would be likely to lead to lower quality service and less consumer choice. It also found that it would lead to a reduction in potential competition with less pressure on the merged entity to establish new routes. The Commission argued that Ryanair had established a number of new routes out of Dublin since 2001 in response to expansion by Aer Lingus. As a result the number of routes on which the two airlines competed had increased from six in 2001 to 35.

#### **Econometric Evidence.**

Econometric analysis has come to play an increasingly important role in merger analysis in recent years, particularly in unilateral effects cases. This reflects the development of new sophisticated analytical tools, along with greater availability and potential for analysing data due to increases in computer power. It is now common for parties to commission such analysis prior to notifying a merger to the relevant authorities. Econometric analysis can certainly assist the merging parties in identifying any potential competition problems that might need to be addressed and may help strengthen the case in favour of a merger if it indicates that the merger is unlikely to have an adverse effect on competition. The Commission’s assessment of the econometric analysis undertaken on behalf of the parties in the present case illustrates, however, that such analysis has its limitations. In particular it is

important to ensure that the right questions are addressed and that the appropriate analytical tools are applied and properly specified.

Ryanair submitted econometric evidence to support its contention that Aer Lingus did not constitute a competitive constraint on its activities. The Commission rejected this evidence on several counts.

1. The results were not robust to small changes in model specification.
2. The cross-section technique used could not control for unobserved or unmeasured factors that influence prices but vary between routes leading to likely bias in results.
3. The analysis was not confined to routes out of Dublin or even Ireland but covered some 300 Ryanair routes across Europe, on the vast majority of which Aer Lingus was not a competitor.

The Commission then went on to observe:

“A regression can either establish a statistical link between two parameters (say, simultaneous presence of Ryanair/ Aer Lingus and price levels) or it can fail to do so. However, failure to prove a statistical link is not equivalent to proving that no such link exists. Alternative explanations for an ‘unsuccessful’ regression include, in particular, unsuitable data sets or misspecified regression equations. It would appear that Ryanair, by choosing a complex two-stage approach and a data set with routes outside Ireland, increased the likelihood that its regression would not yield statistically significant results. Because Ryanair had a vested interest in seeing its regressions ‘fail’, the probative value of such an outcome is

low and cannot be taken as evidence that Ryanair is not constrained by Aer Lingus on routes out of Ireland.” (Para 476).

Aer Lingus also provided econometric evidence to support its contention that the acquisition would be anti-competitive using three different specifications to capture the impact of Ryanair’s presence on a route. Ryanair objected, and the Commission agreed, that two of the approaches used were flawed as they used capacity shares as an explanatory variable and could thus (a) yield biased results and (b) imposed strong restrictions on the model results. The Commission noted that the third approach, which applied a “presence dummy” which was not subject to such criticisms indicated that Ryanair’s presence on a route resulted in Aer Lingus fares being [5-10%] lower than they would otherwise be.

#### **Postscript: Is Ryanair Dominant?**

Ryanair claimed in its submissions to the Commission that its business model was unique and that therefore it was not subject to any competitive constraint from other airlines. In other words, Ryanair argued that it was in a market of its own. Such an argument would appear to constitute something of a double edged sword. If Ryanair and Aer Lingus were in different markets, then the merger would have no impact on competition. At the same time, the logic of such an argument is that Ryanair effectively enjoys a dominant position in such a market. Indeed it would have an absolute monopoly if the market is defined so as to include only Ryanair. It is certainly unusual to see a firm arguing for a market definition that would define it is a monopolist.

#### **Conclusions.**

Whereas in the past the Commission was criticised for a failure to adopt modern sophisticated analytical tools, in this case it has undertaken a detailed analysis and its decision would appear to be based largely on quantitative rather than qualitative analysis. The Decision also highlights that, while parties may bring forward econometric evidence, such evidence is likely to be subject to rigorous examination by the Commission. The decision has been appealed to the Court of First Instance.

---

<sup>1</sup> This article is an abbreviated version of a speech given by Compecon’s Director Patrick Massey at a Competition Press conference on 30.4.2008.

<sup>2</sup> *Airtours plc v. Commission*, case T-342/99, [2002] 5 CMLR 25.

<sup>3</sup> As noted in the previous article, the EU Commission found that Glasgow and Prestwick airports were substitutes but unlike the UK Competition Commission did not find that Edinburgh Airport was a substitute for Glasgow and Prestwick. Edinburgh Airport is considerably less than 100km from Glasgow city centre while evidence from passenger surveys and airlines also tended to suggest that Edinburgh was a substitute for Glasgow and Prestwick. The distance between Edinburgh and Glasgow airports (78km) is similar to that between Manchester and Leeds-Bradford (72km according to the EU) which the EU Commission concluded were substitutes.

© Compecon Limited 2008.

---

**This note is for guidance purposes only. Compecon Ltd. cannot accept any responsibility whatsoever for loss or damage occasioned or claimed to have been occasioned, in part or in full, as a consequence of any person acting, or refraining from acting, on the basis of this note.**

Compecon Limited is a private limited company registered in Ireland Number 343962.  
Registered office: 37 Willowbank Park, Rathfarnham, Dublin 14.  
Compecon – Competition Economics is a registered business name of Compecon Limited.