ANNEX G – RYANAIR SUBMISSIONS TO COMPETITION AUTHORITIES AND PRESS RELEASES

1. Summary of hearing held with Ryanair, 26 July 2007

   http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/hearing_summary_ryanair.pdf

2. BBC website report, "Ryanair reduces Stansted flights", 21 July 2009

   http://news.bbc.co.uk/1/hi/business/8160923.stm

3. CC BAA market investigation, Ryanair's response to provisional consideration of possible material changes of circumstances, 30 March 2011

   http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2007/airports/pdf/ryanair_response_to_mcc.pdf

4. Ryanair Submission on SLC Question to OFT, 31 August 2011

   http://www.competition-commission.org.uk/assets/competitioncommission/docs/2012/ryanair-aer-lingus/ryanair_submission_to_the_oft_on_the_slc_test.pdf

5. Ryanair press release, "Ryanair urges Ferrovial/BAA to sell Stansted as airlines abandon high cost airport", 26 October 2011

   http://www.ryanair.com/en/news/ryanair-urges-ferrovial-baa-to-sell-stansted

6. Ryanair press release, "Ryanair calls for early sale of Stansted as BAA's high fees fund £240m dividend to Spanish shareholders", 19 December 2011

   http://www.ryanair.com/en/news/ryanair-calls-for-early-sale-of-stansted-as-baa-s-high-fees-fund-240m-pounds-dividend

7. Ryanair press release, "Ryanair calls for urgent sale of Stansted Airport", 14 May 2012

   http://www.ryanair.com/en/news/ryanair-calls-for-urgent-sale-of-stansted-airport

8. Telegraph website report, "Ryanair cuts capacity at Stansted by one million passengers", 28 February 2013

   http://www.telegraph.co.uk/finance/newsbysector/transport/9901242/Ryanair-cuts-capacity-at-Stansted-by-one-million-passengers.html

9. Stock Exchange Announcement, "Ferrovial/BAA hikes Stansted fees by 6% from April 2013 in a parting gift to Manchester Airport Group & a parting slap to Stansted's airlines & passengers. Ryanair to cut its Stansted traffic by 9% in response to these unjustified & inflation-busting increases", 28 February 2013

   http://www.londonstockexchange.com/exchange/news/market-news/market-news-detail.html?announcementId=11504116

10. Telegraph website report, "Ryanair to cut down flights from Stansted over landing fee row", 2 March 2013

    http://www.telegraph.co.uk/finance/newsbysector/transport/9904233/Ryanair-to-cut-down-flights-from-Stansted-over-landing-fee-row.html

11. BBC website report, "Ryanair to expand by 30% with bumper Boeing order", 19 March 2013

    http://www.bbc.co.uk/news/business-21845831

COMPETITION COMMISSION

BAA AIRPORTS MARKET INVESTIGATION

Ryanair summary of hearing, 26 July 2007

Ryanair's business overview

1. Ryanair was Europe's largest low-fares airline and Stansted's largest customer, with more than 60 per cent market share of all passenger traffic at Stansted. It expected to carry more than 50 million passengers in Europe and 15 million passengers at Stansted in 2007. While occasionally Ryanair's service levels dropped below target, no other airline could match it for punctuality. It had the youngest fleet of aircraft in Europe, 137 with an average age of two and a half years. It cancelled fewer flights, had fewer delays, and lost fewer bags than any other airline. It was the fastest-growing airline anywhere in Europe and probably in the world.

2. Stansted was by far the most expensive airport in Ryanair's network. It had 40 aircraft based there, five to eight at Luton and none at Gatwick, and none elsewhere in the London region as the airports were already at full capacity. This shortage of capacity was due to BAA being extremely slow to develop additional facilities, which would not happen if there was a competitive environment.

3. Ryanair would like to see growth at Luton as well as at Stansted and had offered co-funding towards additional facilities. Luton was benefiting from a new terminal for a modest £25 million to 28 million which would handle up to 8 million passengers a year. The airport's response to the August 2006 security alert had been good and its feedback to the airlines was very good (it would achieve eight out of ten on a satisfaction scale by comparison with two out of ten for Stansted). Operations at Stansted were bedevilled by the CAA's ineffectiveness as a regulator. It had in practice been captured by BAA. BAA worked the regulatory system with talented people constantly feeding the regulatory process. Ryanair did not have the resources or time to feed information continually into the CAA. The airline approached the CAA when there was a quinquennial review with a list of problems and proposed solutions and then returned to run its business for another five years. BAA, however, was continuously living with the CAA.

4. Two of the CAA's primary regulatory objectives were to advance and protect the reasonable requirements of airline users, which Ryanair thought should take precedence, and to incentivize BAA to provide facilities. In practice the CAA concentrated almost exclusively on the second objective. What BAA wanted it largely got.

Ryanair's view of services provided by BAA

5. The BAA, particularly at Stansted, pursued a long-standing policy of ignoring users' interests. It provided the following examples. Ryanair routinely attended AOC (airport operator committee) meetings and ACC (airline consultative committee) meetings. It would, for example, raise complaints about security and the need for more security staff, only to have the complaint both denied and ignored. Similarly, it persistently asked for information on BAA's Stansted traffic forecasts but could still not obtain the underlying justification for them. The forecasts were not based on consultation with the airlines. Submissions to BAA particularly about the capital investment

programme, had all been disregarded or dismissed. Further, all Stansted airlines had unanimously opposed G2, despite which BAA had simply announced it and said it intended to push it through.

6. Consultation was continuously undermined and had failed at Stansted because there was no sanction on BAA for not consulting. Airlines wrote to the CAA to complain, but the CAA did nothing. In many cases it did not attend meetings and where it did it insisted it was only present as an observer.

7. Other complaints related to BAA's overcharging of the airlines during Q4 for services such as the fuel levy and check-in desks, and over-recovering against the 7 per cent rate of return in the current year by doubling all charges to the airlines. Ryanair paid [✂] in 2006, and charges would rise to [✂] in 2007, or over double the 2006 charges, with much the same traffic. In Ryanair's view, BAA had total market power. The Q5 review was intended to correct any overcharging retrospectively, but now not only had the review at Stansted been moved forward to 2008, but de-designation might take place, placing refunds at risk.

8. Ryanair considered that there should be penalties for service failures at Stansted, of which there were numerous examples. First, the security queues were horrendous and worse than Heathrow's, because BAA would not provide enough staff. Second, baggage failures were a routine problem. The baggage belts were not designed to handle the volume of bags that were currently being put through the system. BAA would not upgrade the system. Third, on the fuel levy, BAA had put in a capital investment of £12.5 million for a fuel pipeline system to be recovered over a 12-year period. However, it had then inflated and indexed the annual charges so that over only an eight- to ten-year period, it had already recovered an unjustifiable £60 million or thereabouts. A final example concerned check-in desks. Three years previously BAA had announced without consultation that it would stop renting check-in desks on an annual basis and instead charge per passenger. Costs to Ryanair rose from [✂] per turn-round to around [✂], an almost tripling of costs. Moreover, passengers who did not even use check-in desk facilities (ie passengers who checked in on the web) were also forced to pay the fee. Ryanair was already paying a passenger charge, as was common in all airports. It was only the regulated monopolies that exacted a passenger check-in desk fee as well as a per passenger airport charge.

BAA security management

9. Ryanair had received written assurances from BAA this year that it would staff 17 security machines, and up to 20 at peak periods during the busy days. Usually, however, the best it managed was an average of between 12 and 15 machines at any time and massive security queues. On 21 July 2007 30 of Ryanair's 39 first-wave flights were delayed because of passengers being stuck in security queues. During that weekend the BAA duty manager in Stansted was handing out a photocopied handwritten note from himself to passengers who had missed their flights because they had been stuck in security, saying, 'BAA is not responsible for compensating passengers for missing flights. Please refer to your airline'. But those delays had occurred solely because BAA would not staff the machines; and the reason for that was very likely that in anticipation of the regulatory review, BAA was seeking to keep its opex low. Generally, however, there was a total unwillingness in BAA to tackle the issue; and anyway ultimately it just passed the cost to the airlines. There was a degree of incompetence and unwillingness to take on the unions. BAA suffered no penalty by having abject security arrangements, and the airlines took most of the blame for it. The damage inflicted had not been reflected in any regulatory difficulties for the airport operator. Nor could the traffic go elsewhere as BAA had a monopoly. Every year BAA said that it was hiring more staff; that fed into the regulatory

accounts, which in turn allowed BAA to claim *(a)* further recovery and *(b)* higher outputs in the next regulatory review. Then rather than do what it should to hire more staff, it preferred to bank the regulatory proceeds. Ryanair had complained to BAA, to the Department for Transport and to the CAA for the last six months about the security problems and queues at Stansted. BAA wrote accepting that security had not been managed as it would wish it to be, and saying that its new customer services director in Stansted had been tasked with improving it. The next week, however, nothing had changed. Ryanair did not believe that the solution to the staff numbers and rostering problems lay in BAA contracting out security, because subcontracting would simply give BAA the opportunity to blame the subcontractor for any shortcomings.

Regulatory failure

10. Ryanair said that excessive return on the RAB encouraged overspending. Unlike any other industry, BAA's returns and income were guaranteed. Whatever BAA spent, it got a percentage recovery of it. Ryanair, by contrast, was in the middle of a $multi-billion investment in aircraft on which the risk was borne entirely by the airline. In almost every other industry, as volumes rose, unit prices fell. Only in regulated monopolies did one find a completely irrational structure under which the more capex rose, the more income rose; and then the capex was inflated further so as to inflate the income yet again. It was a system designed to encourage gaming.

Examples of gold-plating

11. All of the facilities provided by BAA were gold-plated because cost recovery was set at x per cent of capex; so the bigger the capex, the bigger the recovery. The result of this system was, for example, an excessive proposed land grab at Stansted. The whole G2 plan was driven by creating excessively expensive capital planning for notional future users. BAA was developing a twin runway capacity capable of handling coterminous landings and take-offs of A380s meaning that it would need more land, both to the side and at either end of the airport, and yet further land for a commercial area of developments like hotels, car parks and office blocks. It was the current users rather than the notional future user, however, who was having to pay for this—the airport passenger charge of £11 was planned to double to around £22 over the next five to six years. In fact, BAA could build a second runway and a second terminal with half the land it claimed to need for future users. The G2 plan was estimated by BAA to cost £4 billion. Ryanair did not think that costs of that order would be incurred any where else on the globe. BAA had said that £500 million of this was for railways, £500 million was for motorways and £2 billion for 'earth moving and landscaping'. There was only about £120 million in the total for the actual runway.

12. Ryanair supported the case for a second runway and would like to see a second terminal built for about £400 million but it was very difficult to understand the justification for the other £3 billion plus. Ryanair did not expect 'everything for free'. In fact, it had offered to pay for a second terminal. It sought rapid growth, and therefore growth in facilities. Its agenda was, however, the development of additional capacity at the lowest possible cost. The difficulty for the airlines was that once BAA had received planning permission for something it went into the RAB and the airlines started paying for it. They were already paying for a number of facilities that BAA claimed would be necessary but which were not. The airlines were also trying *(a)* to prevent further costs being incurred in G1 before they were necessary while allowing for growth in the short to medium term and *(b)* to prevent the likely situation that the G2 phase would be much more expensive because of decisions BAA had taken on

G1 and to ensure that if and when there was a G2 that there would be potential for developing a cost-effective alternative. Otherwise the CAA would simply rubber stamp BAA's proposals.

13. Another example was the TTS—the track transit system in Stansted. Ryanair had campaigned for many years to shut down this train. It cost about £1 million a week to run it, despite being unmanned. It had taken Ryanair about eight years to convince BAA to build a walkway to satellite 3. However, BAA had also extended the tunnel for the TTS under satellite 3, despite the fact that Ryanair walked every passenger out to satellite 3. BAA took this action because it might build a satellite 4 and might then want to run the TTS to it. That kind of gold-plating, opposed by airport users, was not being tackled by the CAA.

Costs

14. Costs per passenger for Ryanair had escalated from [✂] in 2003/2004 to [✂] this year. The increase was 111 per cent this year and the cumulative increase over the five-year period was almost 200 per cent. High charges, in Ryanair's view, had had a significant impact on traffic growth. When the airlines had passed on the airport increased charges in April, Stansted entered the first decline in traffic since 1991. In April alone, Stansted traffic declined by over 7 per cent compared with BAA's forecast.

Ryanair's view of the future

15. Ryanair favoured breaking up the BAA monopoly and replacing it with separate ownership of the three BAA London airports. Ryanair believed that if the airports were separately owned all three would be continuously pushing to grow their own businesses. There would be a much faster pace of development of new capacity, eg runways and terminals for airlines, both new and existing. The three would be in competition with each other to provide this additional capacity. Ryanair also thought that if there was separate ownership there would be more capex, and more efficient capex, because each owner would be more focused on each airport delivering additional capacity without the cross-subsidization of which was going on, for example, in relation to T5. If there were three competing London airports, Stansted could be offering discounts to the likes of BA in Heathrow and Gatwick in order to attract their short-haul traffic.

16. The airline said that, having broken up BAA, effective regulation remained vital and should be based on control of the RAB. A suitable regulatory regime would at its heart support development only with user support for new facilities. In the current ownership situation, if agreement could not be reached with the users, there should be an onus on BAA to demonstrate that it had done its best to provide facilities at a reasonable cost for these users. Equally there should be an onus on the users to explain why they thought something should or should not be built. BAA must be able to demonstrate that it took consultation seriously. At the moment in Stansted they could not do so. Ryanair believed that it should have a much bigger part in the development of facilities and that BAA should consider alternative funding mechanisms, such as co-funding with users, as Ryanair had proposed repeatedly over the second terminal at Stansted. Rewards should be built into the new regulatory system for the successful growth and development of an airport. Ryanair believe that there would be a much brighter future for BAA if it built low-cost efficient facilities that encouraged rapid traffic growth. The airlines would respond with rapid traffic growth. Ryanair believed the BAA would make more money out of that than they would by clinging to the massive G2 capex which would ultimately restrict and

kill off traffic growth. At present, however, airlines were unreasonably excluded from consultation on progress because BAA enjoyed a system that allowed them to build what they wanted, when they wanted and where they wanted and then to be excessively rewarded by the regulatory regime for wasting their own and the airlines' money.

Effect of new owners of BAA, Ferrovial

17. On this, Ryanair considered that management changes, a focus on delivering financial returns to the new owners, insensitivity to political concerns and the regulatory environment in the UK, and the delays in recruiting for the new security demands had caused the BAA's airport operations to deteriorate in the first year since the Ferrovial acquisition. For G2 BAA continued to roll forward plans without consultation. They were slightly more aggressive in retail sales.

Terminal competition

18. One way of injecting competition into the system might be to create separate ownership of terminals in airports. At JFK three airlines ran, leased or owned three of the five terminal buildings. Ryanair saw no reason why competing terminals should not work in the UK. Ryanair accounted for 60 per cent of the traffic at Stansted, so why should it not be allowed to build a separate terminal at Stansted Airport? At Gatwick, BA had the north terminal. While it might be owned and controlled by the BAA, basically it was a BA terminal. T5 at Heathrow was also entirely a BA terminal. But BAA had excluded any possibility of Ryanair or any other airline tendering for G2, or operating G2, or having a competitive process which would allow the CAA to assess the competing merits of BAA's proposals to spend £4 billon on it and of Ryanair's belief that it could do it for approx £1 billion. The problem at the moment was that BAA was able to exclude all competitors and run developments itself, while from an operational point of view, there was nothing to prevent separately owned and competing terminals.

Low fare airlines

19. As to the responsiveness of airport operators and infrastructure providers to the needs of the low fare airlines, Ryanair said that the airline industry had grown up with airlines which were on a quite different model from Ryanair and regulated airport operators had not realized how big Ryanair and other low fare airlines were in the market. There had been a remarkable transformation right across Europe at most other airports. At almost every other airport that was not a regulated monopoly there was a very active engagement with all the airlines about the development of facilities.

Possible method of assessing capex in Q5

20. Ryanair favoured the concept of zero rating to produce a base price and then a negotiation for a price above that. It would determine a fair base market price at Stansted having stripped out all the historic over-investment and that would represent the standard service at Stansted. If a particular airline then wanted something better or different from that, and was willing to pay for it, that should go ahead.

Relationship between BAA and CAA/Department for Transport

21. Among features in this relationship mentioned by Ryanair were:

- BAA had a very big and acknowledged input into government thinking, and the last White Paper appeared very much to be BAA's blueprint of how it wanted to develop London Airports for the next 20 years.

- BAA always took the view that additional facilities would mean higher charges to the airlines and that BAA must always be rewarded. Both the CAA and DfT have accepted this erroneous concept.

De-designation

22. Ryanair thought that the case for de-designation of Stansted would be somewhat stronger if it was in separate ownership. Its concern would be over what would happen at the other two airports. If Stansted or if the three London airports moved to de-designation then, even in separate ownership, one large abusive monopoly would simply be replaced by three smaller equally abusive monopolies because all three airports were operating at full capacity. Ryanair had earlier said that these three separate owners would start competing for development of capacity, but there was likely to be a monopoly problem while they got through the planning stages and actually built—stages which would take three to five years at best. Whether Stansted was de-designated or not, if it remained under BAA continued ownership Ryanair feared that BAA would simply drive through the £4 billion G2 plan on the basis of the White Paper.

Ryanair's view of the Scottish Airports market

23. Glasgow and Edinburgh were interchangeable markets. Wherever there was a lower fare a significant proportion of the traffic would certainly move between Glasgow and Edinburgh. The business traffic would not. Given that they were relatively small regional airports, Ryanair considered Edinburgh and Glasgow to be remarkably expensive. The facilities they had were overgenerous for their size. In principle, subject to a low enough price, Ryanair considered that it could serve its Scottish market business equally well from Edinburgh as from Glasgow. It would not consider, however, abandoning Prestwick. The point was that it could be useful to have a facility in Edinburgh so as to offer Edinburgh as a destination for its overseas services.

Ryanair reduces Stansted flights

Budget airline Ryanair has announced a reduction in its services at Stansted Airport, blaming higher charges.

Ryanair will reduce the number of aircraft it runs at the airport by 40% in its winter schedule, and will cut the number of flights by 30%, it said.

But it will operate only four fewer planes than it did last winter.

The company said that Stansted was one of its most expensive bases, and added that an increase in air passenger duty tax was also a factor in its decision.

The airline operated 40 aircraft from Stansted in the summer, but said this would fall to 24 this winter.

Last winter, Ryanair also cut its Stansted fleet to 28 planes from 36 in the summer.

Stansted Airport's managing director, Stewart Wingate, said: "It is common practice for [Ryanair] to reduce frequency to various destinations during the winter season as they have done in previous years.

"However, it should be noted that Ryanair recently announced it will launch a new service to Oslo from Stansted this October."

Ryanair said it would switch the 16 aircraft it was withdrawing from Stansted to other European bases. It expects to carry 2.5 million fewer passengers between October and March as a result of the latest move.

Ryanair also confirmed it had been in talks with European safety regulators about proposals to allow passengers to stand on its flights.

Tourist tax

In November, air passenger duty will increase from £10 to £11.

Ryanair said it had written to the prime minister, asking him to scrap "this damaging tourist tax", adding that several other European governments had done so in recent months.

Ryanair chief executive Michael O'Leary said that UK traffic and tourism was collapsing, although Ryanair continued to "grow traffic rapidly in those countries which welcome tourists instead of taxing them".

"Ryanair's 40% capacity cutback at London Stansted shows just how much Gordon Brown's £10 tourist tax and the BAA monopoly's high airport charges are damaging London and UK tourism and the British economy generally," he added.

Mr O'Leary added that Britain's airports would see 10 million fewer passengers this year.

RE PROVISIONAL CONSIDERATION DATED 30 MARCH 2011

RESPONSE OF RYANAIR LIMITED

1. This is the response of Ryanair Limited ("Ryanair") to the Provisional consideration of possible material changes of circumstances of the Competition Commission ("CC") dated 30 March 2011 ("the Provisional Decision").

2. Ryanair agrees with the conclusions of the Provisional Decision and, in particular, that there has been no material change of circumstance that would justify a change to the remedies imposed by the 19 March 2009 report of the CC ("the 2009 Report").

3. In the Provisional Decision, the CC has rejected most of the supposed "material changes in circumstances" proposed by BAA on the grounds that they are not material changes at all. Ryanair respectfully agrees.

4. In the Provisional Decision, the CC proposes to accept that the Coalition Government's opposition to the proposals for the third runway at Heathrow Airport (Heathrow) and SG2 at Stansted and its opposition to new runway development at Gatwick, constitute a significant development because, it is said, such a new policy means that the delivery of runway capacity will be delayed or not take place at all.

5. Ryanair would respectfully suggest that even if this is a "significant" development (which Ryanair does not accept) it is one whose importance should not be exaggerated and certainly does not come close to justifying a change to the remedies set out in the 2009 Report. In summary:

   (1) Regardless of the change of policy, there is now spare capacity at London airports because, in large part due to BAA's monopolistic pricing, there has been a decline in traffic which has freed up existing capacity. This is a countervailing factor that entirely negates any significance that the change BAA refers to may have had.

   (2) Secondly, the Government's policy relates only to an opposition to building new runways. It does not extend to not increasing capacity; on the contrary, there are strong indications that Government supports other methods of expanding capacity. As explained below, there are numerous ways of increasing capacity without building a new runway. Accordingly, even if

increases in capacity were a necessary condition for realising the benefits of divestment (which is not accepted) such a necessary condition is satisfied.

(3) Thirdly, as the Provisional Decision rightly notes, the benefits of competition are not premised entirely (or even largely) on the existence of spare capacity. There is ample scope for competition even between capacity-constrained airports. Given the spare capacity, the scope for such competition has increased yet further.

(4) Fourthly, it was always the case (and recognised in the original report) that the creation of additional airport capacity by way of additional runways was something that was always long term – as well as highly contingent and uncertain. At most, the supposed change simply imposes a further constraint – of persuading the government to relax its existing policies.

(5) Fifthly, the current Government's current opposition to more runway capacity is not expressed to be for all time. In the long run, it is exceedingly unlikely that even the existing Government will wish, or be able, to maintain an indefinite opposition to additional runway capacity given its recognition of the economic importance of connections to London. Rather, at most, the Government will seek to reconcile such additional runway capacity with its environmental goals.

(6) Finally, the Coalition Government's policy is itself, in large part, a result of BAA's monopoly and its consequent failure to lobby for additional capacity. It cannot, therefore, be right that BAA is permitted, in this way, to take advantage of its own wrong and to use that as an excuse to perpetuate that monopoly. On the contrary, it only underlines the importance of putting in place a competitive structure that will give airports an incentive to lobby Government to expand capacity in the long term – which, done in an environmentally sensitive manner, will bring resultant benefits to consumers.

We briefly expand on each of the above points below.

(1) There is spare capacity

6. None of Heathrow, Stansted or Gatwick airports is currently operating at full capacity, although Heathrow is nearing its previous pre-T5 demand levels. Ryanair is aware that T5 was intended to provide increased capacity at the Airport.

7. In particular, as noted at paragraph 137 of the Provisional Decision, the decline in traffic at Stansted means there is now substantially more spare capacity available to allow competition for traffic to develop. There is also now significant spare capacity at Gatwick, which the new owners are seeking actively to promote.

8. This is a more significant development than the change in Government policy (or, at the least, an equal and opposite development). What it means, in short, is that provision of new runway capacity is a much less important consideration because any additional capacity that is required for fully effective competition to take place is already with us today.

9. Furthermore, Ryanair would suggest that it is plain that the decline in traffic at Stansted (that has freed up this capacity) is not principally the product of the recession, still less the result of 'buyer power' from low cost airlines. Rather, it reflects BAA's overwhelming focus on growing revenue from Heathrow, where they earn far more per passenger. This has given BAA no net financial interest in offering a more competitive offering at Stansted – leading to the spare capacity. In addition Stansted, under common ownership and without the motivation to attract passengers away from Heathrow, can make a better operating profit by charging more to fewer passengers. This can be demonstrated by the table below:

TABLE 1

Year to March	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Terminal Passengers (000's)	19,409	21,169	22,237	23,845	23,541	21,635	19,758
Net Revenue from Airport Charges (m)	£54.3	£62.4	£72.5	£80.7	£138.3	£141.1	£132.9
Net Revenue per pax from Airport Charges	£2.80	£2.95	£3.26	£3.38	£5.87	£6.52	£6.73
Other Revenue (m)	£93.5	£101.7	£103.1	£108.2	£112.1	£107.7	£103.2
Expenditure (m)	£113.1	£122.3	£136.9	£155.2	£187.2	£186.9	£178.1
Regulatory Operating Profit (m)	£34.7	£41.8	£38.7	£33.7	£63.2	£61.9	£58.0
Regulatory Operating Profit per Passenger	£1.79	£1.97	£1.74	£1.41	£2.68	£2.86	£2.94

10. As paragraph 100 of the Provisional Decision rightly recognizes "*Ryanair has not to date successfully used its strong position at Stansted to achieve the terms and conditions for use of the airport that it is seeking*".

11. Whilst BAA has been able to increase revenues at Stansted, the higher revenues which it can earn at Heathrow means that it has far greater incentive to facilitate growth at that airport. This reflects conduct on the part of BAA that, given common ownership, is only to be expected from any rational monopolist in BAA's position.

(2) Increase in capacity possible without new runways

12. Even if there was not current spare capacity, there are, in any event, numerous ways of increasing capacity without building a new runway. In particular, as the CC observes, using larger planes and better use of slots can do this.

13. Ryanair would add that there are a number of further, well recognised, ways of increasing capacity at an airport. In particular:

    (1) Runway movement capacity can be increased by more efficient operations; by incentivising (or even requiring) airlines to operate aircraft with higher seat density;

    (2) Runway utilisation can be optimised by incentivising maximisation by airlines of load factors;

    (3) Terminal capacity can be increased by incentivising internet check in and CUSS check in methods; by incentivising less hold baggage by passengers (and hence less use of bag drop and check in facilities); by limiting the number of carry-on bags (thereby reducing the burden on security) and by increased investment in infrastructure.

    For all the reasons already canvassed by and before the CC, independently-owned, competing airports are far more likely to seek to achieve such increased capacity than BAA. In this regard, it is notable that, under its new ownership, Gatwick has recognised the scope for significant increases in capacity through better use of runway capacity. (See paragraph 137 of the Provisional Decision).

(3) Independent competitive benefits

14. As rightly identified in the Provisional Decision, the 2009 Report identified numerous competitive benefits quite independent of capacity increases (let alone runway capacity increases) that independent ownership could be expected to bring.

15. In particular, the CC's 2009 report found that under separate ownership there would be scope for competition even within current capacity (Appendix 5.1 paras 20-21). Para 45 of Appendix 10.1 to the Report expressly sets out likely benefits of divestment even in the presence of excess demand. We will not repeat these, but, as already stated in previous submissions, these benefits are fully endorsed and accord with Ryanair's experience.

16. As regards Gatwick in particular, Ryanair has already described the limited, but real, emerging competitive benefits from its recent independent ownership.

17. We have also explained how, in our view, increased competition between London Gatwick and an independently owned Stansted would generate SUBSTANTIAL further benefits.

18. We note that the Provisional Decision records the following at paragraph 64:

"*Ryanair also said that separate ownership of Gatwick had not stimulated a competitive response by Stansted. BAA noted this and said that there was no rational basis for a view that Gatwick's competitive behaviour depended on the ownership status of Stansted, and that it would be perverse for the CC to require BAA to divest Stansted to make Gatwick behave more competitively. We noted BAA's comments; however, the purpose of the remedy requiring divestment of Stansted is to encourage competition between all three airports in the South-East.*"

19. We agree with the Provisional Decision. In particular, we stand by what we said in our original submissions (at para 29) namely that "*Separate ownership of Gatwick has not stimulated a competitive response by Stansted. Stansted's own divestment will be necessary to achieve that result.*" And "*Gatwick will only behave competitively in the event that it comes under competitive pressure from Stansted – something that will not happen unless Stansted is in separate ownership*".

20. As noted above, BAA has alleged that our submissions are not "rational" or are even "perverse". This allegation is, however, based on a plain mischaracterisation of the point that Ryanair has made. Ryanair's point is not that separate ownership of Stansted will, in and of itself, cause Gatwick to behave differently. Our point is not (and never has been) that, in the first instance, separate ownership of Stansted will *automatically* and in isolation change Gatwick's conduct and cause it to behave competitively. Rather, the point we have made (and continue to make) is that

divestment of Stansted will, in all likelihood, give rise to different and more competitive conduct on the part of Stansted itself – and that will, in turn, likely spark more competitive conduct by Gatwick. In particular:

(1) The likely change in Stansted's conduct under separate ownership is expressly adverted to in the 2009 Report. For example, at para 45 of the Report (cited in our response at para 15) it is noted that, even in the presence of excess demand at Heathrow, the divestiture of Stansted is liable to lead Heathrow to lower passenger charges (because the impact on Stansted would no longer be factored in to the profitability of doing so) and that Stansted would also be expected to compete with Heathrow to retain passengers and on service quality. In relation to the latter, it may also be noted that under separate ownership (and particularly given the spare capacity that now exists) Stansted might also *initiate* such competitive conduct as against Heathrow (because the impact on Heathrow would no longer be factored in to the profitability of doing so). Whichever airport initiates the competitive conduct (Stansted or Heathrow), under separate ownership, Stansted may reasonably be expected to improve quality and reduce its prices.

(2) That changed (and newly competitive) conduct by Stansted will, in turn, very likely have an impact on Gatwick. In particular, it should prompt Gatwick to behave more competitively (by increasing its own service quality and reducing its prices). That is because, if Gatwick fails to respond to Stansted's more competitive offerings, Gatwick is liable to lose valuable passengers and revenue.

(3) This competitive conduct by Gatwick should engender a competitive response by Stansted – and so on.

21. In other words, the separate ownership of Stansted is likely to lead to the establishment of a beneficial competitive *dynamic* between the three airports. That is how competitive markets (such as the airline industry) operate.

22. Such a suggestion is hardly novel or contentious. On the one hand, there is the possibility of leaving the current situation where there is effectively a duopoly – with one clear leader, BAA, owning 60% of London's runway capacity and GAL owning Gatwick. On the other hand there is the possibility of changing the position such that there become three competitors (Heathrow, Gatwick Stansted) of more equal size. One does not need a degree in industrial economics to know under which market structure there is more likely to be more vigorous competition.

23. Further, Ryanair agrees with the Provisional Decision's conclusion that there is now, on a proper analysis, more - and certainly not less - scope for competition (direct or indirect) between Heathrow and Stansted, if only they were under separate ownership.

24. Ryanair can confirm that it is not the case, as BAA has suggested, that there is significant competition to Stansted from non-UK airports. Whilst Ryanair can, to a limited extent, mitigate its losses at Stansted by moving aircraft and developing bases in Europe, such action is no substitute for serving the key market around London and South East England. It is important to bear in mind that the figures quoted by BAA are liable to be misleading – as they reflect a time of rapid fleet expansion and the need for Ryanair and easyJet to develop new markets.

25. In particular, Ryanair's decision to move some capacity from Stansted was, in effect, a decision partially to exit a market caused by BAA's refusal to offer competitive terms.

26. Moreover, the proof of BAA's monopoly power is in the eating. Whatever BAA may say, there is simply no evidence that pressure either from supposed 'buyer power' from low cost airports or from continental European airports has led to any constraint whatsoever on BAA's behaviour at Stansted. Stansted continues to price to the cap rather than reducing prices as a response to the downturn and to use up its own substantial spare capacity. It is hard to conceive of any company operating in a competitive market acting in such a manner.

27. Finally, in this regard, we do not accept that Stansted's financial performance has, on analysis, deteriorated. Its profit per passenger is continuing to grow as seen in the table taken from BAA's Regulatory Accounts. As the CC recognizes, Stansted remains more profitable on an EBIT basis than other European airports.

(4) Additional runway capacity was always recognized as uncertain and long term

28. The 2009 Report always recognised that runway capacity was uncertain and highly contingent. In particular, it recognised that Government policy (then in favour of additional runway capacity) was never sufficient in itself to ensure that additional runway capacity would be delivered.

29. As the 2009 Report expressly said at para 4.15(c), in very tentative terms, it "*may potentially lead to more capacity*" and that new capacity would come into effect "*subject to environmental requirements being satisfied and the final outcome of planning inquiries, by around 2017 at Stansted and 2020 at Heathrow*".

30. The 2009 Report was therefore never premised on the certainty of new capacity in the form of additional runways – it always recognised that such capacity might not materialise on time (or at all) in view of environmental and planning considerations. On any view, the 2009 Report always assumed that the first additional capacity in the form of an additional runway would, at the very earliest, only materialise no less than 8 to 11 years from the date of the report i.e. in the long term.

31. Moreover, the environmental requirements foreseen by the 2009 Report are the principal reason for the Government's change in policy in the short to medium term. On one view, therefore, this is not a significant change at all; it is simply a contingency foreseen in the 2009 report coming to pass.

(5) Government policy is not immutable

32. It is entirely wrong to regard current Government policy as immutable. Indeed, every indication is that it may reasonably be anticipated that the present Government (and indeed any Government) will accept expansion in runway capacity in the long run.

33. In this regard, since the CC published its Provisional Decision, the Government has published its document entitled *Developing a Sustainable Future for UK Aviation: Scoping Document* ("the Scoping Document") on future aviation policy. Whilst this report confirms that no new runways are in prospect at least in the short term, it also refers to the "strong view" from some stakeholders, particularly within the business community, that additional airport capacity is required to meet the UK economy's needs. By clear implication it thereby leaves the door open to additional runway capacity in the longer term: see paragraph 2.18 of the Scoping Document.

34. The Scoping Document also shows an intent by Government to make better and more efficient use of existing capacity and a willingness (subject to environmental requirements) to take legislative and other steps to put that intent into effect: see paras 2.12 to 2.15 of the Scoping Document.

35. Moreover, as illustrated by the recent letter dated 29 March 2011 to the Times [Appendix A] from no less than 74 Chief Executives, Chairmen or senior executives of major British companies, there is already growing and substantial pressure on the Government to revisit its policy on new runways. It is not realistic to suppose that these demands will simply be ignored indefinitely.

36. As we discuss below, it is notable, but not surprising that BAA's executives are not amongst the signatories of this letter.

Taking advantage of their own wrong

37. As the 2009 Report observes at paragraphs 5.25:

"...the situation that currently prevails under common ownership — where significant capacity expansion at one BAA London airport would generally take traffic away from (cannibalize) others and therefore reduce BAA's incentives to undertake and push forward with capacity expansions— separate owners would face stronger incentives to expand capacity and win traffic from rival airports. Their decisions would also be undistorted by the fear of a common owner that promoting a project at one of its airports would adversely affect the prospects of obtaining approval for projects at its other London airports.

We would therefore expect separate owners to display a greater appetite for runway capacity expansion than BAA has and to lobby the Government accordingly for the necessary policy framework to support such development, rather than lobby against them as BAA appears, at times, to have done."

38. In other words, current Government policy in opposition to more runway capacity is itself in part a result of common ownership under BAA. As the 2009 Report recognised, such common ownership has given BAA little appetite to support such runway expansion.

39. In this regard, it is interesting to contrast the approach of BAA and (now independent) Gatwick to current Government policy on new runways. BAA has either embraced or, at best, limply acquiesced in the new policy. By contrast, independent Gatwick has registered its disapproval and commenced lobbying the Government hard for appropriate changes to its policies [see Appendix B].

40. It would be ironic and most unfortunate if a policy failure borne partly of BAA's own monopoly could serve to justify the preservation of that very monopoly.

APPENDIX A

Letter to the Times on 29 March 2011

THE TIMES

The strategy for growth must start with improving airports

March 29 2011 12:01AM

Our main airports — particularly in the South East — are blighted by overstretched infrastructure

Sir, Having taken crucial fiscal steps to reduce the deficit, the Government needs a strategy for growth.

Continued investment in capacity-building transport infrastructure such as London's Crossrail and Birmingham's New Street Station is welcome. However, there is, as yet, no plan to secure the UK's international connectivity.

Our main airports — particularly in the South East — are blighted by overstretched infrastructure, where the slightest disruption results in thousands of passengers queuing in the terminal and dozens of aircraft circling overhead. High Speed Rail will enhance connections to UK and near-Europe destinations, but business also needs to reach fast growing markets in the Far East and South America.

The Government's forthcoming aviation review must demonstrate compatibility with carbon reduction targets and offer a credible approach to capping local air pollution, but it cannot and must not ignore the economic benefits of flying.

All options must be considered, short and long term, to address growing demand.

Baroness Valentine, Chief Executive, London First; Mark Elborne, President and CEO, GE; John Griffith-Jones, UK Chairman, KPMG; John Stewart, Chairman, Legal & General Group Plc; Sir Winfried Bischoff, Chairman, Lloyds Banking Group; Steve Holliday, Chief Executive, National Grid; Andreas J. Goss, Chief Executive, Siemens

Anton Valk, Chief Executive Officer, Abellio; David Campbell, President & CEO – AEG Europe / The O2, AEG Europe; Roger Madelin, Joint Chief Executive, Argent Group; Surinder Arora, Chairman, Arora International; David Alberto, Chief Executive, Avanta; Sean Mulryan, Executive Chairman, Ballymore Group; Tony Pidgley, Chairman, Berkeley Group; Victoria Mitchell, Deputy Chairman, Berkeley Group; David Blitzer, Senior Managing Director, The Blackstone Group International Partners LLP; Adrian Foster, Partner, Booz & Company; Jean-Louis Bravard, Director, Burnt Oak Partners Ltd; Rod Macdonald, Chairman, Buro Happold; Hugh Seaborn, Chief Executive, Cadogan Estates Limited; George Iacobescu CBE, Chief Executive, Canary Wharf; Stephen Hubbard, Deputy Chairman UK & EMEA, CB Richard Ellis; Robin Hall, Chairman, Cinven; Peter Ecsery-Merrens, Director IBSG, Cisco; Stuart Fraser, Chairman of the Policy & Resources

Committee, City of London Corporation; Steve Parkin, Chairman, Clipper Logistics Group; Andreas Markides, Chairman, Colin Buchanan; Des Gunewardena, Chairman & CEO, D&D London; John Connolly, Senior Partner and Chief Executive, Deloitte; John Burns, Chief Executive, Derwent London plc; Julian Barwick, Director, Development Securities plc; Robin Tye, Chief Executive Officer, Ernst & Young LLP; Richard Banks, Chief Executive Officer, European Land & Property; Cornelius Medvei, Partner, Eversheds; Kevin Murphy, Chief Executive Officer, ExCel; Geoffrey Pelham-Lane, Global President, FD; Ian Mulcahey, Global Head of Planning, Gensler; Toby Courtauld, Chief Executive, Great Portland Estates; Peter Vernon, GBI Chief Executive, Grosvenor; Jonathan Scott, Senior Partner, Herbert Smith; Peter Ferrari, Managing Director, Heron International; Ian Carter, President of Global Operations, Hilton International; Simon Vincent, Area President Europe, Hilton Worldwide; John Young, Co Chair, Hogan Lovells; Robert Hamilton, CEO and Founder, Instant Offices; Dave White, Managing Director, ITRM; Simon Camamile, European Director National Investment, Jones Lang LaSalle; George Kessler CBE, Joint Deputy Chairman, Kesslers International Limited; Robert Noel, Managing Director, London Portfolio, Land Securities; David Cheyne, Senior Partner, Linklaters; Charles Millard, Director, Head of Office, M Moser Associates; Mark Reynolds, Deputy Chief Executive, Mace Ltd; John Morgan, Executive Chairman, Morgan Sindall Group plc; John Spencer, Chief Executive, MWB Business Exchange Plc; Steve Holliday, Chief Executive, National Grid plc; Lord Marshall of Knightsbridge, Chairman, Nomura International plc; Michael Crossan, Chairman, Powerday; Ian Powell, Chairman and Senior Partner, PricewaterhouseCoopers LLP; Ray Auvray, Executive Chairman, Prospects Services Ltd; Jeremy Titchen, Managing Director, Qatari Diar Development Company (UK) Ltd; Jasminder Singh, Chairman, Radisson Edwardian Hotels; Irvine Sellar, Chairman, Sellar Property Group; Gareth Pearce, Chairman, Smith & Williamson; John Synnuck, Chief Executive, Swan Housing Association; Daniel Rosenberg, Partner, Taylor Wessing LLP; Peter John, Vice Chancellor, Thames Valley University; Mike Nichols, Chairman and Chief Executive, The Nichols Group; Gareth Clutton, Chief Executive, The Portman Estate; William McKee, Chairman, Tilfen Land; Ric Lewis, Chief Executive, Tristan Capital Partners; Vincent Clancy, Chief Executive Officer, Turner & Townsend Plc; Richard Hardie, Chair, UBS Ltd; James Wates, Deputy Chairman, Wates Group Ltd; David Smith, Chief Operating Officer, Wates Construction; Michael Gutman, Managing Director (UK/Europe), Westfield

APPENDIX B

1. Article: FT.com (Gill Plimmer), dated 26 January 2011

2. Transcript of speech of Sir David Rowlands, Chairman, Gatwick Airport at the Transport Times Conference on 27 January 2011

FT.com FINANCIAL TIMES

UK
POLITICS & POLICY

Close

Gatwick chief hits at UK aviation policy

Print

By Gill Plimmer
Published: January 26 2011 00:56 | Last updated: January 26 2011 00:56

The government's opposition to new runways in the south-east will come under fire on Wednesday, with the chairman of Gatwick calling its aviation strategy "ludicrous".

Speaking ahead of a conference expected to underline growing business frustration with the moratorium on expansion, Sir David Rowlands, a former permanent secretary at the transport department, said the government lacked "evidence or analysis" to support its position.

"This government doesn't even have a strategy; it's ludicrous. There is no evidence or analysis to back the government's policy. The government is sitting on its hands while passengers suffer."

David Cameron ruled out building more runways at **Heathrow**, Stansted and Gatwick within days of taking office last year, to the consternation of business groups who believe it will make London less accessible. The government is due to start consulting on its aviation strategy next month, with the outcome published in 2013.

Sir David, who left the department in 2007, dismissed the idea that regional airports would soak up the the overspill from Heathrow, Gatwick and Stanstead because they are already "busy enough".

According to the latest government predictions, air passenger numbers will nearly double to 455m a year by 2030, with 230m of these using airports in the south-east.

The **previous government**, **British Airways** and airport group BAA have all warned that Britain's economic competitiveness will be damaged without a **third runway at Heathrow** to connect it to new destinations in emerging markets such as China.

"Business can't get to China by train; and this is where the business is," said Sir David.

Gatwick airport was sold by BAA in December 2009 to a consortium led by Global Infrastructure Partners, an investment firm, in a £1.5bn ($2.4bn) deal. Sir David said the airport had no plans to build a second runway but had reserved land for one in order to keep its options open.

YOUR LONDON AIRPORT
Gatwick

Strategies without evidence are dangerous

Sir David Rowlands, Chairman, Gatwick Airport
Transport Times Conference, 27 January 2011

Introduction

Good afternoon.

I guess that during the course of today you have been armed with statistics, analysis, forecasts and scenarios to highlight the prospects for UK aviation.

Governments may change but, however inconvenient, the data and the evidence don't. This matters because "strategies" without evidence are just empty rhetoric...and dangerous.

First, let me cover a few basic facts.

On the credit side aviation is a critical pillar of the UK economy. The sector directly generates almost £9 billion for our economy each year with around £2 billion from Gatwick alone. Ours remains one of the few sectors in which the UK enjoys a comparative advantage globally, but it is fast disappearing.

On the debit side our industry recognises its impact on the local environment and its contribution to global carbon emissions and climate change. Airlines, aircraft manufacturers and airports are making investments that will pave the way to decarbonising flying. At the same time we are being taxed significantly for environmental ends.

That's why Gatwick has set challenging targets to reduce its emissions by 50% by 2020. It's why the sector has welcomed its inclusion in the EU Emissions Trading Scheme. And why tens of millions of pounds are being invested every year to develop new low carbon technologies.

So far this Government seems to have majored on environmental issues and paid just lip service to aviation's contribution to the economy – when its job should be to look at the evidence, analyse what it all means and then balance the two considerations. I will come back to that balancing role later.

No more runways in the South East

Why do I say lip service? Well look at the cancellation, within days of coming into office, of the third runway at Heathrow and opposition to a second runway at Stansted, and another at Gatwick for that matter.

What were the Coalition Government's arguments for this? Let me take them one by one.

First the Government said, and I quote, "we recognise that the local environmental impacts of ever increasing usage of the South East's key airports outweigh the potential benefits" (Philip Hammond's speech on Sustainable Transport, 10 September 2010).

How? The Department for Transport calculated a net benefit of more than £15 billion from a third runway at Heathrow and a second runway at Stansted. It is one of those inconvenient facts. And note this was the "net" benefit. So what else did the Government put into the calculation that outweighs £15 billion? Votes?

Second the Government said, and again I quote, "we carefully considered the wider environmental impacts in the context of our – and our predecessors' – clear commitments on climate change" (Philip Hammond's speech to the Airport Operators Conference on 25 October 2010).

Has this Government considered the Committee on Climate Change's advice to the last Government about aviation? The previous Government did which is why it felt able to support additional runway capacity in the South East.

I think it is worth reminding ourselves what that Committee said in its overall assessment.

"On future airport policy.... air transport movements should not increase by more than about 55% from 2005 to 2050 ..." and its main conclusion that "any future airport expansion stays within a limited increase of passenger demand of 60% by 2050". It's an awfully long way from these well-evidenced conclusions to an ill-conceived "no more runways".

Surely, in July this year, when Government issues its response to the Climate Change Committee's report, it has to recognise that aviation growth and tackling climate change can indeed coexist.

Third, and again I quote, "the development of a high speed rail network has been a key factor in our decision on additional runways at London's airports" (Philip Hammond's statement on High Speed Rail, 20 December 2010). That is the high speed network which goes nowhere near Gatwick or Stansted and which will not have a direct link to Heathrow for at least 20 years!

Just in case anyone thinks it might eventually make a difference, it won't. I chaired High Speed Two when it produced the report which this Government has now endorsed. A link to Heathrow does little for the high speed network and the network doesn't do much either for Heathrow. This isn't simply just another of those inconvenient facts. What is a fact is that it is a total nonsense to suggest that building a high speed network means there is no need for more runway capacity in the South East.

And finally how did the Coalition go about deciding all this? One last quotation. "In taking that decision, we listened not just to business, but also to those who would be most affected by the local environmental impacts of proposals for expanding Heathrow, Gatwick and Stansted", I don't recall this consultation. Does anyone?

For the record, we have no current plans to develop a second runway at Gatwick.

We will continue to safeguard land in the eventuality that another runway is required. But Gatwick's management team is busy enough investing £1 billion in our existing infrastructure to transform the experience for passengers.

And also for the record I believe this Government's decision to oppose new runway capacity in the South East is possibly the worst strategic decision taken by any Government during all my time in transport.

Not because it is necessarily wrong. I happen to believe it is but others could quite legitimately disagree. But because a decision of quite breathtaking importance for both the future of UK aviation and for the economic well being of this country was taken, whatever all that "listening" involved, within days of coming into office and with scant regard for the evidence, with wanton disregard of expert analysis and with no attempt to properly balance what I admit are difficult considerations.

I said I would return to the question of "balance".

It is not the job of Government to represent local interests - that is for MPs. It is not the job of Government to take decisions based on local interests – that is for local government.

Government's job is to balance local, national and international considerations, both economic and environmental, before arriving at a well-evidenced strategy and a progressive set of policies.

I am afraid that rhetoric alone simply will not do. Nor will random suggestions like higher Air Passenger Duty at South East airports in the absence of a coherent overall strategy for all Britain's airports.

Towards a new strategy for UK aviation

So how should Government go about putting in place a new strategy for aviation?

Frankly rather more speedily than presently planned. It is ludicrous to put a stop to airport expansion in days and then spend years deciding what it all means.

You will not be surprised if I say any strategy must start with the evidence. And for aviation that must begin with air traffic forecasts and how they do or do not correlate with airport capacity.

The last Government's demand forecasts back in 2009 saw passenger numbers in the UK growing to about 455 million passengers a year by 2030. 250 million of them would be using South East airports. The present Government's block on new runways means that there will be capacity for only about 180 million. So from this I think we can draw two conclusions.

First as matters stand, there will inevitably be substantial suppressed demand for runway capacity in the South East. By 2030 70 million passengers will be looking for a new home.

Second, regional airports will never be able to meet the shortfall. They are likely to grow faster in any event than the South East airports. With the 2009 forecasts suggesting that airports outside London will see an extra 110 million passengers in the 25 years to 2030 they will have their hands full just dealing with their own regional demand. And frankly, in any case international passengers wanting to visit London aren't going to fly to Manchester or Birmingham and then take a train. They just won't come.

If Government wants to claim that is it no longer in the business of "predict and provide" and opts not to provide for demand growth in the South East, then it must have a thorough understanding of the consequences and it must set them out together with the possible policy responses, such as options for pricing scarce slots and the knock-on effect for thin routes.

It must have a detailed understanding of the consequences for Heathrow as a competitive global hub. As an island nation, global connectivity is absolutely vital to the future prosperity of the UK. Heathrow is our only hub airport. It is unique and it is infantile to pretend that other airports could play that role. Not Gatwick nor Manchester nor any other UK airport.

If Government is serious about maintaining a successful global hub then its aviation strategy must set out how this will be achieved – underpinned by rigorous analysis. Bold statements of sentiment mean nothing when competitor airports like Charles de Gaulle has 4 runways, Schipol 5, Madrid 4 and so on.

It must evaluate the impact on the UK economy and on specific sectors such as the City of London or inbound tourism. It must count the cost – both financial and reputational – of severe capacity constraints and failure to serve particular destinations.

A successful and efficient hub at Heathrow is only one facet of our island's need for connectivity. Airports that focus on point to point connectivity are equally vital to the continuing development of a growing and globally competitive aviation sector in this country. It would be wrong and misguided for Government to have only a Heathrow-centric approach to aviation strategy.

On slots Government must decide whether to leave it to the market to price for scarcity. And if it does, then it must recognise that the long run consequence at airports like Gatwick will be the exit of carriers operating smaller aircraft.

Government's analysis of economic impacts must also set out, by region, how much of suppressed demand – inbound and outbound – is likely to be business travel and how much is leisure traffic. Vague references to regional airports and high speed trains simply will not do.

I firmly believe – indeed I know because the work was done for the 2003 White Paper – that any serious analysis will show an overwhelming case for more runway capacity in the South East.

That is why I welcome the Mayor of London's calls for the Government to get serious about airport capacity for London and the South East. What I don't agree with is that the solution is a new airport in the Thames Estuary. Even if – and it's a big if – Government entertain the idea of new hub airport for London and someone – heaven knows who – could be found to pay for it, it would be 30 years in development. So what is the medium term strategy? Or do we simply sit on our hands until then?

I think there is a real danger that continued talk of floating runways will allow too many people to avoid confronting the real issues.

Serving the passenger

The passenger experience is something we hear a lot about and rightly so. Investing to improve the service we deliver to passengers and airlines has been our main goal at Gatwick during our first year of independent ownership.

In fact building on the service improvements made during our first year in new ownership, we have just published our Gatwick Passenger Commitments – conceived and agreed with our airlines and business partners and summed up in three simple statements:

1. We'll treat you as our guest
2. We hate queues
3. We love to be on time

It follows, therefore, that we are happy to be part of the South East Airports Taskforce and happy to support the Government's goal of improving service and efficiency at airports. But "Better not Bigger" is not a substitute for a proper long-term strategy.

I guess I know a lot about Government involvement in transport services and it is not a pretty picture. Remember the routes taken from British Airways at privatisation and given to British Caledonian only for it to end up in a heap. Remember the rolling stock built for Eurostar services which never ran. The international station at Stratford which has never opened for services... Railtrack... PPPs. I could go on.

And the successes in an area like aviation? Well, the CAA never wanted to give a licence to Virgin Atlantic. And could any Government with public sector ideas of what constitutes good service have ever have invented Ryanair?

The proper role for Government is to set a framework for a competitive market place, then get out of the way and only intervene if there is a market failure sufficiently serious to warrant it doing so. If we look back into history at real policy successes for government, first there was putting an end to BA's monopoly role as our international flag carrier and second, together with the Commission, opening up the EU internal aviation market. Government changed the framework and then got out of the way.

So the right approach for any strategy is to consider how best to foster a competitive aviation market and only to consider regulation where it is simply not possible. You do not start by thinking of things you would like to regulate, or set standards for, in order to improve the passenger's experience. That is the role of the private sector not Government.

I am too old, or perhaps too cynical, to believe that regulation will disappear anytime soon. Even so after last month's snow, you can't imagine how disappointed I was to hear ministers suggest they would explore how to use pending legislation – the Airports Economic Regulation Bill - to control airport performance during snowfall.

To the public that may have sounded like firm action or at least until they find out it may be 2012 before we see legislation. To many in the industry it was yet another potential burden to be imposed on us by politicians ever-too-ready to regulate, but slow to support the industry.

We could discuss the pre-Christmas snow disruption at length. But I think the comments of the Business Editor of the *Daily Mirror* on 22nd December are particularly telling.....

"The fact – he said - that Gatwick's new owners invested £8million in kit to stay open.....proves that ending the stranglehold on UK airports was right"

The inference is clear. Poor performance by airports during snow is not improved by more regulation but through enhanced competition.

And I can testify that competition is working. The freedom to make our own choices and the flexibility to take our own decisions has driven the 'New Gatwick' ever since the sale in December 2009.

The aim of breaking-up the BAA monopoly was ultimately to improve service for passengers. This has been happening with travellers to, through and from Gatwick, whether departing through reduced check-in and security queues or arriving through swifter immigration and baggage reclaim processes. Passengers are welcoming the changes. Complaints are down substantially and compliments have doubled.

Our ability to invest and innovate has brought significant enhancements to passengers' journeys. I believe the sale of Stansted will be equally beneficial to passengers. It will inject an additional dynamic into the UK airports sector.

However the sale of Gatwick and the potential sale of Stansted mean that there is a pressing need to review the regulation of major airports.

The current regulatory regime has its basis in the 1986 Act. It is not appropriate or proportionate to apply a framework that is 25 years old. The case for change is overwhelming. Not just because airports and aviation have changed, but because the overall economic and business climate and circumstances have changed so much since the mid 1980s.

Understandably Gatwick is keen to engage with the CAA on whether there is a case continuing with the current economic regulatory regime at our airport. Every regulated asset will always have those discussions with their regulator.

There is a need to look at whether Heathrow should be regulated differently to Gatwick. I will make no secret of the fact that I believe that a move to a much more flexible regulatory oversight of Gatwick should be an outcome of any review of the present arrangements.

And this is because it is the market, and not any regulator, that should drive service standards and decide the future success of Britain's airports.

So, turning to my conclusion, if the Government must take years to produce a new aviation strategy then at least it has the luxury of time in which to get it right.

Getting it right means sifting through all the available evidence no matter how inconvenient some of it may be and commissioning new work where appropriate.

It means proper analysis. It means fully consulting all those who have an interest in aviation and airports both supporters and opponents.

It means setting out strategic objectives, justifying them and showing how they can best be achieved.

Above all it means balancing a host of difficult considerations before reaching a considered view.

It does not mean siding with one side or another. And it most certainly does not mean announcing policy piecemeal, without evidence and in ways that then constrain strategic choices. For that is dangerous.

And that I fear is exactly what the Coalition Government has done with runway capacity in the South East.

Thank you.

RYANAIR'S ACQUISITION OF A MINORITY STAKE IN AER LINGUS

RYANAIR'S SUBMISSION ON THE SLC TEST

1. Executive Summary

1.1 Ryanair's primary case is that the OFT has no jurisdiction to investigate its minority stake because the OFT is out of time in asserting jurisdiction and, in any event, Ryanair does not have material influence over Aer Lingus. Ryanair has prepared this paper on a precautionary basis to explain why, even if the OFT has jurisdiction, there is no realistic prospect that a substantial lessening of competition ("**SLC**") has resulted, or may be expected to result.

1.2 In investigating the SLC issue, it is necessary to take account of the legal and economic context including, in particular, the size of Ryanair's stake, the nature of the rights attached to it, and the value of the stake compared with Ryanair's market capitalisation – it accounts for around 1 per cent. of Ryanair's value.[1] An important aspect of the legal analysis is that the acquisition of the minority shareholding has to be seen as an investment with two possible outcomes: the first is that the politically-driven opposition by the Irish Government to Ryanair's acquisition of legal control of Aer Lingus will finally evaporate, the Irish Government will see the sense of having a single Irish airline, and the airline passenger market will be seen by the European Commission as more than capable of resisting any possible adverse effects from the merger, with or without commitments. The second is that if there is a willing buyer prepared to offer a reasonable price, Ryanair will consider it.

1.3 Any suggestion that Ryanair's minority stake has resulted, or may be expected to result, in an SLC needs to overcome, as a threshold issue, the fact that the evidence over the past five years demonstrates comprehensively that Ryanair has not used its minority stake to create a lessening of competition. This is entirely consistent with Ryanair's rationale for acquiring and retaining its stake.

1.4 Nevertheless, Ryanair follows the conventional route of identifying theories of harm for investigation. This paper discusses three.

1.5 The first theory of harm is that Ryanair has in fact competed, or is incentivised to compete in the future, less strongly against Aer Lingus, since increasing Aer Lingus' profits might increase the value of Ryanair's shareholding. Normally this theory of harm would be framed around the impact of competition from Ryanair on Aer Lingus' ability to pay dividends. However, Aer Lingus has a policy of not paying dividends,[2] and, despite requests from Ryanair to do so, there is no indication that this strategy will change in the foreseeable future. Accordingly, we have instead focused on the

[1] Moreover, Ireland now accounts for only around 7 per cent. of Ryanair's business.

[2] Despite making large payments to individual shareholders (the Employee Share Ownership Trust ("**ESOT**") received over €30m in December 2010).

possibility that Ryanair might capture the benefits of the strategy through increases in the value of its shareholding. We conclude that such a concern can be ruled out for the following reasons.

(a) The OFT is, of course, increasingly using "Indicative Price Rise" ("**IPR**") calculations to provide a better proxy of merger effects. In its decisions, the OFT has commonly ruled out competition concerns in markets in which the model predicts a price increase of less than 5 per cent. Accordingly, Ryanair's economic advisers, Oxera, have carried out an IPR calculation, taking account of the fact that Ryanair has only a minority stake in Aer Lingus. Their work shows that, even if Ryanair had the information about Aer Lingus' route-by-route profitability necessary to set a profit maximising price, nevertheless price rises of 5 per cent. or more are *not* predicted and, accordingly, in line with the OFT's consistent approach, the first theory of harm can be ruled out with confidence.

(b) Moreover, even if the 5 per cent. threshold were crossed in the model, this is not a realistic proxy because Ryanair lacks the *ability* to implement a strategy of profitably raising prices as it does not have access to the necessary information, namely Aer Lingus' profit margins on the routes in question. This imperfect information means that, in reality, any price increases would be lower than those predicted by the model. Further, Ryanair would have no *incentive* to sacrifice 100 per cent. of the profits it could have earned by competing hard against Aer Lingus in order to enhance the value of its shareholding in Aer Lingus because the mechanism through which its stake would increase in value is so uncertain: even if the increased profitability of the route did not attract entry or expansion from other airlines, Aer Lingus might well spend any increased profits competing more aggressively against Ryanair or on projects which in Ryanair's view reduce shareholder value (e.g. buying aircraft at the top of the cycle or supporting the construction of an unnecessary new terminal at Dublin airport).

(c) There is no evidence that Ryanair's minority stake has affected entry or exit decisions by either party.

(d) Finally, the first theory of harm is disproved by the substantial evidence of increased and intense competition between Ryanair and Aer Lingus at Belfast, Shannon, Cork and Dublin airports since 2006 including Ryanair's board minutes and papers, Ryanair's press releases, Ryanair's adverts and the history of dealings between the two companies. Moreover, there is scope for further increased competition in future: Ryanair has offered the Dublin Airport Authority ("**DAA**") and Irish Government growth of 5 million passengers at Irish airports (even though, if accepted, this would clearly reduce the value of its shareholding in Aer Lingus). Finally, Aer Lingus' share price has fallen from a peak of €3.275 per share during the first six months of trading to under €0.60 in 2011, which is consistent with it facing strong competitive constraints.

1.6 The second theory of harm is that Ryanair's ability to block a special resolution and/or a scheme of arrangement may have resulted, or may be expected to result, in an SLC.

Such a concern can be ruled out: Ryanair was soundly defeated when it opposed the one resolution in the last five years that concerned Aer Lingus' commercial strategy (the US$2.4 billion aircraft order) and Aer Lingus can readily fund its commercial strategy from its significant available gross cash of €925 million or via external financing and does not need a waiver of pre-emption rights or a takeover in order to implement its strategy. Further, Ryanair has repeatedly made clear that it is open to offers for its stake.

1.7 The third theory of harm is that the acquisition by Ryanair of a minority stake may have increased, or may be expected to increase, the likelihood or intensity of coordinated effects in markets for air passenger services.

(a) It follows in particular from the evidence summarised in para. 1.5(d) above that there is no evidence of any such coordination having occurred to date in the market. Since Ryanair has held its stake for five years and there are no recent or expected material changes in circumstances, the possibility of coordinated effects occurring in the future can be ruled out.

(b) In any event, the relevant passenger airline markets are not conducive to coordinated effects in the light, in particular, of the complexities of pricing and the ease of competitive entry and launching new routes.

(c) Ryanair's minority cross-shareholding does not alter the normal analysis: Aer Lingus' relationship with Ryanair is at best dismissive and both parties ensure that they comply with stock exchange and competition rules regarding price sensitive and commercially sensitive information. As a result, Ryanair's stake does not give rise to any contact between competitors of the sort that might lead either to alter its commercial strategy.

There is therefore no evidence of historic coordination and no realistic prospect of coordination in the future.

1.8 The three theories of harm are discussed in sections 5 to 7 below. Before addressing them, Ryanair makes some introductory comments about the application of the SLC test in this case and the transaction rationale (section 2), discusses market definition and market shares (section 3) and identifies actual and potential competitors (section 4).

2. Introduction

(a) The SLC Test

2.1 The OFT has a duty to refer when it believes that there is a realistic prospect of an SLC[3] but, in line with the Court of Appeal's judgment in *IBA Health*,[4] "*The OFT's judgment on whether there is a realistic prospect of an SLC will take due account of*

[3] Merger Assessment Guidelines, OFT1254/CC2 (Revised), September 2010 (the "**Guidelines**"), para. 2.6.

[4] *Office of Fair Trading v. IBA Health* [2004] EWCA Civ 142.

the evidence available to it at the time of its decision."[5] In this case, the facts are unusual because:

(a) Ryanair has held its minority stake for five years; and

(b) Aer Lingus is very keen for the UK competition authorities to require Ryanair to sell some or all of that stake to free itself from what its legal advisers have wrongly claimed is material influence from Ryanair.[6] Aer Lingus therefore has every incentive to make available to the OFT any information that might lead the OFT to find a realistic prospect of an SLC.

The availability of such extensive evidence – including *ex post* evidence over five years demonstrating that the minority stake has had no effect on competition in the market – is therefore very important in applying the "*realistic prospect*" test. In short, the OFT is much better able to rule out competition concerns when it has real world historic evidence of the effects of the merger than in an anticipated or recently completed merger when the analysis is entirely or largely prospective and therefore (necessarily) somewhat speculative and uncertain. This investigation gives the OFT a unique opportunity to review the transaction's effects over a period of five years. This *ex post* evidence demonstrates the absence of SLC.

(b) Transaction Rationale

2.2 Ryanair acquired most of its minority stake as part of its original 2006 offer to acquire sole control within the terms of the EC Merger Regulation ("**ECMR**"). Ryanair's first attempt to acquire Aer Lingus was blocked by the European Commission's decision of 27 June 2007 (the "**2007 Decision**").

2.3 Ryanair subsequently increased its minority stake as it believed that it would eventually be able to bid successfully for Aer Lingus, obtaining approval from the European Commission under the ECMR (perhaps subject to commitments) and agreement from the Irish Government to sell its stake to Ryanair. Consistent with that strategy, Ryanair made a second offer for Aer Lingus in 2008, but the bid was withdrawn in January 2009 when the Irish Government declined Ryanair's offer.

2.4 Ryanair has retained its minority stake as it believes that it will eventually be able either:

(a) to make a successful bid for Aer Lingus, in particular since Dublin airport has increased its capacity whilst demand has fallen since the 2007 Decision[7] and the Irish Government has an increased incentive to realise the value of its minority shareholding in the light of its debt crisis; or

(b) [CONFIDENTIAL].[8]

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5 Guidelines, para. 2.7.

6 The submissions from Aer Lingus' advisers are at odds with public statements by Aer Lingus' senior management as noted in Covington & Burling's letter of 18 August 2011. In any event, the purpose of merger control is not to protect companies from perceived activism by minority shareholders.

7 This point is developed in section 4 below.

8 [CONFIDENTIAL].

3. Market Definition and Market Shares

3.1 Ryanair has carried out an initial investigation of potential market definitions and the market shares arising from them. This work indicates that the OFT's investigation should focus on whether an SLC may have resulted, or may be expected to result, on a relatively small number of routes from the UK to Ireland – accounting for relatively small proportions of each of the parties' networks – where the parties are currently the only actual competitors. Other routes are of limited or no significance because there is either little or no competition between Ryanair and Aer Lingus on the route or there is sufficient actual competition from other airlines. The analysis can be summarised as follows.

(a) There are five routes on which Ryanair and Aer Lingus[9] overlap between the UK and Ireland where the *airport pair* is the same. On one of these, London Gatwick–Shannon, Aer Lingus has announced plans to terminate its service from 11 September 2011[10] and so there is an historic but no prospective overlap. On three, Ryanair and Aer Lingus face no competition from another airline at either an airport or a city pair level, or on any reasonable potential market definition and the combined market share is therefore 100 per cent.:

(i) Birmingham–Dublin;
(ii) London Gatwick–Cork; and
(iii) Manchester–Dublin.

On the fifth route (Gatwick–Dublin), both parties are present, but passengers can also use bmi's Heathrow–Dublin service.[11]

(b) There is another set of *city pair* routes where previous decisions suggest that there is a relevant overlap, but Ryanair believes that a fresh review ought to lead to a different conclusion. If there is a relevant overlap on these routes, then the parties have combined shares of 100 per cent. The routes are:

(i) London Luton–Dublin;
(ii) London Luton–Knock;
(iii) London Stansted–Dublin;
(iv) London Stansted–Cork;
(v) London Stansted–Knock; and
(vi) London Stansted–Shannon.

(c) Ryanair submits that the following categories of routes can effectively be disregarded on the grounds that there is either little or no competition between Ryanair and Aer Lingus or there is sufficient competition from other airlines:

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9 Ryanair believes that overlaps between Ryanair and Aer Lingus' franchisee, Aer Arann, should be disregarded for reasons given in [Annex Removed].

10 See http://www.aerlingus.com/travelinformation/weboffersfromuk/flytoshannon.

11 This is true whether or not Gatwick–Dublin is defined as part of a market that includes Heathrow–Dublin.

(i) Several of the airports in the south-west of Ireland are within two hours drivetime of each other, but the locations of population centres relative to the airports means that they are very unlikely to compete actively with one another because the majority of people live near to one airport or another, with few people located roughly equidistant from two airports.

(ii) Whilst there are arguably overlaps between Ryanair and Aer Lingus on four routes from Derry or Belfast (to Alicante, Faro, London and Tenerife), there is a wealth of competition on these routes, with easyJet competing on three of them from Belfast International, Thomas Cook on two of them, and Jet2 on two of them. Even if Derry and Belfast are found to be in the same geographic market, there is intense competition, for example with at least two alternative competing airlines on the Alicante, Faro, and London services.

(iii) There is also strong actual competition on the London-Malaga route, with BA and easyJet also offering Malaga–London services.

3.2 The detailed work behind these conclusions is included in the following Annexes:

[Annex Removed]

4. <u>Actual and Potential Competitors</u>

4.1 In considering the three theories of harm summarised in section 1 above and described in more detail in sections 5 to 7 below, it is relevant to understand the extent of the actual and potential competitive constraints faced by Ryanair and Aer Lingus. In particular, any incentive Ryanair may have to "soft-pedal" against Aer Lingus (the first theory of harm) is reduced if such soft-pedalling would or might lead to entry or expansion by rivals. Similarly, any incentive Ryanair may have to damage Aer Lingus' competitiveness using Ryanair's rights as a minority shareholder (the second theory of harm) is reduced if such damage would or might lead to entry or expansion by rivals. Finally, the external stability of a coordinated outcome (the third theory of harm) depends on competition from outside the coordinating group.[12]

4.2 This section is structured as follows. First, we identify the actual and potential competitors. Secondly, we show that entry barriers are low and that there is a credible threat of entry. Thirdly, we demonstrate that the absence of observed recent entry is due to the intensity of competition and the falling demand on the relevant routes and not to entry barriers.

<u>(a) Actual and Potential Competitors</u>

4.3 Airlines are distinguished primarily by their operating model (point-to-point vs. network carriers) and by the level of fares (low-, mid- and high-fares).

(a) Point-to-point carriers, such as Ryanair, offer direct services from an originating airport to a destination airport without connecting flights. Network

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12 The Guidelines, para. 5.5.9(c).

carriers focus on a "hub-and-spoke" business model, which involves feeding a major "hub" airport with services from other "spoke" airports. Aer Lingus has opted for an "intermediate model":[13] it provides some point-to-point services, but it also provides connecting services from Dublin, Heathrow and New York airports, therefore offering onward connections along the lines of the hub-and-spoke model, and operates certain long-haul routes.

(b) Level of air fares: Ryanair is a low-fares airline and does not target customers who value additional services such as seat allocation, flexible fares, business lounges, and frequent flyer programmes. In 2010, Aer Lingus abandoned a low-fares approach and has positioned itself as a "value carrier", i.e. a mid-fares operator.[14]

4.4 In recent years, a number of successful point-to-point low- and mid-fares carriers have emerged in Europe creating a sizeable pool of actual competitors and potential entrants that actively seek opportunities to join profitable routes and are able to divert aircraft to new routes very quickly. The following independent point-to-point carriers are already active in Ireland and/or the UK and can easily expand their activities:

(a) *easyJet*. easyJet is a low-fares, point-to-point, airline operating on a pan-European basis and maintaining an extensive network of bases and 196 aircraft which serve 125 destinations. In 2010, it carried 48.8 million passengers and had revenues of £2.97 billion. In its business model and scale of operations, it is very close to Ryanair. easyJet maintains a strong presence at Belfast International airport, flying to 16 destinations, 10 of which are located in the UK mainland. In *easyJet / GB Airways*, easyJet submitted that it "*constantly reviews its route mix to determine whether there are profitable opportunities available*".[15] It is therefore a potential entrant on to UK-Ireland routes, particularly if it judged that Ryanair and Aer Lingus would not compete effectively because Ryanair was pursuing a "soft-pedalling" strategy or the two airlines were coordinating.

(b) *Flybe*. Flybe is, much like Aer Lingus, a medium sized, medium-fares airline. It is characterised by a multi-base, point-to-point business model. With a fleet of 71 aircraft it serves 76 destinations. Given its strong position in the UK market (particularly since its acquisition of BA Connect in March 2007), its current presence in Dublin airport and its existing Dublin-Exeter service, it is well positioned to compete extensively with Ryanair and Aer Lingus.

(c) *Jet2*. Jet2 has a fleet of 38 aircraft and serves over 50 principally leisure destinations. It has a medium-fares, point-to-point, multibase business model and operates a successful route in Ireland from Cork to Newcastle. Jet2 has a base at Belfast International airport, flying to eight destinations, two of which are in the UK mainland.

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13 See Aer Lingus Annual Report, 2010, p. 6, Table, row "Network connectivity". Aer Lingus contrasts its position with low cost carriers and full service flag carriers, stating: "*Appropriate connectivity offering at selected hubs Emphasis on partnerships and connectivity to other airlines.*"

14 Aer Lingus explains the background to its change in strategy in its Annual Report, 2010, p. 6.

15 *EasyJet / GB Airways*, para. 31.

(d) *Air Berlin*. Air Berlin, a German airline, provides point-to-point services, but has some characteristics of a network airline. It operates a fleet of 170 aircraft, both long and short haul, and flies to 163 destinations mainly in Europe. Air Berlin is active on the Irish market, flying to three Austrian destinations from Shannon. Whilst Aer Berlin has recently announced a retrenchment to address its financial difficulties, it remains a significant and experienced operator with a large fleet and every incentive to deploy that fleet on the most profitable routes. In the light of its established presence in Ireland and at the London airports it is therefore a potential competitor to Ryanair and Aer Lingus on the UK-Ireland routes.

4.5 Following a wave of consolidation in the industry, three network mega-carriers, Air France-KLM, IAG (i.e. British Airways and Iberian), and Lufthansa, lead the European market. These network carriers have the ability and the incentive to expand to new routes:

(a) *Air France-KLM*. In FY 2010, the Air France-KLM group transported 71 million passengers and had revenues of €23.6 billion. It has a significant presence in continental Europe operating out of two hubs in Paris CDG and Amsterdam. It is a member of the Skyteam alliance. In Ireland, it is present via its wholly owned subsidiary Cityjet, headquartered in Dublin.[16] Cityjet operates short haul aircraft on behalf of Air France-KLM on several routes, including Dublin-London City, Dublin-Luxembourg and Dublin-Pau.

(b) *IAG*. IAG was formed in January 2011 by the merger of British Airways ("**BA**") and Iberia. In 2010, the merged airlines transported a combined total of 58 million passengers and had consolidated revenues of €13.8 billion. BA and Iberia are members of the Oneworld alliance. IAG's principal hubs[17] are London Heathrow and London Gatwick. It is also strongly positioned in other UK airports such as Birmingham, Edinburgh and Manchester. BA and Aer Lingus have a codeshare agreement for routes between Dublin, Cork, Belfast and Heathrow. IAG has both the financial resources and managerial expertise to enter routes to Ireland if and when it chooses.

(c) *Lufthansa*. In 2010, German group Lufthansa transported 90 million passengers and had revenues of €27.3 billion. As part of its expansion strategy, Lufthansa has recently acquired Swiss, BMI, SN Brussels Airlines, Germanwings, and Austrian Airlines. It is a member of Star Alliance. BMI operates a fleet of 47 aircraft mainly on routes from and to the UK, including a number of Ireland-UK routes (including London Heathrow to Dublin) and provides Lufthansa with an enhanced platform to compete, particularly in the UK-Ireland market. Germanwings is a low-fares airline that competes head-to-head with Ryanair; it operates a fleet of 35 aircraft and offers 14 routes from Dublin, many of which are to destinations outside Germany (such as Zurich, Venice and Dubrovnik).

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16 KLM has a codeshare agreement with Aer Lingus for services between Dublin and Amsterdam and Cork and Amsterdam.

17 In addition to Madrid.

4.6 Because their business model is similar to that of Ryanair,[18] low-fares carriers exercise a particularly strong competitive pressure on Ryanair. Conversely, following Aer Lingus' repositioning as a medium-fares operator, both the network carriers and the low-fares carriers are reasonably close competitors to Aer Lingus. Thus, when considering the scope for Ryanair and Aer Lingus to dampen competition themselves (whether through Ryanair "soft-pedalling" or coordinated effects[19]) all of the airlines identified in paragraphs 4.4 and 4.5 above are important actual or potential constraints.

4.7 Contact information for the competitors identified in this section (b) is given in [Annex Removed].

(b) There is a Credible Threat of Entry Due to Low Entry Barriers

4.8 The airline industry is generally characterised by low barriers to entry.[20] Low sunk costs make it feasible for existing airlines to enter, expand, contract and/or exit from individual routes. This is because virtually all of the assets required to operate an airline can readily be re-deployed to other routes or leased out in response to changing market circumstances. The EU exhibits especially low barriers as a result of deregulation and aircraft can be shifted quickly from one route to another to take advantage of profitable opportunities. Tickets for new routes can be advertised and distributed via the Internet without incurring significant costs.

4.9 The OFT has in the past cleared mergers between airline operators resulting in high combined market shares after finding that entry barriers were low and the parties' market power was constrained by potential entrants.[21]

4.10 In *Flybe / BA Connect*, the OFT recognised that "*the airline industry has seen a large amount of entry and exit in the last 5-10 years as a result of deregulation and the development of low-cost carriers*". The OFT found that the only potential barrier to entry in the airline industry arose from runway capacity constraints.[22] It relied on the airport classification established by the European Airport Coordinators Association. The OFT concluded that only "Level 3 Coordinated" airports experienced capacity constraints.[23] According to this classification, the airports in the following cities in the UK and Ireland are "Level 3 Coordinated": London (other than Luton), Dublin, and Manchester.[24] Other relevant airports are Level 2 or 1 and, therefore, do not experience any capacity constraints. Ryanair also believes that there is a credible threat of entry in London, Dublin and Manchester:

(a) In London, there is substantial off-peak capacity available, particularly at Stansted and Gatwick, and peak-time slots also appear regularly at London airports other than Heathrow. Further, potential competitors with existing slots in London airports could easily re-allocate these slots to UK-Ireland flights if the relative profitability of such flights rose as a result of a reduction in

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18 [CONFIDENTIAL]

19 See sections 5 and 7 below.

20 Indeed, low cost airlines are the most commonly cited example of a contestable market.

21 See, e.g., *EasyJet Airline Company Limited / GB Airways Limited*, para. 28.

22 *Flybe / BA Connect*, para. 40.

23 *Flybe / BA Connect*, paras 41-44.

24 http://www.euaca.org/FTableList.aspx?list=6

competition between Ryanair and Aer Lingus. Finally, Luton is only Level 2 Coordinated.

(b) Similarly, several major actual or potential competitors (including IAG/BA, easyJet, Flybe, as well as suppliers such as Thompson and Monarch) hold slots at Manchester airport that could be re-allocated to UK-Ireland flights if the relative profitability of such services increased and airlines flying from Manchester compete with those using Liverpool and Leeds, which are not congested, and provide a ready opportunity for entry or expansion.

(c) With respect to Dublin, the "Level 3" classification is outdated and does not take into account recent capacity expansions or reductions in traffic. In 2010, Dublin airport opened a new terminal (Terminal 2), adding 19 new air bridges and providing for extra capacity of 15 million passengers per year. The Dublin Airport Authority also completed Pier D at Terminal 1, adding 12 new gates, parking for up to 14 aircraft and additional capacity of 10 million passengers per year. Ryanair believes that, following the completion of Terminal 2 and Pier D, Dublin airport now has a total capacity of some 55 million passengers per year.[25] However, the airport is operating at only one-third of its capacity, handling only 18.4 million passengers in 2010.[26] It is clear that substantial runway capacity is now available at Dublin airport and can be used by new entrants, including for services at peak times.

4.11 In the 2007 Decision, the European Commission found that entry was hindered by the fact that both Ryanair and Air Lingus had large operations ("**bases**") in Dublin.[27] However, the concerns that the EU Commission identified in 2007 about the effectiveness of competition from rivals with a base *at the other end of the route to/from Dublin* (termed a "destination-based competitor") do not operate today as a significant deterrent to entry on UK-Dublin routes.

(a) The Commission identified an "*asymmetry of origination on a number of the overlap routes (in particular continental destinations)*".[28] Given the geographic scope of the OFT's investigation, it need not be concerned about Irish-Continental routes.

(b) The Commission was concerned that a carrier operating only one route to Dublin might face higher unit marketing costs in targeting Irish-origin passengers.[29] However, this issue is not a significant barrier to entry on UK-Dublin routes in 2011: (i) some of the airlines identified in section (a) above already operate at least one route into Ireland (e.g., Flybe, Jet2 and Air France-KLM); (ii) a significant proportion of passengers on UK-Ireland routes originate from the UK; (iii) since 2007 the use of price comparison websites and targeted marketing (e.g. through internet search advertising) has increased, reducing the need for an airline with a competitive offering to incur significant costs in generalised advertising; and (iv) marketing targeted at the UK may also reach Irish consumers since some media are consumed in both countries.

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25 http://www.dublinairport.com/gns/about-us/airport-development.aspx
26 http://www.dublinairport.com/gns/about-us/statistics.aspx
27 Case COMP/M.4439, paras 552 et seq.
28 Case COMP/M.4439, para. 568.
29 Case COMP/M.4439, para. 568.

(c) The European Commission was concerned that the merged Ryanair/Aer Lingus might react aggressively to any new entry.[30] The theory of harm that the Commission was investigating was wholly different from the present case. The Commission was considering whether, if Ryanair could control all of Aer Lingus' commercial decisions (pricing, scheduling etc.), this would lead to a significant impediment to effective competition. By contrast, the first and third theories of harm discussed in this paper (namely that Ryanair would soft-pedal against Aer Lingus or that there would be coordinated effects) involve Ryanair competing <u>less hard</u> against Aer Lingus. If this occurred, it would create an obvious opportunity for entry in circumstances where an aggressive response from Ryanair to that new entry would affect Aer Lingus as well as the entrant, undermining Ryanair's (hypothesised) strategy of soft-pedalling or any coordinated outcome.[31] This shows that the European Commission's argument regarding Ryanair's alleged "reputation" does not apply to the present investigation.

(d) Related to point (c), the Commission concluded in 2007: "*destination based entry ... [was] in general not sufficient to replace the competitive constraint exerted by the Merging Parties on each other pre-merger... Even though entry may occur on particular routes, such selected entry cannot replace the competitive pressure exerted by the two Merging Parties today.*"[32] By contrast, in the present case, Ryanair and Aer Lingus remain separate and independent competitors. The theories of harm ask whether the competition between them is less intense than it would be in the absence of Ryanair's minority shareholding. Any reduction in competition that would need to be made up by actual or potential entry is therefore very much smaller than in the case of a full merger where all competition between the merging parties is lost. The "*selected entry*" that the Commission envisaged may occur *would* be sufficient to counterbalance a limited and selected loss of competition on some UK-Ireland routes, even if it were not sufficient to counterbalance the loss of all competition on all overlap routes in the EU.

<u>(c) Lack of Recent Entry is Due to Intense Competition and Falling Demand</u>

4.12 In recent years, there has been limited entry/exit activity on the affected routes. This can be explained by two factors.[33] First, the markets are already highly competitive. Ryanair is the largest and most successful low cost/low fares airline in Europe. Ryanair's fares remain consistently low on all its routes due to Ryanair's "yield passive, load factor active" business model. Aer Lingus has also proven to be an aggressive competitor in the market, competing with other airlines on both price and service. Thus, routes served by both Ryanair and Aer Lingus are highly competitive

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30 Case COMP/M.4439, para. 569.

31 In any event, there are plenty of instances of airlines entering against Ryanair. For example: Jet2 has recently announced its entry on routes from Glasgow to Tenerife, Barcelona, Ibiza, Alicante and Faro, from Edinburgh to Alicante and Malaga, from Manchester to Barcelona and from Leeds Bradford to Gran Canaria; easyJet has announced its entry on routes from Manchester to Madrid, London Gatwick to Fuerteventura, and London Southend to Barcelona; and IAG/Iberian has announced is entry on the Manchester to Madrid route.

32 Case COMP/M.4439, para. 584.

33 At present, the oil price is high (reducing the incentive for airlines to buy new aircraft and to operate their existing fleets), although it has varied significantly over the period since 2007.

and this level of competition may deter new entrants (as well as evidencing the absence of an SLC).

4.13 Secondly, the economic downturn that began shortly after the EU Commission's 2007 Decision has reduced demand for air travel, thereby diminishing profitable opportunities for potential entrants. A number of elements contribute to these conditions, most notably a failing economy both in Ireland and in the UK and DAA cost increases which Aer Lingus' CEO has described as "insane":

(a) Ireland was in recession from September 2008 until the first quarter of 2010. It has endured drastic austerity measures and high unemployment figures (currently at 14.3 per cent.). One consequence of this harsh economic climate has been reduced demand for air transport services in some of the affected markets. Between 2007 and 2010, the number of passengers travelling annually through Dublin airport has decreased by around 21 per cent. and the current capacity utilisation is at an historic low of around one-third.[34] This fall in demand has been made worse by a burdensome travel tax levied by the Irish government.[35]

(b) The UK economy was in recession from January 2009 until January 2010 and fears of a double-dip recession have recently resurfaced. The coalition government has implemented austerity measures and unemployment remains high (currently around 8 per cent.). Since 2008, the number of passengers travelling through UK airports has been falling. According to CAA statistics, between 2008 and 2010, passenger air traffic between the UK and Ireland fell from 12.3 million to 9.5 million passengers, i.e. a drop of around 22 per cent.[36]

4.14 Against this backdrop, it is hardly surprising that potential competitors have not recently entered or expanded on to the Irish market.

5. <u>First Theory of Harm: Ryanair is *not* incentivised to compete less strongly against Aer Lingus and has not *in practice* competed less strongly against Aer Lingus since it became a minority shareholder</u>

<u>(a) Introduction</u>

5.1 Ryanair has retained Oxera to provide economics advice and Oxera has led the preparation of this section. As a result, it is relatively technical in nature.[37]

34 See para. 4.10(c) above.

35 In its 2009 Budget, the Irish government introduced an air travel tax of €10 per passenger per route on all routes with a distance greater than 300 km. In March 2011, this was reduced to €3 per passenger on all European routes.

36 http://www.caa.co.uk/docs/80/airport_data/2010Annual/Table_11_Intl_Pax_Traffic_to_from_UK_by_Country_2000_2010.pdf

37 Oxera would, of course, be willing to discuss with the OFT's economists the contents of this section and the general availability of data.

5.2 The OFT is, of course, increasingly using "Indicative Price Rise" ("**IPR**") and Gross Upward Pricing Pressure Index ("**GUPPI**") calculations to provide a better proxy of merger effects. In its decisions, the OFT has commonly ruled out competition concerns in markets in which the model predicts a price increase of less than 5 per cent. Both models have pros and cons. In particular, on the facts of this case, both suffer from the disadvantage that they inevitably predict price increases, with the only issue being the magnitude. Nevertheless, for reasons described in section (b) below, Oxera identified the IPR model as the more appropriate for this case and have tailored it to take account of the fact that Ryanair has only a minority stake. Oxera's work shows that, even if Ryanair had the information about Aer Lingus' route-by-route profitability necessary to set a profit maximising price, nevertheless price rises of 5 per cent. or more are *not* predicted and, accordingly, in line with the OFT's approach, the first theory of harm can be ruled out with confidence. Section (c) explains that, even if the model indicated that Ryanair had an incentive to raise prices by more than 5 per cent., it lacks the knowledge of Aer Lingus' route-by-route profitability necessary to implement the strategy and the ability to capture the increased profits that Aer Lingus earns. This imperfect information means that, in reality, any price increases would be lower than those predicted by the model. Section (d) explains that Ryanair's minority stake has not affected entry and exit decisions. Finally, section (e) describes the intense competition that has been observed since Ryanair acquired its stake, which is inconsistent with a theory that Ryanair is "soft-pedalling" when competing against Aer Lingus.

(b) An IPR Calculation Demonstrates that Ryanair has no Incentive to Raise its Prices Above the OFT's 5 per cent. Threshold

5.3 The OFT has increasingly used the IPR metric.[38] The IPR and GUPPI indicators originate from US merger control and are intended as first stage screening devices to rule out competition concerns. If adapted properly, the IPR metric might be used as a screening device to assess the impact of Ryanair's minority stake in Aer Lingus on the prices charged by the two firms, albeit that it will tend to overestimate the impact. A key assumption made in the derivation of the original IPR formula is that the two merging parties jointly control the operations of the merged firm, which is therefore able to maximise profits across both firms' operations. This assumption needs to be relaxed in the present context since Ryanair's passive minority stake does not enable it to influence commercial decisions made by Aer Lingus. Moreover, a second change to the original IPR formula has to be made in order to reflect the different ownership structure. If those assumptions are adapted, a modified formula is obtained that relates the IPR to four variables: the ratio of prices charged by the two firms, the variable margin of Aer Lingus and both firms' diversion ratios. The diversion ratios from Ryanair to Aer Lingus and from Aer Lingus to Ryanair are assumed to be equal to each other (this assumption has frequently been made by the OFT).[39]

38 The simplest version of the IPR formula: $\frac{\Delta p_A}{p_A} = \frac{\Delta p_B}{p_B} = \frac{m\,d}{2\,(1-d)}$, where p_A and p_B are the prices charged by the merging parties (A and B) prior to the merger, Δp_A and Δp_B are the price changes (i.e. post-merger prices minus pre-merger prices), m is the pre-merger margin and d the diversion ratio (pre-merger margins and diversion ratios are assumed to be the same for both firms).

39 The modified IPR formula takes the following form: $IPR_R = \frac{2*29.8\%*m_A*D}{4-D^2} * \frac{p_A}{p_R}$, where IPR_R is Ryanair's IPR, p_A and p_R are the (pre-divestment) prices charged by Aer Lingus and Ryanair, respectively, D is the diversion ratio and m_A is Aer Lingus' variable margin.

5.4 In order to assess whether the price rise predicted by the adapted IPR formula crosses the commonly used 5 per cent threshold,[40] estimates of Aer Lingus' variable margins and the ratio of Aer Lingus and Ryanair prices and diversion ratios can be plugged directly into the formula. The IPR obtained in this way can then be compared to the 5 per cent threshold. The formula can also be used in an alternative way as follows. First, one of the variables of the model, e.g. the diversion ratio, is selected. Secondly, the other variables in the model are replaced with point estimates. Thirdly, the value of selected variable for which the IPR is exactly equal to 5 per cent is calculated, given the values of the other variables. This value is called the *critical* value of the selected variable. In order to assess whether or not the 5 per cent threshold is met, one has to analyse whether the critical value is likely to be smaller or larger than the actual market value of the selected variable. If, for example, the critical value of the diversion ratio is larger than the largest diversion ratios observed across a variety of markets, one can conclude that the 5 per cent threshold is never met. It is important to note that the critical value can only be calculated for one variable at a time; the remaining variables in the IPR formula need to be replaced with reasonable estimates. If, for example, the critical value for the diversion ratio is calculated, the price ratio and Aer Lingus' variable margin have to be estimated from market data.

5.5 The advantage of this approach is that it generally enables robust conclusions in the absence of an exact estimate of one of the variables (although estimates for all other variables need to be available). However, this approach may not always be successful. If it cannot be argued that the critical value is always larger (or always smaller) than any plausible value observed across different markets, it is not possible to draw conclusions using this approach. In this case, another approach has to be applied.

5.6 Since diversion ratios are particularly difficult to estimate, the above approach can be used to determine whether or not the 5 per cent threshold is met in the absence of immediately available data on diversion ratios. Although no precise estimate of diversion ratios is needed in order to implement the approach, a range of plausible diversion ratios needs to be determined. The survey-based evidence cited in Annex 2.6 of the 2007 Decision suggests a range of between 18 per cent. and 54 per cent.[41] In order to show that the 5 per cent threshold is met, it needs to be demonstrated that the critical diversion ratio is larger than the 54 per cent. However, the evidence is likely to overestimate the true diversion ratio because the survey question asked consumers whether they would "consider switching" to the other airline – and not whether they would actually switch and under what conditions. For routes where both airlines operate from different airports, the 2007 Decision cites a lower estimated diversion ratio of 36 per cent. and on London routes, this estimate is 34 per cent. Moreover, the 54 per cent. estimate is determined for airport pair routes on which only Aer Lingus and Ryanair operate. On routes with more than those two competitors, diversion ratios are considerably lower (e.g., 33 per cent. on the Dublin-Frankfurt route which is also operated by Lufthansa). The choice of a threshold of 54 per cent. can therefore be considered as highly conservative. In addition we choose

40 See *Asda / Netto*, para. 36.

41 According to the survey evidence cited in Annex 2.1 of the 2007 Decision, 90.6 per cent. of Ryanair customers and 66.1 per cent. of Aer Lingus customers would have bought a cheaper ticket from another airline. Clearly, those numbers do not satisfy the OFT's definition of diversion ratios between Aer Lingus and Ryanair as they include customers switching to a third party.

conservative estimates of Aer Lingus' variable margins and the ratio of Aer Lingus and Ryanair prices. Oxera allow Aer Lingus' prices to be around [CONFIDENTIAL] higher than Ryanair's price level, reflecting a price sampling exercise and consistently with Aer Lingus' higher cost base (a greater disparity in prices would lead to a lower critical diversion ratio). In addition, we conducted a basic estimation of Aer Lingus' variable margin. The result of this analysis implies that a margin in the range between 20 per cent. to 30 per cent. can be considered as conservative.[42] Combining those assumptions, we find a critical diversion ratio between [CONFIDENTIAL]; other specifications produce a critical diversion ratio of [CONFIDENTIAL].[43] This range clearly lies above the range of plausible diversion ratios identified above (i.e. above the 54 per cent. threshold). It follows that, despite the conservative nature of this analysis, the 5 per cent threshold is clearly not crossed. The OFT should therefore rule out the first theory of harm.

5.7 Since the critical diversion ratio lies clearly outside the interval of all plausible diversion ratios, the approach adopted above is sufficient to conclude that the OFT's 5 per cent threshold is not crossed. In other words, even if one were to estimate the diversion ratio from market data, any plausible outcome of this procedure would imply that the 5 per cent threshold is not crossed. Oxera therefore do not consider it relevant to obtain diversion rations from a costly consumer survey.

5.8 Oxera's conclusions are based on a simple and conservative estimate of Aer Lingus' margin. If the OFT were to estimate Aer Lingus' margin, it can reject Oxera's conclusions only if the value found in its study is considerably larger than the 30 per cent. Oxera assumed here. If such a large margin is found, Oxera's conclusions are still likely to remain valid, owing to the conservative nature of the analysis (whose results are not, in any case, very sensitive to the Aer Lingus margin). And in this case, the diversion ratios would still have to be estimated from a consumer survey in order to determine the actual IPR.

5.9 As noted in section (a) above, a simpler Gross Upward Pricing Pressure Index ("**GUPPI**") is sometimes used as an alternative to the IPR metric in order to assess the likely effect of a merger. The GUPPI approach compares the upward pressure on post-merger prices in the absence of efficiency savings to the magnitude of efficiency savings that arise from the merger. If ownership is only partial (as in the case of Ryanair's minority stake in Aer Lingus), a modified GUPPI formula[44] can be used that accounts for the reduced upward pricing pressure as a result of partial ownership.

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42 We find that Aer Lingus' variable margin is below 10 per cent.. The analysis uses the following cost categories (obtained from the presentation "Aer Lingus - Investor and Analyst Day" in London on 26/01/2010): staff, aircraft lease, maintenance, distribution, ground operations, catering and other, airport charges, enroute charges, fuel. We understand that those cost categories may not perfectly reflect Aer Lingus' variable costs. We address this issue by allowing the margins used in our analysis to be 2 to 3 times larger than the margins obtained here.

43 [CONFIDENTIAL]

44 The modified GUPPI approach compares the following two expressions: $\theta \frac{(P_2{}^0 - c_2{}^0)d_{12}}{P_1{}^0} > \frac{c_1{}^0 - c_1}{P_1{}^0}$, where d_{12} is the diversion ratio from firm 1 (Ryanair in this case) to firm 2 (Aer Lingus in this case), θ is the size of the minority stake, $c_1{}^0$, $P_1{}^0$ and $P_2{}^0$ indicate marginal costs and prices obtained in the absence of the minority stake, and c_1 is marginal cost obtained in the presence of the minority stake (ie the efficiency savings of firm 1 are given by $c_1{}^0 - c_1$ and firm 2's gross profit margin is given by $P_2{}^0 - c_2{}^0$).

5.10 As the OFT will know, the GUPPI approach is not designed to derive specific estimates of price effects but rather to enable a comparison between the magnitudes of upward and downward pressures on market prices. There is no downward pressure in the present case since Ryanair's minority stake in Aer Lingus does not produce any efficiency savings (the two firms' operations remain separate). If efficiency savings are zero, the modified GUPPI approach always predicts, by definition, net upward pricing pressure. However, in reality, there are countless examples of firms holding minority stakes that would not be considered harming competition. For example, nobody would claim that competition between Airbus and Boeing would be diminished if Airbus were to purchase 1,000 shares in Boeing. The (modified) IPR metric, on the other hand, explicitly quantifies the price effect of Ryanair's minority stake (in the absence of efficiency savings). Such an approach has some advantages over the GUPPI approach in the present context because it puts less weight on efficiency savings (which are irrelevant) and more weight on measuring (theoretical) price increases.

(c) Ryanair has neither the ability nor the incentive to sacrifice its own profits to favour Aer Lingus

5.11 Even if the modified IPR model were to predict a price rise of more than 5 per cent, this is not a realistic proxy. Ryanair lacks access to the information necessary in order profitably to implement a strategy of raising prices. The first theory of harm assumes that Ryanair knows Aer Lingus' profit margin on the route in question (which is required to calculate optimal prices). This assumption is highly unrealistic. Although Aer Lingus' overall profit margin is publicly available, Ryanair would need to know Aer Lingus' profit margin for individual routes in order to determine its optimal price rise. This information is not available to Ryanair, which makes it very difficult to raise prices by the correct amount. In fact, if Ryanair raises its prices by too much it risks losing money. Ryanair therefore lacks the *ability* profitably to charge higher prices.

5.12 The first theory of harm is based on the assumption that Ryanair earns profits from its minority stake if it raises its prices (because the price rise has a positive impact on Aer Lingus' profits due to customers switching from Ryanair to Aer Lingus). In reality, however, it is unlikely that Ryanair can capture those profits. Since Ryanair does not have any control over Aer Lingus it cannot control its dividend policy.[45] Instead of converting additional profits obtained from higher prices into dividends, Aer Lingus may decide to use this money for alternative purposes, possibly harming Ryanair. Acting in the general interest of its shareholders, it may use additional profits to compete more aggressively with Ryanair. For example, Are Lingus may use those profits to improve its lounges or amenities to attract passengers away from Ryanair. Since Ryanair does not have any control over Aer Lingus' operations, it cannot prevent such investments. It is therefore extremely unlikely that Ryanair would have the *incentive* to raise its prices.

45 Ryanair recently tried to convince Aer Lingus to pay a dividend to shareholders and was rebuffed.

5.13 Finally, any incentive Ryanair may have to "soft-pedal" against Aer Lingus is reduced because such soft-pedalling would or might lead to entry or expansion by rivals for the reasons given in section 4 above.

(d) Ryanair's Minority Stake has not affected Entry and Exit Decisions

5.14 We have also investigated a variation of the first theory of harm involving possible effects of Ryanair's minority stake on entry and exit by Ryanair. The theory of harm is that Ryanair might avoid head-to-head competition against Aer Lingus on routes operated by Aer Lingus in order to maximise the value of its minority shareholding in Aer Lingus..

5.15 In this section we examine instances of entry and exit by Ryanair before and after the "event" of Ryanair acquiring its minority stake, which demonstrates that the theory of harm discussed in para. 5.14 above is invalid. The intensity of competition between Ryanair and Aer Lingus since the "event" is also demonstrated by the evidence summarised in section (e) below.

5.16 In order to have a relevant set of entry/exit events, we have focused on UK-Ireland routes. A qualitative analysis is the only practical approach since there is no measure available of *ex ante* expectations of the profitability of a particular entry decision, and moreover the factors influencing entry/exit decisions for Ryanair are [CONFIDENTIAL].

5.17 We have examined the reasons for Ryanair's entry and exit decisions before and after the "event" of acquiring the minority stake: see [Annex Removed]. This review supports the conclusion that the minority stake has had no effect on these decisions. Looking first at the entry decisions where no possible overlap with Aer Lingus existed, the main reason for all entry decisions was [CONFIDENTIAL]. The same is true for entry decisions where potential or actual overlaps exist, [CONFIDENTIAL]. The minority stake in Aer Lingus had no influence on any of these decisions.

5.18 Looking at exit decisions, most Ryanair exits were prompted by [CONFIDENTIAL]. The remaining exit decisions were made either [CONFIDENTIAL]. The minority stake in Aer Lingus had no influence on any of these decisions, and there is no discernable difference according to whether the route had any possible overlap with Aer Lingus.

(e) There is no evidence from the last five years that Ryanair has competed less strongly against Aer Lingus

5.19 The first theory of harm is also disproved by the intense competition that has occurred between the two companies over the five years since Ryanair first acquired its minority stake, as evidenced by the following:

(a) The study of entry and exit summarised in section (d) above.

(b) [CONFIDENTIAL].

(c) A review of the press releases annexed to the MI paper, which paint a picture of Ryanair relentlessly targeting Aer Lingus on the basis of its lower prices and larger network.[46]

(d) A review of Ryanair's print advertising, which includes many examples of adverts that target Aer Lingus specifically: [Annex Removed].

(e) The history of dealings between the parties, which is summarised in section 4.2 of the MI Paper, and is wholly inconsistent with any suggestion that Ryanair has sought – whether unilaterally or through some form of coordination – to compete less aggressively against Aer Lingus.

5.20 There is also scope for further increased competition in future: Ryanair has offered the Dublin Airport Authority ("**DAA**") and Irish Government growth of 5 million passengers at Irish airports (even though, if accepted, this would clearly reduce the value of its shareholding in Aer Lingus).

5.21 Finally, Aer Lingus' share price has fallen from a peak of €3.275 per share during the first six months of trading to under €0.60 in 2011, which is consistent with it facing strong competitive constraints.

6. Second Theory of Harm: if Ryanair holds material influence through its ability to block a special resolution and a scheme of arrangement, this does not give rise to a realistic prospect of an SLC

(a) Introduction

6.1 Ryanair believes that it does not have material influence over Aer Lingus for the reasons given in the "Submission to the OFT on Material Influence" ("**the MI Paper**"). As noted in section 1 above, this paper has been prepared without prejudice to that primary case and on the assumption that, notwithstanding Ryanair's arguments, the OFT finds that Ryanair may have material influence over Aer Lingus.

6.2 Ryanair has held its stake in Aer Lingus for five years. This section reviews the history of matters taken to a shareholder vote during that period and explains that the vast majority of such resolutions could have had no conceivable impact on Aer Lingus' commercial strategy and [CONFIDENTIAL]. There is accordingly no evidence that Ryanair's stake may have resulted in an SLC and there are no grounds for believing that this might change in the future. We then explain why the issues discussed in *BSkyB / ITV* do not arise here (section (c)).[47]

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46 Many of the press releases seek to highlight to consumers Ryanair's status as the lowest fares airline with an extensive network, e.g. those calling for lower fares or the abolition or reduction of Aer Lingus' fuel surcharges. See also the press releases of 2 February 2010 (Ryanair opened seven new Summer routes from Cork to compete with Aer Lingus' high fares from Cork), 28 July 2010 (Ryanair open three new Winter sun routes from Cork at much lower fares than Aer Lingus) and 30 July 2010 (Ryanair launched a €50 one way rescue fare for Aer Lingus passengers stranded by cabin crew strikes).

48 For example, Aer Lingus has entered partnerships and alliances with other airlines without putting them to a shareholder vote, including a franchise agreement with Aer Arann that is described in [Annex Removed].

(b) An Analysis of Matters Put to Shareholder Votes

6.3 The second theory of harm is that Ryanair could weaken the competitive constraint it faces from Aer Lingus by using its position as a shareholder to worsen Aer Lingus' competitive offering, for example in terms of an attempt to force Aer Lingus to differentiate its offering from that of Ryanair, or else constrain Aer Lingus' expansion on Ryanair routes.

6.4 Ryanair would be able to do this only if: first, there were relevant decisions that required a shareholder majority vote (e.g., decisions to open new services, or to change the product positioning of Aer Lingus); and, secondly, Ryanair could block these decisions using its voting rights.

6.5 However, the history of voting records at Aer Lingus general meetings over the last five years, which is set out in detail in the MI Paper, clearly shows that:

(a) Aer Lingus' decisions to open new routes overlapping with Ryanair or change its competitive stance in the market (or any similar decisions) have *never* been the subject of a shareholder vote, but rather are always within the control of Aer Lingus management without specific shareholder approvals;[48] and

(b) on the very rare occasion Aer Lingus has put to shareholder vote a matter that might be considered to affect opening new services (specifically, the 10 April 2008 EGM voting on the Airbus purchase arrangement) the motion has carried easily despite Ryanair's opposition.

6.6 Ryanair's conduct has in fact been *opposite* to that which would be expected if Ryanair were attempting to weaken the competitive constraint it faces from Aer Lingus.

(a) As explained in the MI paper in section 4.2(a), in September 2007, Ryanair attempted to call an EGM of Aer Lingus so that shareholders could vote on a decision taken by the Aer Lingus Board to close its Shannon-Heathrow route in favour of opening a base in Belfast. Aer Lingus rejected Ryanair's call for an EGM and proceeded to close the Shannon-Heathrow route as planned. As it happens, Ryanair operated a Shannon-Stansted route, which if Aer Lingus' Shannon-Heathrow route had closed might have been a possible beneficiary from the Aer Lingus Board's decision. Also Ryanair did not operate routes from Belfast, meaning that it was very unlikely to have lost out from the Aer Lingus Board's intention to operate from Belfast. Ryanair's conduct in September 2007, opposing the Heathrow closure, therefore seems completely opposed to the theory of harm that Ryanair has sought, or will seek, to use voting rights to constrain Aer Lingus' expansion on Ryanair routes.

(b) Ryanair has offered the DAA and Irish Government growth of 5 million passengers at Irish airports (even though, if accepted, this would clearly reduce the value of its shareholding in Aer Lingus).

48 For example, Aer Lingus has entered partnerships and alliances with other airlines without putting them to a shareholder vote, including a franchise agreement with Aer Arann that is described in [Annex Removed].

6.7 There is accordingly no evidence that Ryanair's stake may have resulted in an SLC and there are no grounds for believing that this might change in the future.

(c) The Issues Discussed in *BSkyB/ITV* do not Arise Here

6.8 In *BSkyB / ITV* the Competition Commission found:

> "*it likely that the board would need to make major investments requiring external funding over the next two or three years. A non-pre-emptive rights issue would be the only feasible or efficient funding mechanism for some investments. BSkyB's ability to block a special resolution would limit ITV's ability to raise funds, ruling out some strategic options and affecting its ability to compete in the market for all-TV.*"[49]

> BSkyB might "*disrupt an acquisition of ITV that might otherwise strengthen ITV's competitive position, or encourage the acquisition of ITV by another buyer who might act in BSkyB's interests.*"[50]

6.9 By contrast, in the present case, Ryanair has held its stake for five years. During this period, Aer Lingus has never sought a waiver of pre-emption rights for the purposes of implementing its commercial strategy[51] and no party has made an offer to acquire Ryanair's stake or made a stock exchange announcement identifying an interest in bidding for Aer Lingus. Is it therefore not the case that the acquisition of the minority stake may *have resulted* in an SLC.

6.10 Turning to the prospective analysis, it is *very unlikely* that Aer Lingus will *need* a waiver of pre-emption rights as *the only feasible or efficient mechanism* in order to implement its strategic options. As discussed in section 3.4 of the MI Paper:

(a) Aer Lingus has very large cash reserves – it has gross cash of €925m – and access to other means of raising capital including aircraft leases and bank lending.

(b) In line with guidance from the Irish Association of Investment Managers, Aer Lingus' requests for a waiver of pre-emption rights have all been limited to issuing 5 per cent. of the currently issued equity share capital. This would enable it to raise at most €15.49m,[52] a trivial sum compared to its gross cash of €925m.

(c) Aer Lingus' strategy – which it has announced to investors – is to downsize, whilst forming alliances with other airlines, and it is therefore very unlikely to wish to make a large strategic acquisition or other significant investment.

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49 Summary, para. 17.

50 Summary, para. 18(c).

51 Aer Lingus has sought such waivers of pre-emption rights as a matter of routine and Ryanair has blocked them for the reasons described in the MI Paper.

52 534m shares in issue x €0.58 current share price x 0.05 = €15.49m. Any equity capital raising is likely to be at a discount to the then prevailing share price, which would reduce the sum raised.

6.11 Further, in the light of the successful turnaround by Aer Lingus' current management, it is also *very unlikely* that Aer Lingus would *need* to agree to a takeover to *strengthen its commercial position* or facilitate its commercial strategy:[53] Aer Lingus is well capitalised and able to implement its commercial strategy without needing a takeover. Moreover, it is also important to note that Ryanair has made clear that it is open to offers for its stake.[54]

6.12 These remote possibilities are insufficient to give rise to a *realistic prospect* of a *substantial* lessening of competition.

7. Coordinated effects

(a) Introduction

7.1 There is not any meaningful prospect of coordinated effects being created or enhanced by Ryanair's minority share ownership in Aer Lingus.

7.2 The conditions for there to be coordinated effects in a merger situation are set out in section 5.5 of the Guidelines.

(a) Firms need to be able to reach and monitor the terms of coordination.

(b) Firms have to find it in their individual interests to adhere to the coordinated outcome.

(c) There must be little likelihood of coordination being undermined by competition from outside the coordinating group.

7.3 In a normal case, the first question is whether there is any evidence of pre-merger coordination. However, in this case, Ryanair has held its stake for five years and so the first question is instead whether there is any evidence of actual coordination following the acquisition of its stake. If there is not, then coordinated effects can be dismissed as a theory of harm, unless there were evidence of a recent or expected change of circumstances that might result in the emergence of coordination. In this case, the evidence indicates that the acquisition by Ryanair of its stake has not resulted in any dampening of competition: see section 5(e) above. There are no recent or expected changes of circumstances that might alter this analysis and coordinated effects can therefore be dismissed as a concern.

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53 Moreover, whilst there is regular chatter about the possibility of a bid for Aer Lingus by a national flag carrier such as International Airline Group (which incorporates British Airways), Air France/KLM or Lufthansa, and most companies become attractive if the price is low enough, any potential bidder would be concerned about Aer Lingus' heavily focus on Ireland, which is very weak economically and offers no prospects of growth in the medium term.

54 See http://www.nytimes.com/2011/05/28/business/global/28air.html?pagewanted=2&_r=2

7.4 For completeness, in the remainder of this section Ryanair explains why none of the three conditions for coordinated effects are present[55] (sections (b) to (d)) and why this conclusion remains true regardless of Ryanair's minority stake in Aer Lingus (section (e)). In a standard merger two firms are integrated and, following the merger, operate as a single entity maximising joint profits. Thus, the issue under consideration is the manner in which the merger affects the incentives of the merged firm, and its rivals in the market, to engage in coordinated behaviour. In this case, however, Aer Lingus and Ryanair do not operate as a single entity maximizing joint profits, and the primary issue to be considered is the manner in which Ryanair's shareholding in Aer Lingus changes the incentives of the two companies to coordinate their behaviour with one another.

7.5 Before turning to the analysis, Ryanair makes two preliminary comments about the scope of the analysis.

(a) We focus our discussion on possible coordination on price, but also address in section (f) possible coordination on non-price elements, including market shares.

(b) Any theory of coordinated effects would need to identify the candidate coordinating group. As discussed further below, if the group is limited to Ryanair and Aer Lingus, then the competitive fringe is larger. By contrast, if the group comprises Ryanair, Aer Lingus, bmi and Air France then there are six potential relationships, only one of which is affected by the cross-shareholding, implying that the cross-shareholding is very unlikely to be material to the analysis of coordinated effects. We discuss both candidate coordinating groups in this section.

(b) Condition 1: Reaching and monitoring coordination

7.6 The first condition for coordinated effects is that the firms have to be able to reach a coordinated understanding, and then to monitor that other firms are adhering to that understanding.

7.7 Ryanair does not believe that it would be possible for airlines in the UK to Ireland aviation markets to reach an initial coordinated understanding or, in any practicable way, to monitor adherence to that coordinated understanding.

7.8 There are several reasons why reaching a coordinated understanding in the aviation market would be extremely difficult.

7.9 *Significant cost asymmetries*. In order to coordinate, all firms must reach a combined understanding of a price that is above the competitive level and which all are happy to continue to adhere to. The greater the cost asymmetries between firms, the more difficult it will be to find a price that all are willing to adhere to, as a firm with a higher level of marginal costs will desire a higher price than a firm with lower marginal costs. In the current case, Ryanair believes that it has a marginal cost base

55 See also *easyJet / GB Airways*, paras 50 to 53, ruling out coordinated effects concerns in an airline merger.

well below that of Aer Lingus, Air France, or bmi. In such a case, Ryanair would have little incentive to coordinate its price with other airlines, as it will be able to price profitably at levels which would be loss-making for its competitors.

7.10 *Significant differences in service offerings*. The differences in service offerings between Ryanair and its rivals add another layer of complexity when attempting to determine a tacitly collusive price. Some services which are effectively bundled into the ticket price of competitors (e.g., checking in hold baggage, checking in at the airport, allocated seating) are separate charges for Ryanair passengers. Even if Ryanair had the same cost base as other airlines (which it does not), it would therefore need to set a lower ticket price than its rivals to reflect these disaggregated charges. However, this would complicate "agreeing" the coordinated price, as not all passengers use any of these disaggregated charges – there would therefore be considerable scope for confusion between Ryanair and any other airline trying to tacitly collude, as there would be a need for the coordinated prices to be different.

7.11 *Lack of well-defined focal price points*. Often, coordination can be focussed around certain well-known price points, with moves away from these price points requiring large proportionate price changes.[56] The airline sector does not have any such obvious price points, and it is therefore unclear what the price point for any initial coordination would be. Pricing is often undertaken in small increments; at the same time, passengers on the same flight may have paid for their flight in different currencies (for example, in pounds sterling and euros), adding an extra degree of complexity, with different home country prices having been quoted at the time of purchase, and different airport tax and airport charge levels on each airport pair.

7.12 Overall, therefore, there appear to be substantial impediments to Ryanair and its competitors ever reaching an initial coordinated position. Ryanair believes that due to its low cost base it will always be able profitably to undercut all of its competitors in the market. As such, Ryanair has no incentives to enter into coordination with rivals.

7.13 In order for coordination to be sustainable over time, two features must be present. First, there must not be frequent changes in the coordinated price desired by firms which are coordinating; and, secondly, firms must be able to monitor whether coordination is being observed. Neither of these is the case given the conditions of competition in aviation markets in which Ryanair is active.

7.14 *Different extent of cost shocks*. Even if an initial understanding can be reached, then there will be a need to sustain that coordination in the face of shocks to demand and supply. On the supply side, the very different set of services offered by Ryanair in its ticket price, combined with its lower cost base, means that its average cost per passenger would change in a different way to its rivals when faced with cost shocks. In the aviation sector, these are most commonly shocks in the price of oil, causing increases or decreases in fuel costs, but can also be shocks from changes in the taxation regime facing airlines, or in labour costs given the strikes which have regularly afflicted airlines such as Aer Lingus. In particular, airlines have different fuel hedging strategies[57] which will have the impact of creating asymmetric cost

[56] For example, in many retail sectors where £9.99 might be considered a key price point.

[57] Ryanair and Aer Lingus have pursued different fuel hedging strategies.

impacts even when airlines have similar underlying cost structures. Where there are asymmetric cost shocks, this will tend to undermine coordination, as one airline will wish to change the coordinated price by a different amount than the other airline.

7.15 *Different extent of demand shocks*. Ryanair's low cost business model, with its relentless focus on cost minimisation at the expense of any optional "frills" places it in a different segment of the market than Aer Lingus' higher cost model, and the full-fare offerings of bmi's services from Heathrow, and Air France's services from City. This will tend to create asymmetries in the extent of demand shocks which affect the airlines. For example, Aer Lingus' route between Heathrow and Dublin is likely to have a higher proportion of business travellers than Ryanair's flight between Stansted and Dublin. Consequently, if there is a decline in business traffic, but not leisure traffic, then this will reduce Aer Lingus' demand by more than Ryanair, and Aer Lingus will therefore want to reduce the coordinated price by more than Ryanair. This form of asymmetric shock will therefore tend to undermine coordination.

7.16 *Frequency of cost and demand shocks*. Cost and demand shocks, particularly if significant, will change the coordinated price that firms wish to charge. Where there are frequent shocks, therefore, firms will have difficulty sustaining coordination, as there will be a need for firms continually to reach a new agreement on the coordinated price. The airline industry is one which is particularly prone to cost shocks (often from oil price changes, but also from security procedure changes) and demand shocks (with sharp drops in demand having previously been observed after the September 11th attacks and during the second Gulf War). These shocks will make it difficult to sustain coordination over time.

7.17 *Difficulties in monitoring defection from coordination*. [CONFIDENTIAL]. Aer Lingus is also believed to operate a yield management system, but one which targets load factors less intensively. In the presence of such complex yield management systems, which are simultaneously operating across a large number of routes, and with separate prices for each individual flight, it is nearly impossible to monitor whether there has been a breach of a coordinated pricing policy. To do so would require continuously observing prices across many thousands of flights, potentially in multiple currencies at the same time. [CONFIDENTIAL]. Consequently, it would be impossible either for an airline other than Ryanair to determine the yield which Ryanair obtains on a given route, or for Ryanair to ascertain other airlines' yields. The monitoring condition is therefore clearly not met.

7.18 *Difficulties in determining what constitutes a defection from coordination*. In the presence of thousands of prices simultaneously available to passengers, it is likely to be impossible to determine what constitutes a defection from coordination. For example, would pricing a single flight at an inappropriately low level constitute a defection from coordination? It seems unlikely that an airline would enter into a punishment phase for such a limited defection which may impact less than 0.01 per cent. of either Ryanair or Aer Lingus' annual revenue, but if a single incident of breaching the collusive agreement is insufficient to lead to punishment, then there is no obvious point at which an airline's behaviour would be "sufficiently uncoordinated" to lead to punishment. In the absence of such a clear dividing line, then coordination is unlikely to be sustainable.

7.19 *Presence of alternative outlets for competition*. Most models of coordinated behaviour focus exclusively on companies' pricing, which will often be appropriate in industrial markets with broadly homogenous outputs and professional buyers. However, the aviation market is one where customer demand can be substantially influenced by the extent of advertising and quality of service factors (particularly, in Ryanair's experience, timeliness of take-offs and landings). Such non-price conditions of competition can undermine coordination. For example, if Ryanair were to launch a high profile, targeted advertising campaign on a given route, this could have a similar effect on switching demand to engaging in price cuts. Such a campaign could be seen as representing a defection from a coordinated position by an alternative airline which had lost demand due to the advertising campaign, and undermine coordination. There may therefore be a need also to reach an understanding on the level and type of advertising in the market if coordination is to be sustained, further complicating any attempts to coordinate over extended time periods.

7.20 It is worth noting that Ryanair has consistently sought to target Aer Lingus with advertising which has aimed to poach passengers from Aer Lingus (examples are attached as [Annex Removed]); and there has been sustained litigation and other disputes between the two companies[58] as noted in section 4.2 of the MI Paper. Such behaviour, which has been ongoing rather than intermittent, is inconsistent with the "quiet life" which would be expected in sustained coordinated equilibrium. Such non-price forms of competition would tend to undermine price coordination, and therefore represent *prima facie* evidence that there has been no such coordination.

7.21 Overall, therefore, there are strong reasons to believe that coordination could not be sustained in the airline markets in which Ryanair operates. There is a significant number of factors tending to undermine both the establishment and maintenance of coordination, and no strong factors tending to support coordination.

(c) Condition 2: Firms must be incentivised to coordinate

7.22 It is a core element of Ryanair's corporate philosophy to be the lowest cost airline on all routes on which Ryanair operates. As such, Ryanair believes that it has no incentives to coordinate its behaviour with Aer Lingus, bmi, or any other airline.

7.23 Moreover, as set out above, Ryanair has a considerably lower cost base than other airlines. As such, Ryanair will always engage in price competition to the benefit of consumers, as it knows that it will be profitable at price levels which other airlines find unsustainable. Ryanair therefore will always wish to set a lower price than its rivals, removing its incentive to coordinate. Any price which Aer Lingus or another high-cost airline wished to set as a "coordinated" price (which must be a price above the level that the other airline would set in the absence of coordination) would almost certainly be above a level that Ryanair would find commercially attractive. Ryanair's low cost base will reduce or eliminate the additional profits that coordination would in many other markets be expected to generate.

7.24 Ryanair also believes that other airlines would not be able to find an effective punishment mechanism against it. As the lowest cost operator in the European airline

58 See in particular the Hanger 6 controversy that is discussed in the MI Paper in section 4.2(f).

sector, Ryanair believes that punishments are likely to be very costly for Aer Lingus or any other airline which might attempt to "discipline" Ryanair, while having a much more limited impact on Ryanair's profits. This is particularly the case in the light of Aer Lingus only overlapping on a small (less than 10 per cent.) minority of Ryanair's European routes; any Aer Lingus punishment strategy would be unable to impact on Ryanair's much wider non-Irish operations.

(d) Condition 3: Coordination must not be undermined

7.25 Ryanair believes that entry barriers into the markets in which it operates are low, due to low sunk costs arising from the redeployability of assets between different geographically diverse airline markets.

7.26 The arguments regarding low barriers to entry are set out in detail in section 4 above, and are not repeated here.

7.27 Overall, however, Ryanair believes that even if conditions 1 and 2 were met in the airline markets in which Ryanair operates (which they are not) then any possible coordination between Ryanair and its competitors would be undermined by entry into the market following price increases.

(e) The cross-shareholding does not have any effect

7.28 The shareholding between Ryanair and Aer Lingus does not have any effect on the above conclusions regarding coordinated effects. There are two main reasons for this, relating to the two main theories of harm which have been advanced with regard to minority shareholdings in relation to coordinated effects.

7.29 *Information exchange*. Both parties ensure that they comply with stock exchange and competition rules regarding price sensitive and commercially sensitive information. As a result, Ryanair receives no information at a detailed enough level to enable coordination to take place at the level of individual routes. As such, the cross-shareholding does not impact on the transparency of Aer Lingus' operations to Ryanair.

7.30 *Incentives to coordinate*. Although intuitively a cross-shareholding may enhance incentives to coordinate, on the basis of economic theory the impact can be either to raise or lower incentives for coordination, depending upon the precise circumstances of the case.

7.31 On the one hand, at least in an abstract setting, the cross-shareholding raises the incentives for the firm holding the shares to coordinate (in this instance, Ryanair). This is because Ryanair would benefit not only from its own increase in profits, but also to some extent from Aer Lingus' increased profits. On the other hand, the cross-shareholding would increase the costs of engaging in punishment to sustain a coordinated situation (as Ryanair would take a share of any Aer Lingus losses), and therefore would make Ryanair less willing to engage in such a punishment strategy. If Ryanair is less willing to punish Aer Lingus for breaching any collusive equilibrium, then such a collusive equilibrium will be less sustainable, as Aer Lingus will find it more profitable to engage in price cuts. In the sense set out in the Guidelines, the "*extent to which punishing the deviating firm is costly to other coordinating firms*" (in this case Ryanair) would be increased.[59]

7.32 Moreover, Ryanair's shareholding in Aer Lingus is asymmetric. This means that Aer Lingus has no increased incentives to engage in coordinated behaviour with Ryanair as a result of the shareholding, as it will not consider Ryanair's profits when making its pricing choices. It is generally acknowledged that asymmetries between firms tend to undermine coordination.[60] Ryanair's shareholding in Aer Lingus, which is not reciprocated, will tend to make the two airlines more asymmetric than otherwise, so helping to undermine the prospects for coordination.

7.33 Finally, the practical implication of Ryanair's stake in Aer Lingus has been to create ongoing antagonism between the two airlines as illustrated by several examples provided in Section 4.2 of the MI Paper. Such a hostile atmosphere does not promote coordinated behaviour.

7.34 Overall, therefore, the net impact of the asymmetric cross-shareholding would, in Ryanair's assessment of the economic theory, tend to reduce the possibility of reaching and sustaining a coordinated equilibrium.

(f) Non-price collusion

7.35 The market characteristics that tend to lead to collusion on non-price factors are similar to those which lead to collusion on prices — there is still a need to reach a coordinated understanding, to monitor that understanding and punish any defections from it, and for coordination not to be undermined by entry to the market.

7.36 The one difference from the analysis presented above is that it is likely to be somewhat easier to monitor some non-price aspects of competition (such as scheduling) than it is to monitor price competition. However, given the extent of asymmetries between Ryanair and other airlines (particularly with regard to their relative cost bases), the inability of other airlines to effectively punish Ryanair, and the likelihood of entry if Ryanair does not continue to maintain a competitive offering, Ryanair believes that there is no realistic prospect of coordination.

7.37 Moreover, considering non-price factors, Ryanair has had a clear strategy which is not based on coordination with other airlines. Ryanair has relentlessly focussed on making cost savings and ensuring as low a price as possible for its core product, moving many costly ancillary activities into being charged for separately. This has generally led to Ryanair being increasingly differentiated from its rivals. The same non-price strategy has been pursued across the whole of Ryanair's network.

7.38 Ryanair and Aer Lingus have never engaged in a policy of geographic market sharing.[61]. Moreover, given the features of the market outlined above, Ryanair would have no incentives to coordinate in this way – where there is a profitable opportunity, then Ryanair will pursue that opportunity. It does so irrespective of what other airlines are already operating on the route. Ryanair does not believe that Aer Lingus would be

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59 The Guidelines, para. 5.5.16, second bullet.

60 The Guidelines, para. 5.5.16, final bullet.

61 See section 5(d) above.

able to find any effective punishment strategy which might act as a deterrent to engaging in head-to-head competition on any profitable Aer Lingus routes.

7.39 As such, the conclusions set out above with regard to price coordination continue to hold. Ryanair has not engaged in non-price coordinated behaviour, and there is no theoretic support for the proposition that it might at any point seek to do so.

(g) Conclusions

7.40 Overall, therefore, it is clear that there could not be any coordinated effects arising as a result of Ryanair's minority stake in Aer Lingus. None of the three conditions for coordination are met; and, in any case, the cross-shareholding is more likely to reduce the prospect of coordination than to enhance it. There is no prospect of a lessening of competition due to tacit collusion between Ryanair and Aer Lingus, or indeed between Ryanair and any other airline.

8. Conclusion

8.1 If the economists on the OFT's team would find it useful to meet with Ryanair's economic advisers (Oxera) to discuss the economic work in this paper and the general availability of data, we would be happy to arrange this.

31 August 2011

LIST OF ANNEXES

[Annexes Removed]

Ryanair News

News Release

26.10.11

RYANAIR URGES FERROVIAL/BAA TO SELL STANSTED AS AIRLINES ABANDON HIGH COST AIRPORT

Ryanair, the world's favourite airline, today (26th Oct) urged the Ferrovial/BAA monopoly to stop delaying the sale of Stansted Airport, as recommended by the Competition Commission over three years ago, when the Ferrovial/BAA monopoly is clearly not in the airport users' best interest as Air Asia X is the latest of a number of airlines withdrawing or cutting services at London Stansted.

The sale of Stansted Airport was recommended by the Competition Commission in 2008 as the BAA's ownership of Stansted and the way the BAA operates Stansted, had *"adversely affected competition"*. Ryanair confirmed that while Ferrovial/BAA repeatedly delays the sale of Stansted, they continue to raise fees at Stansted, which has suffered five successive years of traffic declines because of BAA Stansted's uncompetitive and high charges. Ryanair, together with Air Asia X, Air Berlin, Cyprus Airlines, Easyjet, T. Cook, Thomson and Star One have cut routes to/from Stansted in 2011 while other airports in the UK are growing routes and traffic.

Ryanair's Stephen McNamara said:

"Ryanair calls on the Ferrovial/BAA monopoly to stop delaying the inevitable sale of Stansted Airport and stop damaging airport users and passengers with higher charges and cost increases. It is not surprising that Air Asia X has joined the growing list of airlines cutting routes from Stansted airport and switching its operations to Gatwick Airport instead.

Stansted airlines and passengers continue to suffer high and rising charges, abject service levels and declining traffic at Stansted and we call on the Ferrovial/BAA monopoly to stop delaying the sale of Stansted Airport before further damage to London tourism is done."

Ryanair News

News Release

19.12.11

RYANAIR CALLS FOR EARLY SALE OF STANSTED AS BAA'S HIGH FEES FUND £240M DIVIDEND TO SPANISH SHAREHOLDERS

WHILE BAA STANSTED'S TRAFFIC KEEPS FALLING FERROVIAL'S DIVIDENDS RISE

Ryanair, the world's favourite airline, today (19th Dec) called for the early sale of London Stansted Airport, as recommended by the UK Competition Commission in 2008, after the BAA monopoly confirmed that its high airport charges will fund dividends of £240m next year to its Spanish shareholders, Ferrovial. Ryanair calls on the UK Government to intervene and procure the early sale of Stansted and one of the Scottish airports to allow competition between airports to deliver lower costs for airport users, where the BAA monopoly has repeatedly failed while delivering bigger dividends for its Spanish shareholders.

Over the past five years the BAA has doubled its charges to airlines at Stansted, and is generating excess profits, which it is now distributing to shareholders. However, during this five year period, traffic at Stansted has collapsed from over 24m in 2007 to just over 18m in 2011. Already this year, Ryanair, easyJet, Air Berlin, Thomas Cook, Thompson and Air Asia have announced further cuts in flights and traffic at Stansted in the face of continuing high costs and monopoly profiteering by the BAA Stansted monopoly.
Ryanair's Stephen McNamara said:

*"Back in August 2008, the UK Competition Commission recommended the break-up of the BAA airport monopoly. The Competition Commission found that "**the BAA's monopoly ownership of Heathrow, Gatwick and Stansted airports had adversely affected competition**". It also found that "**the way the BAA has conducted its business has adversely affected competition**". It also concluded that "**the inadequate regulatory regime operated by the CAA has adversely affected competition**".*

It is regrettable that today, while it continues to overcharge passengers and airlines at its London airport the BAA has still failed to comply with the Competition Commission's 2008 ruling to sell Stansted but is now further enriching its Spanish shareholders while it strangles London traffic, tourism and jobs.

Ryanair believes that the BAA is an abusive airport monopoly, which has engaged in significant overcharging and monopoly profiteering at Stansted. It is now time for the Government to intervene to force the early sale of Stansted and one of the Scottish airports and allow competition to provide UK consumers with more choice, lower costs and a better experience at the London airports instead of allowing declining London passenger traffic to be fleeced by the BAA monopoly in order to reward its already rich Spanish shareholders."

Ryanair News

News Release

14.05.12

RYANAIR CALLS FOR URGENT SALE OF STANSTED AIRPORT

Ryanair, the UK's favourite airline, today (13 May) called for the urgent sale of London Stansted Airport, as advised by the Competition Commission in 2008, after the BAA monopoly confirmed that traffic at Stansted continues to decline, with April's figures down 5% on April 2011 resulting in a total loss of 400,000 passengers in the first 4 months of 2012. While Stansted traffic declines, Heathrow and Gatwick's traffic has grown which proves that the BAA monopoly is damaging Stansted.

STANSTED PAX COLLAPSE

	2011	2012	Decline
Jan	1.1m	1.0m	-7%
Feb	1.2m	1.1m	-5%
Mar	1.4m	1.3m	-5%
Apr	1.6m	1.5m	-5%
Avg	1.3m	1.2m	-6%

The reason for Stansted's traffic declines is the BAA airport monopoly's policy of increasing passenger charges and providing abject customer services which at Stansted comprises long security queues, frequent baggage belt breakdowns, and excessive passport queues causing delays for British citizens and visitors at Stansted.

Ryanair's Stephen McNamara said:

"The BAA's traffic figures show continued declines at Stansted due to its high costs and airport mismanagement. These declining passenger numbers provide further evidence of the urgent need to expedite the BAA's sale of Stansted airport, as first recommended by the UK Competition Commission back in 2008, over 4 years ago. The sale of Stansted into separate ownership will lead to more competition, lower passenger charges, improved passenger services and the roll out of additional and much needed traffic growth at competitive prices in Stansted."

Ryanair cuts capacity at Stansted by one million passengers

Ryanair announced it will cut capacity at Stansted by 9pc on the day the airport came under new ownership.

Heathrow Airport Holdings on Thursday completed a £1.5bn deal to sell Stansted to Manchester Airport Group. Photo: Paul Grover

By Nathalie Thomas

7:59PM GMT 28 Feb 2013

The low cost airline said the move was in response to a "further unjustified" increase of 6pc in landing charges from April.

The carrier blamed Heathrow Airport Holdings, previously known as BAA, for the rise in the "already high charges" at the airport.

A steep 6pc jump in fees was a "parting slap" from Heathrow to Stansted's airlines and passengers, the self-styled ultra low cost carrier claimed.

Heathrow on Thursday completed a £1.5bn deal to sell Stansted to Manchester Airport Group.

Ryanair claimed it had planned to grow its traffic at Stansted by 5pc from April but will now cut frequencies on 43 of its routes and reduce its weekly operations by more than 170 flights.

The airline said the swingeing cuts could potentially lead to a loss of 1.1m passengers and more than 1,100 jobs at Stansted airport.

According to research, 1,000 jobs are sustained at airports for every 1m increase in passengers.

Robin Kiely, spokesman for Ryanair, said it is "impossible to understand" why Stansted's prices will rise again from April when the airport has changed ownership.

"Ryanair and other Stansted airlines now must ask was this surprise price increase part of a "sweetener" package to persuade MAG to pay £1.5bn for Stansted?" he added.

Heathrow Airport Holdings declined to comment, pointing out the airport is now owned by MAG. However, it is understood the 6pc rise is a part of a settlement made with the industry's regulator, the Civil Aviation Authority five years ago.

Stansted is one of several UK airports, including Gatwick and Heathrow, that negotiates price increases every five years.

Both Gatwick and Heathrow recently submitted plans to the CAA for landing charges over the next five-year period, between 2014 and 2019.

An MAG spokesman said: “As part of our plans to grow passenger volume at Stansted over the short, medium and long term, we will continuously engage with all of the airlines that operate there, many of which are already valued customers of ours.”

FERROVIAL/BAA HIKES STANSTED FEES BY 6% FROM APRIL 2013 IN A PARTING GIFT TO MANCHESTER AIRPORT GROUP & A PARTING SLAP TO STANSTED'S AIRLINES & PASSENGERS

RYANAIR TO CUT ITS STANSTED TRAFFIC BY 9% IN RESPONSE TO THESE UNJUSTIFIED & INFLATION-BUSTING INCREASES

Ryanair, Europe's only ultra-low cost carrier (ULCC), today (28 Feb) announced that it will cut its London Stansted traffic by 9% over the coming year (from 12.5m to 11.4m) after the Ferrovial/BAA Stansted monopoly announced a further unjustified increase of Stansted's already high charges of 6% from April 2013, despite the fact that Ferrovial/BAA has sold Stansted to Manchester Airport Group (MAG) who will take over the airport sometime before the end of March.

Ryanair has called on Stansted's regulator, the CAA, to investigate whether this unjustified and unwarranted 6% price hike was a "*sweetener*" by Ferrovial/BAA's sale of Stansted, which raised £1.5bn in proceeds for Ferrovial, despite the fact that Stansted's traffic has declined from 24m p.a. to 17.5m p.a. over the last 6 years.

Ryanair, which had planned to grow its Stansted traffic by 5% from April 2013, will now cut frequencies on 43 of its routes and reduce its weekly operations by over 170 flights, with the loss of 1.1m passengers (-9%) and over 1,100* jobs at Stansted, in direct response to this unwarranted and unjustified 6% price hike. Ryanair called on the CAA regulator to explain why Ferrovial/BAA is allowed to hike charges by 6% when UK inflation is less than 3% and Stansted's traffic continues to decline.

Ryanair also called on Ferrovial/BAA to reverse this unjustified and unwarranted price increase before the sale to MAG is concluded and further called on MAG to confirm that it will not permit any further price increases at Stansted unless, or until, the traffic declines of the past 6 years (during which the Ferrovial/BAA monopoly has doubled Stansted's fees) are reversed.

Ryanair's Robin Kiely said,

"It's bad enough that Ferrovial/BAA has doubled prices over the past 6 years and presided over record traffic falls at Stansted, but it appears that the CAA now rewards this commercial failure by allowing Ferrovial/BAA to again raise fees in 2013 to compensate for its traffic declines in 2012.

Given that Ferrovial/BAA has now agreed to sell the airport to MAG, it is impossible to understand why the BAA monopoly is again raising Stansted's prices from April 2013 when it clearly won't be running the airport from that date. Ryanair and other Stansted airlines now must ask was this surprise price increase part of a "sweetener" package to persuade MAG to pay £1.5bn for Stansted? Are passengers and airlines at Stansted again being hit in order to boost the sales proceeds for the Spanish giant, Ferrovial, from the sale of BAA Stansted?

As the London Times has previously commented, the appropriate response to a traffic decline would be to lower prices and grow volumes. Instead the Ferrovial/BAA monopoly, as it runs down the runway trousering £1.5bn from the sale of Stansted, is imposing a further, unjustified 6% price increase one month in advance of MAG's takeover of Stansted. There's something very smelly about the timing and the scale of this price increase, which is more than double the rate of UK inflation.

Ryanair believes that this price increase, which will clearly be of no benefit to Ferrovial/BAA, was part of a "sweetener" to MAG in order to boost the sale price of Stansted Airport. The CAA must now investigate the reasons for this price increase and take action to protect Stansted users from this latest example of price gouging from Ferrovial/BAA."

* ACI research confirms up to 1,000 'on-site' jobs are sustained at international airports for every 1m passengers

Ryanair to cut down flights from Stansted over landing fee row

Low-cost airline Ryanair has announced it will cut its flights from Stansted Airport by nine per cent over the next year in a row about landing fees.

Stansted was put up for sale in August Photo: Paul Grover

By Josie Ensor

9:34AM GMT 02 Mar 2013

Ryanair had planned to increase the number of flights to and from the Essex airport by 5 per cent from April, but will now cut 170 flights across 43 routes a week because of increased fees at Stansted.

The reduction means that 1.1 million fewer Ryanair passengers will travel through the airport, which Ryanair claims could cause the loss of up to 1,000 jobs there.

More than 50 per cent of Stansted's flights are generated by the budget Irish airline.

The announcement came after Stansted was sold by Ferrovial/BAA to Manchester Airports Group (MAG) for £1.5 billion.

Ryanair blamed its decision on a 6 per cent increase in charges at the airport, which it says should be investigated by the Civil Aviation Authority (CAA).

Ryanair spokesman Robin Kiely said: "It's bad enough that Ferrovial/BAA has doubled prices over the past six years and presided over record traffic falls at

Stansted, but it appears that the CAA now rewards this commercial failure by allowing Ferrovial/BAA to again raise fees in 2013 to compensate for its traffic declines in 2012."

He continued: "Ryanair and other Stansted airlines now must ask was this surprise price increase part of a sweetener package to persuade MAG to pay £1.5bn for Stansted."

Stansted is one of several UK airports, including Gatwick and Heathrow, that negotiates price increases every five years.

19 March 2013 Last updated at 16:08

Ryanair to expand by 30% with bumper Boeing order

Ryanair is planning to increase its aircraft fleet by a third to 400 planes after placing an order with Boeing for 175 planes worth $15.6bn (£10.3bn).

Ryanair hopes to be 30% bigger by 2018

The airline currently has 305 planes. The order will allow older ones to be retired.

The move is a boost for the US planemaker after rival Airbus received a record $24bn order from an Indonesian airline on Monday.

Ryanair hopes to increase its passenger numbers to 100 million a year.

Ryanair, which has has always favoured Boeing aircraft and remains one of the few all-Boeing carriers, said it had received a discount on the price, but did not reveal how deep a discount.

The order is for the current generation 737s, whose 737-800 model list price is $89.1m, but large orders typically involve a discount, which could cut the price paid to half that.

The deal softens the missed opportunity from Indonesia's Lion Air, as that company had previously given Boeing its own record order.

Aerospace and Defence

Boeing resumes deliveries of 787

EADS profits up on Airbus deliveries

Rolls-Royce to back supercar project

Pilotless flight success over UK

Problems

Boeing's reputation has taken a blow in recent months after its latest Dreamliner 787 planes were grounded after batteries on some planes emitted smoke.

Flights of these are expected to restart within weeks.

Boeing's head of commercial airplanes Ray Conner said at a joint news conference with Ryanair on Tuesday that the problems with the 787s had not affected orders.

He added that they were working hard to get the issue sorted out.

Ryanair chief executive Michael O'Leary said he was happy to back Boeing: "Hopefully it will help refocus people's minds on the fact that Boeing continues to deliver great aircraft and is growing strongly, rather than a minor issue on the 787."

Donal O'Neill, an analyst with Goodbody Stockbrokers in Dublin, said the order was good for both sides: "This order puts Ryanair back on track for growth at a time when many European airlines are shrinking.

"For Boeing it keeps a major customer on board and helps position it to hook Ryanair for an order of the [next-generation] 737-Max in a few year's time."

Boeing 737s compete mainly with Airbus's A320s in the short-to-medium range, narrow body jet market.

Ryanair's expansion is expected to have taken place by 2018 and the company said if demand kept growing it could build further on the order with another.

Ryanair's shares were 4% higher in afternoon trading, while Boeing's were 0.5% higher.