



**UNITED KINGDOM
CIVIL AVIATION AUTHORITY**

DECISIONS ON AIR TRANSPORT LICENCES AND ROUTE LICENCES

5/98

Decision of the Authority on its proposal to vary licence 1B/10 held by British Airways Plc and licence 1B/35 held by Virgin Atlantic Airways Limited heard on 10 December 1998.

Panel

Chairman: Mr D Andrew
Mr A Herron
Adviser: Mr D Batchelor
Secretary: Mr G J Elsbury

Objections to the Authority's proposal:

Objector: British Airways Plc represented by Mr A Lydiard of Counsel, Instructing Solicitor, Mr O Highley, British Airways Plc

Witness: Mr J Wood, Regional Director Asia/Pacific, British Airways Plc

Objector: Virgin Atlantic Airways Ltd, represented by Mr C Haddon-Cave of Counsel, Instructing Solicitor, Miss J Durham, Virgin Atlantic Airways Ltd

Witnesses: Mr R Branson, Chairman, Virgin Atlantic Airways Ltd

Mr M Siladi, Regional General Manager, China, Hong Kong and Macau, Virgin Atlantic Airways Ltd

Mr B Humphreys, Director of External Affairs and Route Development, Virgin Atlantic Airways Ltd

SUMMARY

1. This hearing was convened to decide how to allocate between British Airways and Virgin Atlantic Airways the limited rights available for UK airlines to serve Shanghai under the UK/China bilateral air services agreement. Both British Airways and Virgin Atlantic Airways wished to exercise the UK's full entitlement of two services a week between London Heathrow and Shanghai. The Authority had to decide whether to award the two airlines one weekly frequency each or award both frequencies to one of the airlines. The Authority has concluded that its statutory duties would be best served by awarding both frequencies to Virgin. It believes that this will best promote competition between British airlines and with foreign airlines to the benefit of users of air services.

THE NOTICE

2. On 6 November 1998 the Secretary of State, in exercise of his powers under Regulation 3(5) of the Civil Aviation Authority Regulations 1991, gave notice to the Authority that in his opinion, by virtue of provision made by or under the terms of the Memorandum of Understanding concluded on 7 October 1998 between the People's Republic of China and the United Kingdom, the United Kingdom's share of capacity on air transport services between the United Kingdom and the People's Republic of China which may be provided by British airlines would, within 6 months of the date of that notice, be insufficient to enable Virgin Atlantic Airways Limited and British Airways plc to make available all the capacity which they planned to provide. This notice was published in the Authority's Official Record Series 2 on 17 November 1998.

THE PROPOSAL

3. Following the notice from the Secretary of State, the Authority published its proposal to vary the licences of British Airways (1B/10/357) and Virgin Atlantic Airways (1B/35/143) in its Official Record Series 2 on 17 November 1998. After reciting the notice, this proposal stated that:

"2. The Authority is advised by the Secretary of State that both Virgin Atlantic Airways and British Airways wish to operate 2 services a week between London and Shanghai and vice versa within the next six months. Under the bilateral arrangements between the UK and the People's Republic of China, UK airlines may operate up to 2 services a week on routes between the UK and Shanghai, increasing to 4 services a week from Summer 2000. The Authority is therefore required to allocate the 2 services a week currently available.

"3. For these reasons, the Civil Aviation Authority, in exercise of its powers under Section 66 (2) of the Civil Aviation Act 1982, hereby proposes to vary route licence number 1B/10 held by BRITISH AIRWAYS PLC (BA) and route licence number 1B/35 held by VIRGIN ATLANTIC AIRWAYS LIMITED (Virgin) so as to provide that the total number of flights operated between the UK and

Shanghai by BA and Virgin in any one week shall not exceed 2 in each direction. The maximum number of flights which may be operated by each airline will be determined by the Authority in the light of its statutory duties and objectives and the arguments advanced at the hearing.”

OBJECTIONS AND REPRESENTATIONS

4. British Airways (“BA”) exercised its right to be heard on the Authority’s proposal to vary its licence 1B/10 and made a representation in respect of the proposal to vary Virgin Atlantic Airways’ licence.

5. Virgin Atlantic Airways (“Virgin”) exercised its right to be heard on the Authority’s proposal to vary its licence 1B/35 and made a representation in respect of the proposal to vary British Airways’ licence.

6. The Air Transport Users Council (“AUC”) made a written representation on the Authority’s proposal.

BRITISH AIRWAYS’ CASE

7. The decision facing the Authority in this case was to choose which of BA and Virgin should operate to Shanghai. The forefront of Virgin’s case was that allocating Shanghai to Virgin would further competition. However, BA submitted that this case should be decided primarily on the basis of the reasonable interests of users, with further weight given to the need to facilitate competition by British airlines with other airlines. Consideration should also be given to securing the sound development of the industry and to the economic prospects of the service.

8. BA proposed to operate to Shanghai from London Heathrow initially using B747-400 equipment. From Summer 2000, when four frequencies a week would become available, BA intended to operate all four services with a long-range B777 aircraft, so enabling BA to add frequency without creating excessive overall capacity on the route. Its proposed schedule in the first year would be a 1600 departure from Heathrow on Tuesdays and Thursdays, with return departures from Shanghai at 1140 on Wednesdays and Fridays. It had currently been allocated slots at both Heathrow and Shanghai at rather earlier times than this, but hoped to be able to improve them over time.

9. BA believed that Shanghai was one of a small group of cities with exceptional potential in the coming decades for international business in general and air travel in particular. Its experience on other new routes, including Beijing, was that the introduction of non-stop services would result in high levels of market stimulation. Based on the above operating proposal, it forecast that it would carry 49,360 passengers in the first year of operation, 69,100 in year two and 76,010 in year three. It expected to achieve a 59% seat factor in the first year, growing to 65% and 71% in

the two subsequent years. The route would grow in profitability over the three years, producing a profit of over £4m in the third year at an operating ratio of 110.

10. BA argued that there was no reason for the Authority to take into account issues of industry structure in reaching its decision. If the possibility of the Authority awarding each carrier one frequency each were discounted, this was by definition a route on which only one UK airline could operate. There were therefore no considerations of competition between British airlines. This was also not a case where Virgin's ability to grow depended on securing this particular route. There were many other routes which were open to Virgin to operate within existing bilateral constraints if it chose to do so.

11. On quality of service, both airlines offered high quality products, each with its own individual strengths. Both had won many awards, and there was nothing to choose between the two on this score. However, this was a route on which formidable competition was faced from other European airlines. BA's manifest strengths meant that it was best placed to compete and so secure the advantages for users which would result from healthy and strong competition. By virtue of its hub at Heathrow, it could compete with continental European carriers for traffic originating in the UK regions or in continental Europe in a way which Virgin could not. BA's ability to access the connecting market at London more effectively would also be important in sustaining a route which would inevitably be relatively thin in the early years.

12. It was also relevant that BA had put a lot of effort into China over the years. According recognition to such investment would be an incentive for airlines to engage in the sort of exploratory development which aids the sound development of the UK air transport industry.

VIRGIN ATLANTIC AIRWAYS' CASE

13. Virgin argued that there were three grounds on which the Authority should award it the rights to serve Shanghai, any one of which were sufficient and which cumulatively constituted an overwhelming case in Virgin's favour. The first was that only a decision in favour of Virgin would be consistent with the Authority's policy to ensure active competition between British airlines. Secondly, the Authority's policy of encouraging the development and maintenance of an environment in which competition between British airlines could flourish meant that on industry structure grounds the Authority had to decide for Virgin. Thirdly, real user choice and benefit would be enhanced by having a second British long haul carrier flying into mainland China.

14. On competition grounds, Virgin's case was simple. There were two keys to the heart of China - Beijing and Shanghai. BA already had access to Beijing, and if it were to gain the rights to Shanghai two consequences would follow. BA would further increase its dominance of the China market compared with Virgin, to the point of having a stranglehold. And the prospects of a second British long haul carrier breaking into this important market would be dramatically diminished. China should essentially be regarded as one market with three gateways, Hong Kong serving the south and Beijing and Shanghai the mainland. BA already dominated in its own right the two gateways

currently served by UK airlines. Taking into account its partners in the “oneworld” alliance only served to exacerbate this position.

15. In terms of industry structure Virgin was BA's only long haul competitor in the UK, a position which was likely to pertain for the foreseeable future. It had proved itself to be a highly effective competitor to BA in every market it had entered. The future vitality of competition on long haul routes from the UK depended on Virgin being allowed to expand into new markets. However, Virgin's ability to expand was being increasingly constrained by two factors: the difficulty in securing slots at Heathrow and Gatwick at suitable times for additional transatlantic services, and bilateral constraints. Therefore Virgin's strategy, of necessity, had been to diversify into new long and medium haul markets for which it had been able to obtain suitable slots. China was probably the most important market to open up since the United States, and Shanghai, as a city of 14 million people, represented a huge opportunity. Virgin was currently shut out not just of Shanghai but of the mainland China market. Failure to afford Virgin the opportunity to enter this market was likely to have significant consequences for the long term. Conversely, the downside for BA of not being awarded the right to serve Shanghai was not great since it already served Beijing in addition to Hong Kong. The downside for Virgin was far greater.

16. It was plain that user choice and benefit would be greatly enhanced if Virgin were able to serve Shanghai. Virgin would offer an award winning product at extremely competitive fares using an A340 aircraft. The A340 was well suited to routes from Shanghai to Europe, as evidenced by the fact that two European carriers and China Eastern already used this aircraft type on such routes. However, Virgin had the flexibility to upgrade to larger aircraft to meet growth in demand if necessary. Virgin's business class and premium economy products would be of particular significance on this route, given that it was expected to have a higher than normal proportion of business traffic. In summer 1999, it proposed to depart from Heathrow at 1615 on Mondays and Saturdays, departing from Shanghai on the return leg at 1300 on Tuesdays and Sundays. Its traffic and financial forecasts were based on the assumption that it would increase to four frequencies a week with A340 aircraft from summer 2000. On this basis, it forecast that in the first year it would carry 36,362 passengers, in the second 77,880 and in the third 80,521. Its load factor would grow from 68% in year one to 76% in year three. The route would become profitable by the third year, after incurring losses in the first two years of some £2.9m and £1.4m respectively. In the third year Virgin anticipated a profit of just over £1m.

REPRESENTATION BY THE AIR TRANSPORT USERS COUNCIL

17. The AUC did not believe there was a great deal to choose between the two proposals and regretted that the airlines were not free to compete in the open market for the right to serve the route. In reaching its view on which airline should be awarded the rights to serve Shanghai, the AUC considered separately the benefits accruing directly to travellers on the London/Shanghai route and the wider benefits of enhanced competition. On the former, the fact that Virgin forecast much the same passenger carryings as BA despite offering significantly better in-flight service and lower fares led it to the conclusion that Virgin's service would provide greater direct user benefit. On wider competition, it recognised BA's argument that awarding this service to BA would enhance its ability to compete with foreign carriers. However, for the decision to be taken on this basis would represent a significant shift in licensing policy with profound consequences for an airline like Virgin which is seeking to build a network. Unless it was awarded routes such as London-Shanghai (or joins one of the large alliances) it would never have this capacity. For this reason, the AUC was in favour of granting this designation to Virgin on competition grounds.

ANALYSIS AND REASONS

Introduction

18. The Authority's decision in this case is how to allocate between BA and Virgin the two weekly frequencies currently available for services to Shanghai. Under the current bilateral arrangements, the rights available to UK airlines are due to increase to four frequencies a week from the beginning of the summer 2000 season. In putting their cases to the Authority, both BA and Virgin based their traffic and financial forecasts on the assumption that they would each be able to take up the full UK entitlement both now and when the additional frequencies became available. However, based on the notification of scarce capacity from the Secretary of State and his Department's accompanying advice, the decision for the Authority in this case is solely in respect of the two frequencies currently available. Its decision will therefore be without prejudice to any future decision it may be required to take in respect of any additional capacity which is available for UK airlines on the London/Shanghai route. Having said that, the Authority's hope is that any future scarce capacity proceedings will be unnecessary. Benefits to users and the economies of both countries will be best served when airlines of both sides are able to mount the services of their choosing free of artificial government-imposed constraints.

19. The Authority has made clear that its primary concern in carrying out its statutory duties will be for the reasonable interests of users. It sees competition, both among British airlines and between British and foreign airlines, as the best available means of ensuring that users have the widest possible choice of products, services and airports, that quality of service is maintained and that fares are set at reasonable levels in relation to cost. It believes that the interests of users are best met by the existence of a number of efficient and profitable British airlines strong enough to compete with each other and with foreign airlines, directly or indirectly, when the opportunity arises or can

usefully be created. Thus it will seek to encourage the development and maintenance of an environment in which efficient British airlines can operate profitably and in which competition between British carriers and with foreign airlines can flourish and user choice is enhanced.

Competition between British airlines

20. BA argued that the Authority's aim of encouraging competition between British airlines was without relevance in this case because, unless the Authority decided to award BA and Virgin one frequency each which neither airline advocated, the brute fact was that at this stage there could be no direct competition between British airlines on this route. This argument relied on the view that Shanghai was essentially a discrete market rather than part of a wider UK/China market. Virgin argued the alternative case, that for a number of reasons China should be regarded as one market with three gateways. Hong Kong served the south, and Beijing and Shanghai served the north. Its view was that it would be entirely inconsistent with the Authority's policy of promoting competition to allow BA to have the third gateway. It was already the sole UK carrier to Beijing and dominated Hong Kong with its "oneworld" partner Cathay Pacific.

21. There was much discussion at the hearing about whether China was effectively one market or three discrete markets. This question is one which should in principle lend itself to objective analysis, just as relevant markets are defined in competition analyses. However, in this case there is a paucity of reliable data on which to base any firm conclusions. Data available from the Authority's own surveys and the International Passenger Survey would not necessarily provide a true picture of the numbers of passengers whose journeys combined Beijing or Hong Kong with other points in China, particularly if those passengers were making stopovers at the gateway. Virgin's submission was that many passengers travelling to China on business would need to visit one or more cities, and that leisure passengers visiting China also often entered via one point and exited via another, but it was unable to provide any hard evidence in support of its contention. Conversely, BA believed that the number of people flying to other points in China through either Beijing or Hong Kong was limited. While it remains difficult to quantify, it seems reasonable for the Authority to conclude that there are respects in which China can be regarded as one market. To the extent that this is true, competition between British airlines is likely to be strengthened more by allowing Virgin rather than BA to serve Shanghai.

22. Virgin also argued at the hearing that allowing BA to serve Shanghai might deal a fatal blow to its Hong Kong services. This was because some passengers at present travel on a London/Hong Kong/Shanghai itinerary. If BA served Shanghai direct then such passengers currently travelling on Virgin on the London/Hong Kong sector would be likely to switch to BA's services. However, Virgin had not produced any analysis which quantified the effect. It did refer to the fact that its Hong Kong services had declined in profitability due to the economic situation in Asia, and that further drains on traffic could therefore push the route into the red. It must be true that whichever of the two airlines were to gain the rights to serve Shanghai, the other would suffer some loss of traffic from its Hong Kong services. This applies to BA just as much as to Virgin. For the purposes of this decision the question is whether this would be likely to have a

material effect on competition between British airlines. Given the current imbalance in the level of services between BA and Virgin to Hong Kong in particular, and Asia in general, it must be the case that of the two Virgin would be the more vulnerable to any such effects. While the Authority is not in a position to quantify these effects, it nonetheless accepts that it should take the potential effect on competition between British airlines into account in reaching its decision.

Competition between British and foreign airlines

23. An important part of BA's case was that it would provide more effective competition with foreign airlines than Virgin, and would thus have the best prospect of securing the Authority's objectives of ensuring that users had the widest possible choice of products and services. The Shanghai market itself, in terms of origin and destination passengers travelling between London and Shanghai, was fairly modest. The successful development of the route would therefore depend on the support of connecting traffic, both from the UK regions and from European cities, for which the successful UK airline would be competing with European airlines. BA's network of connecting services at Heathrow, which would provide more than thirty on-line connections within three hours, was a strong asset which placed it in a better position to compete with foreign airlines than Virgin.

24. Virgin's response to this was two-fold. First, BA had no particular advantage over Virgin in respect of access to connecting traffic at London. Virgin had effective access to feed traffic at Heathrow through its interline arrangements both with British Midland, which had a more extensive network to UK regional points from Heathrow than BA, and with BA itself, which was its most important connecting partner. Secondly, recent and future growth of direct air services between Shanghai and a number of European cities meant that the potential market for traffic connecting from continental Europe was over-estimated by BA and would in any event reduce over time.

25. BA's argument here seems to comprise two elements. The first relates to the viability of the route and the importance of connecting traffic in ensuring viability. It believed that a major reason that it forecast carrying significantly more passengers than Virgin in the first year was that its point-to-point traffic would be supplemented to a far greater extent by connecting traffic at London. Although the Authority can readily accept that BA may be better placed than Virgin to carry sixth freedom traffic over London, it is nonetheless true that Virgin is able to access such traffic. Indeed, to the extent that BA's connections at Heathrow may require transfers from Terminal 1 to Terminal 4, arguably Virgin may be able to offer some passengers more convenient connections than BA. We return to the issue of viability later.

26. The other element of BA's argument is that its network strengths would help it to compete more effectively than Virgin in the face of formidable competition from its European rivals. This implies that the relevant market at the UK end of the route should be regarded as wider than just London. Virgin's suggestion that BA was overplaying the importance of the connecting market at London implies that it might argue the opposite. Again the lack of reliable data, in part due to the absence of an existing London/Shanghai service, means that it is difficult to draw hard and fast conclusions on

this point. Nevertheless, BA's witness stated in oral evidence that he did not regard competition between the "oneworld" and Star alliances as the relevant issue here. What was relevant was that BA would be better able than Virgin to operate a sustainable programme on what would be a relatively thin route.

27. The Authority accepts that BA may be able to compete with its major European rivals across a wider range of markets than Virgin by virtue of its considerably larger network. However, for so long as Virgin's network remains much smaller than BA's this is always likely to remain the case. If the Authority were to place weight on this argument in all cases where BA and Virgin were competing for scarce rights, the logic would always point in favour of BA. In this case, BA did not demonstrate that Virgin would be unable to compete effectively with foreign airlines in this market. Nor did it demonstrate that this route was crucial to its ability to compete effectively with foreign airlines. In these circumstances, the Authority does not regard BA's arguments about competition with foreign airlines as of great significance for its decision.

Industry Structure

28. BA's response to Virgin's argument about industry structure was that, in order to run this argument, Virgin would have to establish that it needed the Shanghai route in order to further wider competition with BA and that this route was of particular importance to that broader picture. It argued that, in line with the approach taken by the Authority in Decision 2/97 on the Denver/Las Vegas case, Virgin would need to demonstrate that a Shanghai service would be critical in enabling it to remain an effective competitor to BA or that a BA service to Shanghai would have a materially detrimental effect upon it. BA did not believe that Virgin had demonstrated that Shanghai was of "critical" importance to its operations generally. There were a number of routes which were open to Virgin within existing bilateral constraints. Indeed BA had established that Virgin's strategy included a list of ten unspecified medium to long haul routes on which it hoped to expand. Its future was clearly not dependent upon Shanghai.

29. The Authority's policy is clearly laid down in its Statement of Policies, the relevant parts of which are repeated in paragraph 19 above. Decision 2/97 was made in the context of routes to the United States. In reaching a view on Virgin's arguments that industry structure was an important factor in that case, the Authority took into account that Virgin was an established carrier to the US. Unlike the 1991 Tokyo case (Decision 1/91), Virgin's future viability on an existing route was not at stake. The Authority has always made it clear that licensing decisions cannot be divorced from the particular circumstances of the case. The circumstances of this case are different from those which applied in the Tokyo and Denver/Las Vegas cases. So far as Denver/Las Vegas was concerned, the Authority's decision was that it did not regard industry structure as a significant factor given the nature of competition in the UK/US market and when set against other considerations in that case. Shanghai, on the other hand, would be a new route for either airline.

30. Although still a relatively small airline compared to many of the airlines against which it competes, Virgin has been highly successful in providing effective competition

to BA and other large carriers on some of the most competitive inter-Continental routes in the world. It is clear that its ability to expand on existing routes and to enter new routes has been hampered to a significant extent by the problems of acquiring slots at appropriate times at Heathrow and Gatwick. In the past it has entered well-established dense routes, on which its differentiated product has often helped it to secure quickly a market share in excess of its frequency share. Operating an entirely new route in its own right would be a new departure for Virgin. As the UK's only current long haul competitor to BA, however, the Authority regards it as important that Virgin is given the opportunity to grow and compete where it is consistent with its duties to do so.

31. The Authority does not regard it as necessary for Virgin to demonstrate that a proposed route is critical to its general survival for it to take into account considerations of industry structure. Indeed as Virgin grows, it becomes less likely that new routes will ever meet that test. The basic question for the Authority in deciding what weight to place upon considerations of industry structure is the degree to which the general level of competition in the UK industry is likely to be affected by its decision. Many of the cases of scarce capacity which the Authority has had to decide have involved relatively small increases in capacity, which by definition are unlikely to have great consequences for the structure of the UK industry. This also means that to the extent that there are any such consequences, they are likely to be relatively marginal and therefore may be more easily outweighed by other considerations. In this particular case, given that there is relatively little scope for differences between the two airlines in terms of specific user benefits, the broader issues of industry structure and competition carry relatively greater weight.

32. BA pointed out that, despite Virgin's references to the enormity of the Chinese market, the size of the cake the Authority was required to cut up in this case was limited. Two frequencies a week to Shanghai could not, in the general scheme of things, be of great consequence for the structure of the UK industry. The Authority would not deny this, but it nevertheless regards the addition of Shanghai to Virgin's network as likely to strengthen competition in the UK industry to a greater extent than the addition of Shanghai to BA's network. While the Authority does not regard its decision as the watershed which Virgin suggested, it nonetheless accepts that there are valid arguments on industry structure grounds weighing in favour of Virgin in this case.

Viability

33. Both BA and Virgin indicated that operating one service a week each was unlikely to make much sense economically. Neither had carried out the detailed financial analysis to demonstrate how a one service a week might perform, and both stated that if the Authority were to reach such a decision they would probably operate in any event. The Authority can see that such a decision would be very much second best for both airlines, and considers that users would gain substantially greater benefit by having one airline operate twice a week than having two operate once a week.

34. Both airlines stressed the potential for growth in China generally and Shanghai in particular. Although the route was likely to take some time to develop, both airlines believed that they would be able to operate profitable services, and neither airline

seriously challenged the other's ability to do so. BA believed that Virgin's assumptions about market growth may be on the optimistic side, particularly given its view that Virgin was less able to attract connecting traffic to support its services. Virgin queried why BA was proposing to operate a B747 in year one, and only to substitute the smaller B777 in year two. It regarded BA's proposal to operate a B777 after the first year as an admission that it was the appropriate size of aircraft for this route. It was forced to operate a B747 in the first year only due to the lack of availability of long-range B777s. BA argued that it was natural to operate larger capacity aircraft where frequency was heavily constrained. It also conceded, however, that suitable B777 aircraft only became available in the second year. The Authority is satisfied that both airlines should be able to mount viable services on this route. It is not particularly surprising that Virgin's service is forecast to take longer to reach profitability, but the Authority does not regard that as significant for its decision.

User Benefits

35. There was relatively little discussion of issues of specific user benefit in this case. Virgin submitted the results of an industry survey as evidence that the quality of its product in both business and economy classes scored higher than BA's in virtually every category of service. It also argued that its proposed fare structure offered users the benefit of lower fares across the board when compared with BA's proposed structure. BA argued that it too offered a high quality product in all cabins on its flights, and concluded that there was not much to choose between the two airlines on grounds of product quality. The Authority accepts that both airlines would offer a high quality of service.

36. BA's proposal has the advantage over Virgin's of offering greater capacity in the first year only. Thereafter, the two airlines propose using aircraft of similar capacity, and both have the flexibility to operate larger aircraft if demand requires it. Virgin argued that any benefit to users to be derived from BA's capacity advantage in the first year should not weigh heavily in the Authority's decision. It should look to the longer term, where there was no difference between the two on capacity. The Authority recognises the benefits to users which are likely to result from the greater capacity mounted by BA in the first year. It might be expected to lead to lower average fares, at least in the "grey" market, as reflected in BA's lower average yield in the first year. However, this is substantially neutralised by Virgin's ability to increase aircraft size if necessary limits BA's advantage.

Other issues

37. BA argued that it took a number of years for it to build its relationships and presence in China and that this effort should be rewarded. Virgin disputed the length of time it now took to establish these relationships in China and argued that it, too, had invested time and effort in doing so. The Authority regards these arguments as secondary to the principal issues before it in this case. In the event that the balance of other arguments was evenly balanced, such arguments might tip the balance. However, that is not the case here.

Conclusions

38. Virgin described this case as a watershed. Although the Authority recognises the future potential of China as a market, the decision before it here is how to allocate two weekly frequencies on a new route. In that sense it is not about the future of the UK air transport industry. It is nevertheless a decision which carries some implications for its policies towards competition between British airlines on long haul routes from the UK. In terms of specific user benefits, one proposal does not clearly have a significant advantage over the other. The Authority is not persuaded that the addition of Shanghai to their route networks is itself crucial to either Virgin's or BA's ability to compete with each other or with foreign airlines. It does however believe that competition in the UK industry and in the UK/China market is likely to be strengthened to a greater degree by awarding Shanghai to Virgin rather than to BA. In a case such as this the Authority must also consider the potential effects on one of awarding the rights to the other. The Authority believes that the commercial consequences for Virgin of awarding Shanghai to BA would be more serious than vice versa. Given the Authority's policy to maintain and promote competition within a multi-airline industry, the Authority therefore finds that its duties would be best served by granting Virgin the right to operate both weekly frequencies currently available to serve Shanghai in preference to BA.

39. This conclusion rests on an expectation that Virgin will deliver the service it has proposed in its case to the Authority. Any significant delay in the implementation of Virgin's plans to take up these rights might be regarded as grounds for the Authority to reach a different conclusion.

DECISION

40. In accordance with its proposal, the Authority hereby varies the route licence number 1B/10 held by British Airways plc by adding the following condition:

“British Airways shall not operate services between the UK and Shanghai.”

41. In accordance with its proposal, the Authority hereby varies the route licence number 1B/35 held by Virgin Atlantic Airways Ltd by adding the following condition:

“Virgin Atlantic Airways shall not operate more than 2 flights a week in each direction between the UK and Shanghai.”

42. For the purposes of any appeal which may be made against this decision the 'decision date' (see Regulations 26(8)(a) and 27(4) of the Civil Aviation Authority Regulations 1991, as amended by the Licensing of Air Carriers Regulations 1992) is 30 December 1998.

G J Elsbury

For the Civil Aviation Authority
23 December 1998