



**UNITED KINGDOM
CIVIL AVIATION AUTHORITY**

DECISIONS ON AIR TRANSPORT LICENCES AND ROUTE LICENCES

2/99

Applications 1B/423/1 and 1B/423/2 by Go Fly Limited heard on 8 November 1999

Panel

Chairman: Mr D Andrew
Mr C Senior

Adviser: Mr D Batchelor

Secretary: Mr G J Elsbury

Parties and representatives

Applicant: Go Fly Ltd represented by Mr R Lawson of Counsel, Instructed by Mr S Chamberlain, Solicitor, Field Fisher Waterhouse

Witnesses: Mr S Horner, Manager, Network Management, Go Fly Ltd

Ms B Cassani, Chief Executive Officer, Go Fly Ltd

Objector: easyJet Airline Company Ltd, represented by Mr M Howard QC, Instructed by Mr M Brealey of Counsel and M H O'Donovan, Solicitor, Wilde Sapte

Witnesses: Mr S Haji-loannou, Chairman, easyJet Airline Company Ltd

APPLICATIONS

1. Go Fly Limited (“Go”) applied for licences to operate scheduled services on the routes from London/Stansted to Geneva and to Zurich.

OBJECTIONS AND REPRESENTATIONS

2. An objection to the application was received from easyJet Airline Company Ltd (“easyJet”), who asked to be heard. A written representation was received from the Air Transport Users Council.

GO’S CASE

3. Go was launched in May 1998 to meet the relatively new and rapidly growing consumer demand for low-cost, no frills airline operations. It had very quickly and successfully developed a substantial network of routes from Stansted to fourteen major year round European destinations and three European summer destinations. It now proposed to extend this network by operating initially a double daily service between London/Stansted and Zurich and a single daily service between London/Stansted and Geneva. The services would be operated with Boeing 737-300 aircraft configured in a single cabin with 148 seats. In terms of its product, Go was seeking to position itself differently from other so-called “low-cost carriers”, such as Ryanair and easyJet, with a greater emphasis on a quality product at highly competitive fares. In-flight catering would not be complimentary but would be provided at a modest charge.

4. Go’s experience on other routes clearly supported the contention that there was demand for low-cost services coupled with good frequency and that such operations acted as a significant market stimulant. It expected traffic on the London/Zurich and London/Geneva routes to grow at average rates of 7% and 6% respectively per annum over the next three years before taking into account the effect of Go’s proposed operation. Consistent with its experience on other routes during 1998 and the first four months of 1999, Go expected to stimulate these markets and achieve a market share in the first year of operation of around half of the forecast market growth for the year on both routes. On this basis, it forecast that it would return a small profit on Geneva in the first year and a small loss on Zurich. However from year two onwards it forecast annual profits on each route in excess of £750,000.

5. There were currently no other carriers serving either route. easyJet Switzerland, a Swiss carrier in which easyJet’s parent company, easyJet Holdings, currently held a 49% stake, was planning to enter the Stansted/Geneva route in December. There were no impediments to Go’s entry under the bilateral agreement between the UK and Switzerland. In the absence of Go’s entry, there would be no service on Stansted/Zurich and a foreign carrier would have a monopoly on Stansted/Geneva. In these circumstances, there was no reason for the Authority not to grant these licences to Go and it would be inconsistent with its policies not to do so.

EASYJET'S CASE

6. easyJet commenced services on the route between London/Luton and Geneva in December 1997 and on the route between London/Luton and Zurich in November 1998. The basis of easyJet's objection was that granting Go's application would carry serious risks for the medium and long term interests of users in two respects. First, it would threaten easyJet's ability to operate its Luton/Geneva and Luton/Zurich services. Second, it would potentially also threaten easyJet's business more generally, particularly at its Geneva hub.

7. The Authority was aware that easyJet had alleged that GO was being unlawfully cross-subsidised by British Airways and that this allegation was the subject of a High Court action against British Airways. easyJet was convinced that if Go were not being cross-subsidised in this way, it could not continue as it was. However, the Authority was not being invited to try that action. Rather, easyJet was looking to the Authority to act in accordance with its duties and policies to prevent Go's operations from jeopardising the benefits which users had enjoyed from the revolution in low fares and flexible fares which easyJet had started.

8. This was the first opportunity for the Authority to consider in its regulatory role Go's strategy in relation to the UK low-cost carrier market. This was a market in which, prior to Go's entry, there had been three British low-cost carriers: easyJet, Debonair and AB Airlines. Each of these three had been independent of national flag carriers, but now only easyJet survived. The other two had been driven out, whether through bad business judgement or through the effect of Go's entry to their routes or a combination of the two. Go's services so far have been run at a huge loss. It was legitimate to wonder therefore what losses Go were prepared to sustain and with what object in mind.

9. easyJet did not believe that Go's forecasts for its services on these routes were achievable. Low-cost services were already operating on these routes, albeit from Luton, and Go was not proposing to offer fares any lower than those already available. It was therefore difficult to see that there would be the same degree of stimulation from Go's entry as might have occurred in other markets which were not previously served by low-cost carriers. easyJet's primary concern, based on its own experience of routes to Switzerland, was that Go's forecast average yields and load factors were unrealistically high. It anticipated that Go's response to failing to achieve its forecasts would be to reduce its average yield in order to fill its aircraft. The effect of this will be that Go will lose even more money than it has elsewhere and that it will drag easyJet down with it. If Go were licensed on these routes, therefore, easyJet would probably withdraw from the Zurich market by October 2000 and would have a serious problem achieving profitability on Geneva. easyJet's aim of developing Geneva into a hub meant that the Luton/Geneva route was of strategic importance to it. This in turn meant that in the event of a price war the need to defend this route might put easyJet's whole business in jeopardy.

10. If the Authority were nevertheless minded to grant Go's licence applications, they should be granted strictly in the terms on which they are sought. That is, in order to minimise the risks to competition posed by this application, the Authority should restrict Go to two flights a day to Zurich and one flight a day to Geneva.

REPRESENTATION BY THE AIR TRANSPORT USERS COUNCIL

11. The AUC made a written submission in support of the application. It concluded that easyJet had failed to establish that BA and Go were a single commercial entity for the purpose of competition analysis; that the intention behind these applications was anti-competitive; or that the operation of these services by Go would have anti-competitive effect.

ANALYSIS AND REASONS

12. This is the first occasion for some years on which the Authority has held a hearing on an application for route licences in response to an objection from another carrier. This has no doubt been due largely to the fact that the Authority's route licensing powers were removed in respect of intra-EC routes by the completion of the single European market for air transport from 1993. But it is also a reflection of the Authority's general policy towards route licence applications, which has become progressively more liberal over time. The Authority has a clear predisposition in favour of granting applications for route licences. Paragraph 7 of the Statement of Policies on Route and Air Transport Licensing (CAP620) states that "the Authority will license liberally competing services wherever doing so is likely to benefit users". Against this policy framework, it is rare indeed these days for airlines to seek direct regulatory intervention in order to prevent or constrain market entry by competitors.

13. There may be circumstances in which the Authority would be prepared to refuse a route licence application. One such circumstance is described in paragraph 19 of the Statement of Policies, namely where, taking account of the Secretary of State's advice, there seems to be no prospect of obtaining the necessary rights at an acceptable price. This was not the basis on which easyJet objected and, in any event, in this case the bilateral rights for Go to serve Zurich and Geneva are already available. It is also worth noting in passing that it is expected that routes to Switzerland will at some stage be brought within the ambit of the EU Third Package Regulations. When that happens, the Authority's route licensing powers will of course no longer apply in respect of these routes.

14. The Statement of Policies also states that the Authority will use its regulatory powers where the realisation of the objectives laid down in the Civil Aviation Act 1982 is threatened by anti-competitive behaviour. Paragraph 13 states that when assessing allegations of anti-competitive behaviour the Authority will expect to consider whether the actions complained of would have a serious effect on the complaining airline; if so whether there would be an offsetting user benefit; and whether any remedy sought would be proportionate to the perceived ill.

15. easyJet made a number of references to anti-competitive behaviour in both its written and oral evidence. It suggested in its written submission that Go's strategy had been developed to optimise the long run prospects of its parent, British Airways. It went on to argue that Go's entry to these routes would be highly detrimental to easyJet achieving profitability in these markets, and challenged Go's forecast that it would reach profitability on both routes. In putting these arguments, however, easyJet provided scant evidence, particularly in relation to the adverse effects on its own business. The Authority has in the past dealt with a number of cases in which allegations of anti-competitive behaviour have been made. Common to all the previous cases is that the alleged anti-competitive behaviour had already occurred or was ongoing. As a consequence the complainant was potentially able to provide evidence of the actual effect of the alleged action. Clearly easyJet would have been unable to provide evidence of actual detriments in this case.

16. Nevertheless, in order for regulatory intervention to be warranted, the Authority must be presented with evidence of the anticipated detriments of alleged behaviour. Here easyJet asserted that Go's entry to Stansted/Zurich would have the probable effect of forcing it to withdraw from the Luton/Zurich route and that Go's Stansted/Geneva service would make it extremely difficult for it to make a profit on Luton/Geneva. However, it submitted no figures in support of these assertions, either in respect of the current performance of its own services or of the likely effect of Go's entry on its future performance on these routes. There was also no attempt by easyJet to establish that Go was in any sense dominant in the relevant market, the normal prerequisite for establishing that a firm's actions are anti-competitive.

17. The simple fact that new entry to a route might have a detrimental effect on the services currently operated by an incumbent cannot of itself be sufficient grounds for the Authority to refuse a route licence to a new entrant. The tests to be satisfied before regulatory intervention is warranted are high, and deliberately so. But there was no evidence on the basis of which the Authority could conclude that Go's entry constituted anti-competitive behaviour. It is also the case that users will benefit from the provision of services by Go on routes on which there would otherwise either be a monopoly or no air service at all. The Authority therefore sees no basis for refusing these applications nor for adding conditions to Go's licence.

18. If alleged anti-competitive behaviour were to occur in the future, it is of course open to any British airline to apply to the Authority to vary the licence of another, and special provisions were introduced some years ago establishing an expedited procedure for such cases. It is also worth recording that from March 2000 the Competition Act 1998 enters into force and will apply generally to international air services. This will provide an alternative avenue to the licensing system for airlines seeking redress against alleged anti-competitive behaviour in the future.

DECISION

19. Applications 1B/423/1 and 1B/423/2 by Go Fly Limited are granted with immediate effect.

20. 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 25 November 1999.

G J Elsbury
For the Civil Aviation Authority
22 November 1999