UNITED KINGDOM
CIVIL AVIATION AUTHORITY

DECISIONS ON AIR TRANSPORT LICENCES AND ROUTE LICENCES 1/04

Decision of the Authority on its proposal to vary licence S/9 held by British Airways Plc, licence S/13 held by British Midland Airways Limited and licence S/33 held by Virgin Atlantic Airways Limited heard on 11 and 12 November 2004.

Panel

Chairman:	Dr H Bush CB
	Mr R Mountford
Adviser:	Mr A Plant
Secretary:	Mr G J Elsbury

Objections to the Authority's proposal:

Objector:	British Airways Plc, represented by Robert Webb QC
Witnesses:	Mr R Eddington, Chief Executive, British Airways
	Mr R Boyle, Director of Commercial Planning, British Airways
	Dr A Sentance, Chief Economist, British Airways
	Mr A S Stern, Area Commercial Manager, South Asia, British Airways
Objector:	British Midland Airways Ltd, represented by Mr R Venables, Solicitor
Witnesses:	Sir Michael Bishop, Chairman, British Midland Airways
	Mr T Bye, Deputy Chief Executive, British Midland Airways
Objector:	Virgin Atlantic Airways Ltd, represented by Charles Haddon-Cave QC
Witnesses:	Sir Richard Branson, Chairman, Virgin Atlantic Airways.
	Dr B Humphreys, Director of External Affairs and Route Development, Virgin Atlantic Airways
	Mr W Boulter, Commercial Director, Virgin Atlantic Airways

Table of Contents

SUMMARY

1. This hearing was convened to decide how to allocate the twenty-one frequencies newly available for UK airlines to serve various points in India under the UK/India bilateral air services agreement, which become available in three tranches from Winter 2004. British Airways already operate the nineteen services per week available to UK airlines under the terms of the previous agreement between the governments of the UK and India. Three airlines made bids, as follows: British Airways wished to take up all of the additional frequencies available; British Midland Airways wanted to operate seven rights to Mumbai, three rights to Chennai and three to Bangalore; Virgin Atlantic wished to operate seven services to Mumbai, seven to Delhi and four to Bangalore. The Authority concludes that its statutory duties in this case are best served by awarding ten services to Virgin Atlantic, seven of which are to be used on the Delhi route and three on Mumbai, seven services to British Airways, four of which are to be operated on the Chennai route and three to Bangalore, and four services to British Midland Airways to be operated on the Mumbai route.

THE NOTICE

2. On 11 October 2004, 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 in London on 17 September 2004 between the Government of the United Kingdom and the Government of India, the United Kingdom's share of capacity on air transport services between the United Kingdom and India would, within 6 months of the date of the notice, be insufficient to enable British Airways Plc, British Midland Airways Ltd (trading as BM), and Virgin Atlantic Airways Ltd to make available all the capacity they planned to provide.

THE PROPOSAL

3. Following the notice from the Secretary of State, the Authority made its proposal to vary the licences of British Airways (S/9/2), British Midland Airways (S/13/1) and Virgin Atlantic Airways (S/33/2). The proposal was published in the Official Record Series 2 No. 1665 on 12 October 2004. After reciting the notice, the proposal stated that:

> "The Authority is advised by the Secretary of State that under the bilateral arrangements between the UK and the Government of India UK airlines may currently operate 19 services a week between the UK and India. Under the terms of the new bilateral agreement the UK may operate a further 21 services a week, of which seven are available in Winter 2004/5, seven in Summer 2005 and a further seven in Winter 2005/6, of which seven can be used to Delhi, seven to Mumbai and the other seven to be divided between two or more other points in India. The Authority is therefore required to allocate the 21 additional services a week, which become available as set out above.
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> 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 S/9 held by BRITISH AIRWAYS PLC (BA), route licence number S/13 held by BRITISH MIDLAND AIRWAYS LTD (BM) and route licence number S/33 held by VIRGIN ATLANTIC AIRWAYS LTD (Virgin) so as to provide that the total number of flights operated between the UK and India by BA, BM and Virgin shall not exceed 26, 33 and 40 in each direction in relation to the above specified traffic seasons. 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 S/9 and made a representation in respect of the proposal to vary the licences held by British Midland Airways and Virgin Atlantic Airways.

5. British Midland Airways ("BM") exercised its right to be heard on the Authority's proposal to vary its licence S/13 and made a representation in respect of the proposal to vary the licences held by British Airways and Virgin Atlantic Airways.

6. Virgin Atlantic Airways ("Virgin") exercised its right to be heard on the Authority's proposal to vary its licence S/33 and made a representation in respect of the proposal to vary the licences held by British Airways and British Midland Airways.

7. The Air Transport Users Council ("AUC") made a written representation on the Authority's proposal, but did not ask to be heard.

TERMS OF THE UK-INDIA MEMORANDUM OF UNDERSTANDING

8. The CAA's role in determining the allocation of scarce capacity in this case is triggered by the terms of the Memorandum of Understanding concluded between the UK and Indian governments in September 2004 which allowed airlines of each country to each operate a total of twenty-one additional round-trip services each week between the UK and India.

9. These additional traffic rights are restricted in terms of the destinations involved. Of the twenty-one rights, a maximum of seven each may be flown to Delhi and Mumbai (Bombay). The remaining seven have to be flown to at least two of the following destinations: Chennai (Madras), Bangalore, Hyderabad, Kolkata (Calcutta) and Kochi.

10. The new rights become available over a period of three IATA seasons, with seven becoming available during Winter 2004/5; a further seven from Summer 2005; and the final seven from Winter 2005/6.

THE CAA'S STATUTORY DUTIES

11. The statutory duties of the Authority and its objectives in cases such as this are set out in Sections 4 and 64-68 of the Civil Aviation Act 1982 ("the Act"). Section 4 sets out the Authority's general duties and Sections 64-68 set out the Authority's duties with respect to air transport licensing. In particular, Section 68 provides that it shall be the duty of the Authority to perform its air transport licensing functions so as best to ensure that British airlines are able to compete effectively with other airlines on international routes. In performing these functions the Authority is also bound by its general duties as set out in Section 4 of the Act. These state that the Authority must attempt to secure that British airlines provide air transport services which satisfy all substantial categories of public demand at the lowest charges consistent with earning a reasonable return on past and future investment whilst ensuring the sound development of the UK's air transport industry, and to further the reasonable interests of users.[1]

Interpreting the duties

12. The Authority has set out how it interprets its duties under the Act in its published Statement of Policies on Route and Air Transport Licensing, which forms Annex 6 to the Official Record Series 1. Paragraph 5 makes clear that the Authority's overarching objective in cases such as these is to maximise economic efficiency by allocating scarce frequencies to those airlines that provide the highest level of net benefits to users and airlines.

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[1] The UK Government is in the process of making the legislative changes necessary to bring the UK's scarce capacity procedures into conformity with Article 5 of Regulation (EC) No 847/2004 of the European Parliament and of the Council of 29 April 2004 on the negotiation and implementation of air service agreements between Member States and third countries

13. A central part of the Authority's consideration of future net benefits is therefore the assessment of consumer benefits flowing from any choice of award of rights. Consumer benefit is a composite of the static gains arising from higher capacity and greater choice and the dynamic gains from increasing competition in the market, including consideration of the likely effect on the fares paid for the successful airline's services and those of its competitors, and the sustainability of any reductions. As set out in the Statement of Key Issues letter sent to the parties on 4 November 2004, the Authority's comparison of the consumer benefits offered by the applicants is based on the proposals which they have put forward as regards fares and services (and the benefits which they expect these to bring) in their written submissions and at the hearing, set in the context of the likely future competitive environment.

14. The Authority sees the development of competition, both among British airlines and between British and foreign airlines, as normally providing the best means of ensuring that economic efficiency can be achieved and the reasonable interests of users furthered. The precise impact of this on individual decisions will vary from case to case, depending on the strength of existing competition. However, the optimal situation is likely to be one where a number of British airlines can compete with each other in a range of markets, in turn strengthening their ability to compete with foreign airlines. There is benefit therefore in seeking to create opportunities for competition where feasible.

15. It is therefore important in this case to consider how different permutations of the available rights may affect competition, including the degree to which the award of scarce capacity would affect rivalry in all the relevant markets. In considering these points the Authority has had regard to the Office of Fair Trading's published guidelines on market definition[2].

16. This emphasis on competition does not entail the decision in all scarce capacity cases going against the incumbent carrier. There may be circumstances where overall benefits to consumers point to the best outcome being one where an incumbent increases its operations even if there is no competition from another UK airline; this would depend on the facts of the case.

17. In this case there are a number of other factors pertinent to the decisions the Authority has to take. These include the advice from the Secretary of State, which requested that the decision be made in respect of all twenty-one services at one hearing, referred to the likely importance of demonstrating early utilisation of the new rights for future negotiations with the Indian government and intimated that there may be scope for further increases of rights as a result of future talks.

The technical evidence before the Authority

18. To facilitate the comparison of the benefits offered on the different routes by the different applicants, and to draw out the key assumptions underlying those benefits, the applicants were requested in addition to their written submissions to complete the traffic and yield pro-formas set out in Annex 8 of the Official Record Series 1 (Statement of Policies). This is the first time that the Authority has asked for information to be provided in this format to supplement the written evidence. However, the way that the forms were completed in different ways by the three parties made direct comparisons difficult. Also, some of the key data requested was considered by the airlines to be commercially confidential and was therefore not revealed to the other applicants at the hearing, in accordance with proviso (ii) to Regulation 22 of the Civil Aviation Regulations 1991. Consequently it was not subject to expert cross-examination. So, while these forms provided useful data in support of each airline's proposed consumer benefits, they could not be used in a standardised and transparent fashion directly to compare proposals in this particularly complex case.

[2] Office of Fair Trading, Competition Act 1998 Guidelines: "Market Definition" (OFT 403) and relevant sections of the OFT's Enterprise Act 2002 Guidelines: "Mergers: Substantive assessment guidance".

REPRESENTATIONS

19. This section of the decision document provides brief factual summaries of the representations made to the CAA in relation to this case. These summaries are not exhaustive and substantive points in relation to the Authority's views on the arguments put forward are not covered here but later in this document.

The case presented by British Airways (BA)

20. BA submitted their core case on 29 October, and supplemented this with further evidence received by the panel on 10 November.

21. BA asked to be awarded all twenty-one available rights; seven to Mumbai, seven to Delhi, four to Chennai and three to Bangalore. They submitted that their proposals were economically viable, would maximise economic efficiency and provide the highest level of net benefits to users, as well as being the option that enabled the British airline industry to compete most effectively with foreign airlines in the Indian market.

22. At the heart of the BA case was their contention that the injection of new capacity, rather than any additional rivalry, would bring most benefits to users, and that BA's larger aircraft would deliver the greatest additional capacity. In addition, BA argued that the relevant market should be defined broadly, to encompass indirect services and all classes of travel (which, if accepted, would reduce the extent to which a new entrant offering non-stop services would enhance levels of rivalry in the market).

23. A further point raised by BA was that Heathrow airport was a hub for BA, but merely a base for the other two airlines. Further, the economics of hubs meant that the hub as a whole would be most enriched if BA (with the largest network) were awarded any new routes, and least enriched if awarded instead to other carriers.

24. BA referred to their commitment to the India market over 75 years, their efforts in campaigning for more capacity dating back to the 1980s and their recent pro-liberalisation lobbying efforts in India, including visits by their Chief Executive to Indian Ministers and key aviation figures.

25. BA also argued that the only way that the CAA could adhere to the requirement under section 68 of the Act to perform its functions in a manner "which it considers is best calculated to ensure that British airlines compete as effectively as possible with other airlines in providing air transport services on international routes" would be to award all the new rights to BA, as it had the best chance of all UK airlines to compete with other carriers such as Emirates and Lufthansa in the broader airline market.

The case presented by British Midland (BM)

26. BM submitted their core case on 29 October and supplemented this with further written evidence at the hearing.

27. The rights requested by BM were for seven to Mumbai, three to Chennai and three to Bangalore. They argued that their proposals would bring significant user benefits and would in particular enable them to compete directly with BA and Air India on the Mumbai route.

28. A central element of the BM case was their commitment to reduce fares by 10% from BA's current prices on all classes of published fare. They claimed that such fare reductions would be sustainable. Others pointed to fares declining generally; BM's case was different in that it promised to take a more proactive stance to fares reduction.

29. BM stated that their entry to these markets would enhance competition and pointed to BM's record of providing lower fares than incumbents on short-haul services in Europe as well as introducing service innovations such as the introduction of meals on UK domestic routes to and from Scotland.

30. They also drew attention to the greater connection possibilities to and from UK domestic services provided by their proposed schedule, as well as the greater variety of choice of departure and arrival times. In addition, they claimed to provide more seat capacity than BA to UK consumers as fewer seats on their services would be devoted to passengers connecting with long-haul services, such as those to and from the US and Canada.

31. BM contended that the India rights presented a historic opportunity for BM to establish itself more clearly as a long-haul carrier in direct competition with BA and Virgin, and that the structure of the industry in the future would be enhanced by their playing more of a role in a multi-airline long-haul sector.

32. The feasibility of BM's planned aircraft utilisation came under scrutiny at the hearing, with Virgin in particular suggesting that the proposed utilisation rates would be relatively high. BM contended that the block hours required of their aircraft would be stretching but achievable, either with one aircraft operating to Mumbai or two aircraft operating to Mumbai and to Chennai and Bangalore, rotating between Manchester and Heathrow for maintenance when necessary.[3]

The case presented by Virgin Atlantic (Virgin)

33. Virgin submitted their core case on 29 October and supplemented this with further written evidence at the hearing.

34. Virgin requested that they be awarded seven rights to Mumbai, seven to Delhi and four to Bangalore.

35. At the heart of Virgin's case was their contention that they would be best placed to mount effective competition to BA and therefore to provide the largest benefits to users. Virgin pointed to their history of competing head to head with BA on long-haul services and providing downward pressure on fares and innovations in service quality such as limousine services, etc. They perceived their impact on BA to have been beneficial to BA itself and to UK aviation generally.

36. They also highlighted their commitment to the Indian market, evidenced through their determination to enter the Delhi market by leasing rights from Air India when hard bilateral rights were not available, and through their extensive lobbying efforts in India in favour of liberalisation.

37. Virgin claimed that their current and future fleets would provide overall capacity increases larger than those available from BM, and that their scheduling an overnight flight eastbound and an afternoon departure and evening arrival westbound for the Mumbai market would appeal to passengers. Although they do not currently hold slots for all their proposed services they stated that they were confident that they could obtain them.[4]

The Air Transport Users Council (AUC)

38. The AUC submitted written evidence on 4 November. They did not exercise their right to be heard at the hearing.

39. The AUC regarded all three applicant carriers as 'carriers of quality' and stated that, in their view, service quality should not be a major consideration at the hearing. Similarly,

[3] For BA and Virgin, the aircraft to be operated would form part of large fleets, based at Heathrow and so the Authority saw no need to enquire into their aircraft utilisation, nor was it raised as an issue by BM.

[4] Virgin stated that they hold slots for their proposed Mumbai operation, for three of the services on their proposed Delhi operation but none for Bangalore. The remainder would have to be acquired but, given that their proposed Heathrow departure to Delhi at 22:00 hours and the scheduling of Bangalore services to arrive and depart at 22:00 hours, their confidence accords with the data published by Airport Coordination Ltd indicating the relatively greater availability of slots at Heathrow at this time of day. Other bidding airlines would be more able to reconfigure their larger slot portfolios at Heathrow to ensure that their rights to India would be taken up.

because all airlines were signatories to the IATA multilateral airline system, this reduced the importance that should be given to the level of network connectivity for each carrier.

40. The issues that the AUC considered to be of most importance were aircraft size and fares. They viewed aircraft size as important in terms of the benefits to passengers and saw merit in the claims of BA and Virgin that their aircraft fleets provided flexibility to adjust to changes in demand. On fares, the AUC argued strongly that consumer interests would be best served when more than one UK airline was able to compete on a route as this was likely to result in lower prices than continuation of a duopoly (UK plus one foreign carrier) position.

41. On this basis, the AUC recommended that third carrier competition to BA should be introduced on both Delhi and Mumbai by awarding a daily frequency to Virgin on Delhi and to either Virgin or BM on Mumbai. On Chennai, their view was that the balance of benefits from awarding BA or BM additional rights was marginal: four more rights would allow BA to operate a near-daily service whilst giving the three requested by BM would increase competition. They suggested that the balance might be tipped by an assessment of the future ability of the route to support two UK carriers.

42. On Bangalore, the AUC was indifferent between the three carriers as they all offered competitive products. But, with three to four frequencies a week, the AUC did not consider that network connectivity should be an “overriding consideration” in the decision on Bangalore.

THE CAA'S ANALYSIS

Market Definition

43. The panel considered the parties' arguments relating to definition of the relevant market or markets that would be affected by an award of scarce bilateral rights in this case.

44. In summary, BA argued that the relevant market in this case should be defined to include indirect services, as this was a viable alternative to direct travel, and to include all classes or types of travel, as there was a chain of substitution between them.

45. In contrast, Virgin argued that the market should be defined as between airport pairs and should be limited to direct services only. BM's market definition was similar to that advanced by Virgin.

46. The relevant section of the OFT guidance[5] states that:

> "The process starts by looking at a relatively narrow potential definition. This would normally be the products which two parties to an agreement both produce or the products which are the subject of a complaint. Common sense will normally indicate the narrowest potential market definition. The Director General then considers how customers would react if prices were raised a small but significant amount above competitive levels. Common practice in both Europe and the US is to consider a price 5-10 per cent above competitive levels. This will normally be the Director General's approach, although, in practice, it is often difficult to quantify a potential price rise. The 5-10 per cent test is a rough guide rather than a rule.
>
> If significant numbers of customers would switch to substitutes (known as demand-side substitution), the market definition should be widened to include the substitutes. It is not necessary for all customers, or even the majority, to switch. The important factor is whether the number of customers likely to switch is large enough to prevent a 'hypothetical monopolist' exercising market power.
>
> Substitutes do not have to be identical products to be included in the same market. For example, in its report on Matches and Disposable Lighters, the Monopolies and Mergers Commission included matches and disposable lighters in the same market because consumers viewed them as close substitutes. The products' prices do not have to be identical. For example, if two products perform the same purpose, but one is of a higher quality, they might be included in the same market. This depends on whether the price of one constrains the price of the other. Although one is of a lower quality, customers might still switch to this product if the price of the more expensive product rose and if they no longer felt that the higher quality justified the price differential. *The important issue is whether the undertaking could maintain prices above competitive levels."*

47. The Authority views this last italicised sentence as of great importance in coming to a conclusion on market definition in this case. The evidence put forward by all the parties demonstrated that prices for services to Mumbai and to a lesser extent to Delhi were already more than 5 to 10 per cent above the competitive level, not least because all the parties predicted that prices would fall by at least that amount as a result of new entry and/or new capacity on the route. BA also accepted at the hearing that an increase in direct services would result in less switching away from indirect services for those passengers travelling in premium cabins, as they tended not to use indirect services currently. This also suggested a

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[5] Office of Fair Trading, Competition Act Guidelines: "Market Definition", OFT 403.

significant difference between time-sensitive passengers (who are more likely to be travelling in premium cabins) and non-time sensitive passengers.

48. Similarly, in relation to the geographic market, the Authority considers it unlikely that a significant proportion of the business or time-sensitive passenger categories wishing to fly, say, to Mumbai from London would be willing to fly to Delhi instead, even if fares to Mumbai were to increase substantially.

49. This evidence indicated that, although some switching to indirect alternatives may be occurring, customers were not doing so in sufficient numbers to constrain prices from being charged considerably above the competitive level, particularly for the time sensitive passenger. So, even if indirect competition is constraining prices from rising above current levels, this is not the relevant test for the purposes of market definition.

50. The Authority's conclusion therefore is that in this case indirect services, particularly for time-sensitive passengers, are an insufficiently close substitute for direct services to group them in the same market. As existing prices are, on the airlines' arguments, more than 5 to 10 per cent above the competitive level it would be impossible to reach any other conclusion in applying the tests set out in the OFT's guidelines. Similarly, as shown by the evidence that time-sensitive passengers react differently to non-time sensitive passengers when deciding between a cheaper but less convenient indirect service and a more convenient, but more expensive, direct service there appear to be sufficient differences in profile between time-sensitive and non-time sensitive passengers to regard them as distinct.

51. In the Authority's view, the relevant market in the case of London-Delhi and London-Mumbai should be defined as that for direct, non-stop air services between these city-pairs and that time sensitive passengers represent are separate to non-time sensitive passengers. For smaller markets, such as Chennai, where direct frequencies are fewer, there may be a stronger argument that indirect services provide an effective substitute for direct services, although this is likely to be truer of non-time sensitive passengers.

52. In reaching this conclusion, the Authority has taken full account of the arguments put forward by the various parties, and applied the standard methods for defining a market set out in the OFT guidance. As in any competition case, the Authority's view is that the answer to the market definition question lies in being able to identify which products or services consumers may view as reasonable substitutes for the products or services in question.

53. These conclusions on market definition have consequences for how the Authority views the likely impact on rivalry of various options for granting rights. These issues are set out below.

Consumer Benefits

Rivalry and capacity

54. A central issue before the Authority in this case is how to weigh the likely benefits to consumers of options that would provide the greatest additional capacity against those that would provide more rivalry.

55. The Authority does not perceive a simple choice between enhanced capacity on one hand and enhanced rivalry on the other. Both would provide benefits to consumers and need not be mutually exclusive although, depending on the circumstances of a particular case, one element may be more important than another. The Authority is not therefore persuaded by BA's argument that the only important determinant of user benefits is the amount of additional capacity, particularly in markets where competition can clearly be sustained.

56. There is of course a need to consider at what point in the development of a market it is timely to introduce competition when capacity is scarce. In the Authority's view, there may be a general presumption in such cases in favour of allowing a developing market to grow to the point where one carrier has successfully established the route, but not created an unassailable position, and then to facilitate competition as more rights become available.

57. Conversely, where routes are more established it would seem preferable in most cases to introduce competition as soon as possible. For example, if incumbent airlines are operating a daily service already, the optimal means of boosting the level of rivalry would usually be for competing airlines also to operate a daily service. However, in a situation of scarce capacity, this need not be a hard and fast rule, particularly where different applicants are offering different products. Some benefits are likely to flow from the introduction of new airlines onto a route, even at a lower level of frequency, and there may be other, possibly longer-term, considerations to offset against the benefits of stronger competition in the short-term.

58. All these factors may dictate a different response to the question of allocation of rights depending on the routes in question, with different considerations applying in more developed markets such as London-Mumbai and London-Delhi as against developing markets such as London-Chennai and new markets such as London-Bangalore.

59. The Authority does not agree with BA's argument that the CAA's duty in relation to ensuring British airlines can compete as effectively as possible with other airlines means that the rights should be awarded to them as the British carrier best able to compete with other network carriers. This argument is essentially a variant of the "national champion" argument which contends that the only way to ensure that British companies can compete on the world stage is to support a single large player. The Authority instead considers that it is more likely that British airlines will compete effectively with overseas airlines if they face incentives to improve because of vigorous rivalry from other British airlines.

60. Indeed, the positive impact on BA of Virgin's entry to the long-haul market was recognised explicitly in the hearing by BA, who agreed that they have had to respond positively to Virgin's competition. A similar effect can be observed in BA's competitive reaction to BM's expansion on domestic and short-haul routes in the past, and to the more recent advent of low-cost carriers. The Authority is firmly of the view that a healthy UK aviation sector is one where competition is nurtured among UK airlines.

61. BA argued that where markets are constrained the addition of capacity will result in a reduction in the average price paid by passengers, and that the scale of the reduction will be the same irrespective of whether the capacity is added by an incumbent or a new competitor. BA offered in support of its argument a theoretical analysis of the way in which price and capacity might interact. Their analysis was based on simple models of demand, the airline product and the strategic behaviour of airlines. Their argument also equated seats sold with capacity offered and was based, *inter alia*, on an assumption that the profit maximising quantity that would be offered by a single producer is greater than the capacity constraint imposed by the bilateral agreement.

62. The BA analysis would have some appeal in circumstances where the assumptions that underpin its model are more likely to hold, in particular perhaps where demand is homogeneous and extremely price sensitive. Clearly, when aircraft are full in circumstances where all the available rights are being fully used, there is no ability to carry more traffic. However, long-haul air transport demand is not homogeneous and airlines have developed highly differentiated products to address the different preferences of passengers. In these circumstances, a constraint that applies to airlines overall need not apply to their offerings to particular market segments. So, for example, there is still an incentive for a rival to seek to attract higher-yielding passengers away from an incumbent and so to improve the mix of its traffic within the capacity limit. This suggests that rivalry is important in generating passenger benefits, particularly for higher-yielding passengers.

Quantifying benefits to UK consumers

63. BA forecasts that the benefits of its proposals as regards fares paid by UK passengers will amount to around £46m a year. Of this, BA indicated that some £29m might arise on Mumbai, £15m on Delhi, and £3m on Chennai.

64. A large proportion of this £46m would appear to stem from benefits to First and Business Class passengers. On routes such as Mumbai and Delhi, these passengers form a relatively small percentage of the total traffic but would enjoy a disproportionate share of the total fares benefit under BA's assumption that its forecast percentage reduction will apply equally to all fare types given that the fares paid by these passengers are much greater than the average.

65. However, BA stated in the hearing that premium cabin passengers were the part of the market that it would expect to expand the least in response to a capacity addition and associated price discounts. BA noted that the premium market could already be quite well served, and that there may not be many extra premium market passengers who could be attracted onto the new services since, in a constrained market, the people who are prepared to pay more to fly direct will continue to be served in preference to those people who will be prepared to pay less. If this is so, then it is unclear why an incumbent would wish to cut fares for such passengers.

66. Virgin also assumed that the addition of capacity reduces average yield. They forecast that the average fares paid by business passengers on London-Mumbai would fall by between 5% and 12% and those paid by leisure passengers by between 3% and 7%. The forecast reductions on London-Delhi were similar.

67. BM was the only applicant proposing to reduce published fares although, as noted elsewhere, all the airlines acknowledged the importance of the non-published fare market. BM intended to offer London-Mumbai fares 10% below those of BA and to remove the advance purchase condition on the lower Business Class fares. BM forecast that the average fares paid by business passengers would fall by about 30% and those by leisure passengers by 10% to 17%, presumably through a combination of lower levels and more use of the lower fares in the spectrum. However, these fares benefits need to be compared with other benefits to consumers such as greater capacity, and against the claims from other parties that fares would in any case reduce as a result of capacity increase, or greater rivalry, or both. Moreover, the 10% fares promise is not one the Authority would seek to police, although it might wish, in the context of future scarce capacity hearings, to look at the evidence in relation to promises previously made.

68. Virgin contended that consumers had seen great benefits since Virgin had entered the market in the 1980s. The Authority notes that there is strong evidence of the general impact of Virgin's entry to the long-haul market on improved quality of service. However, there is less strong evidence of Virgin being a "price leader" in the India markets, or indeed in other markets, with Virgin instead tending to match BA's published fares. However, in assessing the beneficial impact of rivalry, the important issue is whether the consumer benefits from downward pressure on fares, rather than which airline initiates the reductions, and the usual effect of enhanced competition would be to reduce fares and/or enhance quality of service.

69. The discussion above suggests that the fares benefits which higher-yielding, more time-sensitive passengers may enjoy may be less than forecast by BA and are more likely to arise because of extra rivalry than purely from an addition to total capacity. Additional capacity may play a more influential role in determining the scale of the fares benefits for the lower-yielding, more price-sensitive end of the demand spectrum. However, the extent to which these flow to UK consumers will depend on how much of the capacity is likely to be used by them.

Capacity available for UK-India passengers

70. Because more of BA's seats are predicted to be filled with passengers connecting at Heathrow to or from other international destinations, the capacity made available to UK consumers on many BA services would not always be much higher, and in some cases

lower, than that likely to be offered by BM or Virgin. The tables below and accompanying text explain this in more detail.

71. An indication of the capacity available to UK consumers is given by the number of passengers the airlines expect to carry to/from the UK, excluding those making connections between the India flights and other international services at Heathrow. The following table shows the passengers each airline expects to carry in Year 3 in the gateway-to-gateway markets and in other third/fourth freedom markets. On London-Mumbai in Year 3, for example, BA expects to carry 87,000 passengers who start their air journey in London and end it in Mumbai or *vice versa* and 37,000 on other UK-India routeings such as those from UK regional airports to Mumbai over Heathrow, or, using Mumbai as the primary Indian hub, to other Indian destinations. In addition, BA expects 91,000 international-international connectors in its total carryings of some 214,000 passengers on the London-Mumbai sector in year 3.

UK-India passengers (000s) in Year 3

	BA	*Virgin*	*BM*
Mumbai			
London-Mumbai	87	72	112
Other third/fourth (a)	37	25	13
Total UK-India	123	97	125
Delhi			
London-Delhi	88	88	--
Other third/fourth	14	7	--
Total UK-India	102	95	--
Bangalore		(b)	
London-Bangalore	43	45-60	43
Other third/fourth	7	7-10	2
Total UK-India	50	52-70	45
Chennai	(c)		
London-Chennai	29-39	--	36
Other third/fourth	10-13	--	4
Total UK-India	39-52	--	40

Source: Derived from airline submissions

Notes: (a) "Other third//fourth" refers to passengers flying between London and a specified point in India and making a domestic connection at one or both ends

(b) The higher figure relates to Virgin's proposal for four services a week. The lower figure is a pro-rata estimate of Virgin's carryings if it were to operate three services a week to enable comparison with BA and BM.

(c) The higher figure relates to BA's proposal for four services a week. The lower figure is a pro-rata estimate of BA's carryings if it were to operate three services a week to enable comparison with BM

72. There is clearly uncertainty surrounding forecasts of this kind but, on a route such as Delhi, the airline estimates of UK-India carryings are close and hence there would be little between the benefits they may bring to UK passengers if those benefits were assumed to stem purely from the amount of added capacity. Generally, a similar conclusion holds for the other routes including Bangalore and Chennai when the airline forecasts are adjusted to place them on the same frequency basis. These findings are relevant to the final decisions taken in relation to each of the city-pair markets, as discussed later in this document.

73. The available capacity will in the out-turn depend on the priority given to the various segments and their booking patterns. So, the table above suggests only possibilities and does not provide definitive evidence that one of the applicants will clearly offer more capacity on any of the routes to UK passengers than any of the others.

Flight timings and connections

74. In assessing potential consumer benefits, the Authority also takes into consideration the likely impact of various options on service quality and timing preferences. In some cases there may also be a choice as to whether the availability of more *seats* provides greater benefits than more *frequencies*.

75. The evidence of the three airlines drew out the tension that often exists in the scheduling process between the timing preferences of local passengers and the need to co-ordinate with other flights in order to serve connecting passengers. On some routes connecting traffic may be of great importance to the economics of the route, allowing the airline to provide a more frequent service than it would if it served purely local traffic and, in extreme cases, allowing the service to be operated at all. But where capacity is scarce, local passengers may be denied the flight of their first choice because seats had already been claimed by connecting passengers.

76. Passengers may be connecting onto the proposed Heathrow-India flights from either another international flight or from a domestic service. Although there are UK benefits when passengers from UK regional airports are given an extra connecting opportunity, these benefits may be limited since any passenger travelling from a UK regional airport to India must make at least one connection and many passengers will have the choice of a number of possible hubs over which they can connect.

77. So it is important to place connection benefits in context. BM claimed that UK consumers travelling from regional markets would be best served by their proposed operations, because of their strong network in the UK and because their schedule timings would work well for regional connections. The Authority notes this point, and sees some value in it, but also notes that passengers connecting to or from regional points only constitute around 7%[6] of BM's forecasts of the total traffic on the Mumbai route, for example, and that other airlines' schedules could also provide some of these benefits and that consumers may prefer their alternative connection points and schedules.

78. BA argued that greater benefits could accrue to the hub airport of Heathrow through their acquiring new routes as opposed to other airlines. This argument has some merits, in that a strong network of routes held by one large carrier does tend to facilitate the operation of a hub, and where a new route may only be viable if it can benefit from connecting traffic then the carrier with the biggest network is more likely to be able to make such a route work. However, the increment to BA's network from any particular decision is likely to be marginal. So it is not clear that it should significantly weigh in the balance against other considerations.

Consumer benefits: conclusion

79. In reaching its decisions in this case, the Authority takes the view that there is a greater likelihood of the benefits of additional capacity flowing to the consumer if there is also increased rivalry, where it is possible to facilitate such rivalry on a sustainable basis. This should produce greater downward pressure on costs and fares and incentives on airlines to improve service quality and to innovate.

Choice of awarding rights between cities and sequencing of awards

80. The differing scale of markets to be served to the four cities in question warrants considering each in isolation, as well as evaluating the whole package of twenty-one rights and how the award of rights would affect the overall picture of air services between the UK and India, and the Authority's duties relating to the "sound development of the UK's air transport industry, and to further the reasonable interests of users". These considerations are also relevant to the Authority's choice on which rights to award first, as is the relative market size of the four routes in question.

[6] From evidence presented at the hearing

Market Size

81. The historic data provided by BA and BM, based on sales made through computer reservation systems (CRS), indicated that while London-Mumbai and London-Delhi city-pair traffic volumes have been similar in size as regards total bookings, these two routes are some five times the size of Chennai and around ten times that of Bangalore. The airlines classify higher-yielding traffic segments differently; BA refer to passengers who travel on unrestricted tickets and BM to passengers buying First or Business Class tickets. In either case Mumbai and Delhi have been at least five times the size of both Chennai and Bangalore as regards higher-yield traffic.

82. There are of course sales outlets other than CRS and the introduction of a new service to Bangalore and more direct services to Chennai was expected by all the airlines to stimulate the London-Bangalore and London-Chennai city-pair volumes, particularly the leisure element, as well as drawing passengers from indirect routeings. They also expected some – lesser – stimulation on the two main city-pairs. Nevertheless, from the current position, London-Chennai and London-Bangalore are likely to remain smaller than London-Mumbai and London-Delhi for the foreseeable future.

83. The data presented by the airlines generally suggests that Mumbai is the more highly prized of the two main destinations; indeed, BM chose not to apply for Delhi at all. According to BA, the total CRS bookings for travel between London and Mumbai for the year to March 2004 were 286,000 whereas the corresponding figure for London-Delhi was 254,000. By Year 3, including sales made outside CRS systems and allowing for growth and the stimulation from new services, BA expected the total gateway-to-gateway market to each destination to be around 600,000. Although Delhi was forecast to be the slightly denser of the two, the business content of Mumbai was higher with historic CRS data showing the number of passengers buying unrestricted tickets to be 40,100 compared with 37,600 on Delhi. BA forecast a Year 3 yield of £391 per passenger on Mumbai, some £50 higher than that on Delhi. By Year 3 BA's annual revenue on a new daily service to Mumbai was forecast to be £11m higher than Delhi while costs on the shorter Delhi route were only £3m lower.

84. Virgin also foresaw a higher yield on Mumbai but the difference between Virgin's projected yields for the two destinations were not as great as that suggested by BA. However, Virgin believed that Mumbai offered the opportunity to deploy its 306-seat A330-600 by November 2005 and hinted that this route might in time be suitable for a 747-400 or an A380, whereas on Delhi Virgin expected to be operating the 255-seat A330-300 for the first three years despite having already established a foothold in this market.

85. Chennai and Bangalore are both more than 8,000km from London, significantly further than Mumbai and Delhi. BA expected a higher yield on Bangalore (£334) than Chennai (£309) but both yields were noticeably lower than that which BA forecast for Mumbai. BM also forecast that Bangalore would have a higher yield than Chennai (by £11 per passenger) but, unlike BA, believed that its Mumbai yield would be lower. In terms of overall traffic, BA saw London-Chennai as the denser of the two gateway-to-gateway markets for the near future with annual volume including both direct and indirect services of 125,000 by Year 3, as compared with 108,000 for London-Bangalore; after stimulation, BM forecast 91,000 for the London-Chennai gateway-to-gateway market and 56,000 for London-Bangalore.

86. In terms of carryings on the proposed services, BA's additional four weekly services to Chennai were expected to carry far more passengers than the three times weekly Bangalore operation, although this is in part because BA's forecast included some 70,000 passengers connecting onto its Chennai service from other international flights whereas Bangalore had only 38,000 such passengers. BM forecast similar carryings to both points (65,000 to Chennai and 63,000 to Bangalore) but on the former service it would be competing with BA's existing twice-weekly operation. Although BM believed its first year loss

would be higher on Bangalore, by Year 3 both BM's proposed services were expected to provide £20m revenue and £2m profit.

Rivalry

87. In addition to the arguments around the relative sizes of the markets, the question of how the introduction of rivalry is likely to benefit consumers is also relevant to which rights to award first. Where new competitors begin services on thicker routes such as Mumbai and Delhi, the consumer benefits from increased competition will normally flow to existing passengers as well as to the new passengers travelling on the additional direct services. In contrast, expanding an existing airline's rights may focus more of the benefit on new passengers with less certainty that existing passengers gain from reduced fares and higher quality (as opposed to greater frequency).

Conclusion on the sequencing of the allocation of rights

88. Given the evidence on market size, the Authority's view is that the first two tranches of rights, available from Winter 2004 and Summer 2005 should be attributed to the Delhi and Mumbai routes, with the third tranche to be split between Chennai and Bangalore. The question of how best to split the rights available on Delhi and on Mumbai, and how to split the seven rights between Chennai and Bangalore is a more complex question which is addressed in the following sections on each of these city-pair markets.

THE FOUR CITY-PAIR MARKETS

London-Mumbai

89. The competing proposals for the new rights to serve Mumbai each offered different advantages in terms of scheduling, capacity, pricing and rivalry.

Comparison of proposed schedules

90. The proposed schedules set out by the parties are also relevant to which of these options may bring the largest consumer benefits:

BA's current summer schedule for services between Heathrow and Mumbai is as follows:

Depart from Heathrow at 10:50, arriving Mumbai at 00:15

Depart from Mumbai at 02:15, arriving Heathrow at 07:35

BA's schedule for its proposed second daily service is:

Depart from Heathrow at 18:50, arriving Mumbai at 08:15

Depart from Mumbai at 10:15, arriving Heathrow at 15:35

BM's proposed schedule from the start of the summer 2005 season is:

Depart from Heathrow at 14:45, arrive Mumbai at 03:50

Depart from Mumbai at 06:00, arrive Heathrow at 11:30

Virgin's proposed schedule from 27 March 2005 is:

Depart from Heathrow at 21:00, arrive Mumbai at 10:35

Depart from Mumbai at 14:45, arrive Heathrow at 22:00

Note: BM's UK timings are one hour later than those shown in its submission, which are understood to be winter, rather than summer, times.

91. These schedules may appeal to different consumers. BM's proposed services may be best placed to serve those connecting to and from domestic UK airports and to some extent to short-haul European destinations, whereas the Virgin and BA proposals offered an overnight flight departure from Heathrow (timings which may appeal particularly to business customers) and avoided the more unsocial arrival and departure times. Also, while Virgin and BA's proposed timings may complement the existing BA schedule better than those proposed by BM, at least for the local market, the Authority notes that BM's fare proposals and to some extent their service offering could also present consumers with a further and different option.

Capacity and rivalry

92. BA's argument in relation to London-Mumbai was that the additional capacity that they could provide on this route would maximise consumer benefits. In contrast, BM and Virgin argued that increased rivalry would benefit consumers more.

93. Whilst the total additional capacity provided by BA would have some advantages, the Authority is not convinced that this outcome would best serve the interests of consumers or of economic efficiency. In line with its conclusion that there is a relevant market for direct,

non-stop air services between these city-pair markets the Authority prefers an option that would provide for greater competition on this route.

94. That leaves the Authority with the decision as to how to award the available rights between the two remaining parties and whether to grant all seven to one carrier or, instead, to award rights to two new carriers on the route.

95. The Authority sees some attraction in awarding a new entrant airline a daily service so as to enable it to match BA's current level of service. Such an award would arguably result in stronger immediate competitive pressure on airlines already on the route.

96. However, this approach also has disadvantages in that it could, in future, make it harder for a third British carrier to establish itself, and consumers could be denied some of the choice that would be available if all three bidding UK airlines had a presence in the market.

97. The alternative of splitting the rights between BM and Virgin therefore has attractions in that it would mean three UK airlines would be competing on the route, with greater potential for both new entrants to grow their services in the future, and greater choice for consumers at an earlier stage. For example, Virgin has more experience of competing in long-haul markets and has a good reputation for its business class product (an important segment in this market). BM, on the other hand, has made an explicit commitment in relation to fares, has a good track record of price leadership in short-haul markets and may provide better connections to domestic and short-haul destinations. In addition, the differing schedules available offer different benefits to those passengers flying point to point between the two cities, and different connection opportunities to domestic and short-haul, and to long-haul services. There may also be greater choice in terms of the product/price trade-off between the three competing offerings. Establishing both airlines on the route alongside BA could therefore provide some significant consumer benefits. However, because it is not possible to award sufficient rights to enable both new entrants to operate daily frequencies, there could also be a dilution of the immediate competitive pressure on existing carriers that would result from one airline operating a daily service.

98. The answer to this question of whether it is better to award rights so as to maximise immediate competitive pressure on incumbent airlines or, instead, to bring more players into the market will vary from case to case.

99. The experience of airline entry to other markets, and the evidence provided at the hearing, suggests that a level of operations at three services per week, while by no means ideal, can give a new entrant a sufficient foothold in the market to begin operations, and can provide some competitive pressure on existing carriers. There would normally be a preference to move to a higher number of frequencies as soon as possible, particularly on a route such as Mumbai where demand appears to be very strong, but the scarceness of the available capacity constrains the Authority's choices at this time.

100. Moreover, the apparently high levels of profitability in the Mumbai market predicted by all the bidding airlines suggests this is a route where the potential revenues available should be sufficient to sustain competition among three UK airlines and between those UK airlines and foreign competitors.

London - Mumbai: Conclusion

101. With the ultimate goal of strong three-way competition in mind, the Authority believes that, on balance, there is benefit in awarding the available rights in a way that will provide opportunities for three UK carriers to operate this route at the earliest juncture, with the hope that, as suggested in the Secretary of State's advice, further liberalisation may in due course either remove all limits on frequencies and allow for free competition, or at least provide sufficient rights for each to offer a daily service. This is particularly relevant in the case of

Mumbai, which is the airport most resembling a hub in India and so could be the most important airport for all three UK airlines to have some access to, now and in the future.

102. Weighing all these factors, the Authority concludes therefore that the preferred solution is to split the available Mumbai rights between BM and Virgin.

103. The remaining issue for decision is how best to split the seven available rights between the two airlines. Consistent with the evidence given at the hearing, the Authority considers that in this case a minimum number of services to mount competition is probably three per week. The choice then is to which airline to award four, and which three. In considering how to split the seven, the Authority prefers to grant the larger share to BM, recognising that BM would appear likely to offer more capacity to UK passengers than Virgin (Year 3 estimates were for BM to carry 125,000 UK passengers as compared to Virgin's 97,000) and that awarding BM the larger share may help to offset any initial advantage Virgin may have in terms of brand awareness and sales organisation. This outcome should provide a mix of strong product quality and fares innovation, thus strengthening the competitive impact across the different dimensions of quality and price.

104. The Authority therefore decides to distribute the seven available rights for Mumbai so that BM receive four of the available frequencies, and Virgin the remaining three. The days on which each of the parties chooses to operate the services is a matter for their commercial judgement.

London-Delhi

105. Only two carriers bid for the seven services available to Delhi; BA and Virgin. The current position is that BA operate a daily service to Delhi, whilst Virgin have operated three services per week, using rights leased from Air India.

106. BA argued that the greater capacity they could offer would benefit consumers more than that offered by Virgin, and that competition from indirect carriers negated the pro-competition impact of Virgin's proposal.

107. Virgin argued that their proposal would benefit consumers more because they would be able to compete properly with BA (as opposed to the partial competition they had offered up to now with three services per week leased from Air India).

108. The impact of Virgin's partial entry on to this route seems to have had a beneficial effect on price. Evidence was presented that around 70% of the tickets in all the UK-Indian markets are sold through the unpublished market. So the published market is less representative than in other cases. Nonetheless, and while the data presented by the parties on published sales fares are complex[7], it appears that there have been a greater number of published sales fares in the Delhi market, as compared to Mumbai, since Virgin's entry. Whilst it is not possible to assert with absolute confidence that this is a direct response to Virgin's entry, it is consistent with general economic theory to assume that increased competition will tend to result in greater downward pressure on fares.

London-Delhi: Conclusion

109. Consistent with its conclusion on market definition, the Authority therefore considers that the benefits to consumers on the London-Delhi city pair market would best be served by seeking to enhance rivalry on this route.

110. In the absence of alternative bidders, the Authority proposes to award the seven rights to Virgin, thereby allowing them to compete with BA's daily service.

Sequencing of rights between Delhi and Mumbai

111. The choice of the order in which to award rights between the two largest markets is complex, and constrained by BM's evidence that they could not start their services to Mumbai until Summer 2005. The Authority considers that there are considerable consumer benefits attached to securing an additional daily service to Delhi, in direct and level competition with BA's existing service, and that the earliest operation of this new service by Virgin (i.e. from Winter 2004) would thus be desirable. This appears to be marginally preferable to the alternative of awarding four services on the Delhi market and three on Mumbai for the Winter 2004 season[8].

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[7] These are short-term, lower-priced fares for travel between specific dates that are offered by airlines through computer reservation systems or on their own websites – these are different to "unpublished" fares in that they are not sold through consolidators, rather they are sold direct by the airline or via a travel agent

[8] The Open Skies policy in place for Winter 2004 may provide UK airlines with the opportunity to increase services to Mumbai as soon as possible, if this is desirable in their commercial judgement and feasible in terms of their operational constraints.

London-Chennai and London-Bangalore

112. Under the terms of the Memorandum of Understanding, the remaining seven rights must be split between at least two of a number of Indian cities other than Mumbai and Delhi. The only bids from airlines in this case were for services to Chennai and Bangalore.

113. BA's bid was for four services to Chennai (to take their total operation up to six services per week) and for three services to Bangalore. The bid from BM was for three services per week to Chennai and three to Bangalore, with operating patterns combined with their proposed Mumbai daily service. Virgin did not bid for Chennai services, but applied for four services per week to Bangalore.

114. The Authority's first decision in relation to these markets is whether to award more rights to the Chennai market than to the Bangalore market or vice versa. This judgement needs to take into account the different apparent levels of demand in the two markets, and whether there is a preference for higher numbers of seats or more frequent services. The judgement must also be taken with a view to the future and the likely need to demonstrate the benefits of liberalisation. It is important to all the UK airlines keen to participate in UK-India services in the longer term that the opportunities presented by the current hearing are exploited not only fully but also with demonstrable success. This is particularly relevant to smaller markets which offer greater risk should the foreseen level of demand not materialise.

115. The CRS data provided by BA and BM indicates that Chennai (51,000 passengers by direct and indirect services) is currently about twice the size of Bangalore (27,000 passengers). However, BA believed that the differential is much less marked when direct sales are included. When non-CRS tickets are taken into account, BA estimated total current passengers of around 51,000 on Bangalore as opposed to around 67,000 on Chennai. BA also estimated equivalent per annum growth rates for the two markets but a higher level of stimulation assumed for Bangalore took their estimates to around 108,000 direct and indirect London-Bangalore passengers by Year 3 compared with 125,000 on London-Chennai. BM's forecasts were based on the CRS data. They expected the current differential to be maintained but with significantly lower levels of total traffic. Virgin did not discuss the Chennai market, as they were not bidding for rights.

116. So both BA and BM believe that Chennai is the larger market now and likely to remain so for the immediate future. BA's forecast for Bangalore was dependent on its estimate that many more non-CRS sales are made on Bangalore than on Chennai; these direct sales more than double the size of the Bangalore market from the CRS base. It is unclear how reliable this estimate was but it may be reasonable to assume that BA's estimate for Chennai, a route which it currently operates, was more robust than that for Bangalore.

117. In terms of Chennai, the Authority considers that the dynamics of the market are such that the greater benefit to consumers would flow from allowing a single carrier to develop the route, rather than introducing competition *at this stage*. This market does not yet appear to be sufficiently developed to sustain competition. Consumers would be more likely to benefit currently from increasing the number of frequencies available to a single carrier from the current weak position of two services per week (which provides little choice or convenience for consumers).

118. The choice the Authority then faces is whether to split the rights by granting four services to Chennai and three to Bangalore or vice versa. Neither option produces an allocation of rights between the two routes that fits precisely with the available estimates of their comparative size. A decision to grant four rights to Chennai would create a total of six rights available on that route, with only three left for Bangalore, whereas the available evidence on market size does not clearly support the need for Chennai to be twice as well served as Bangalore. Similarly, the grant of three rights to Chennai and four to Bangalore would produce an outcome where Bangalore had a greater level of service (four) in

comparison to Chennai (with a total of five) than the current and predicted figures would suggest is justified. An optimal split would perhaps be six services on Chennai with four on Bangalore, but unfortunately the rights available are currently insufficient for this.

119. So neither available choice is optimal. However, the Authority considers that there may be less risk in awarding more rights to Chennai as an existing route than to a new and untested route. In addition, the forecasts for the Bangalore market appear more speculative than those for Chennai. As a result, and noting that none of the available choices is ideal, the Authority has decided to award three rights to the new route to Bangalore, a sufficient number to enable a successful start-up and to provide a platform for the future growth of that market, and four rights to the more established route to Chennai.

120. Consequently, the Authority is attracted to the BA proposal to increase their current service on Chennai to 6 services per week operating a Boeing 747-400 aircraft providing an additional 146,000 seats and carrying an extra 52,000 UK origin/destination passengers in Year 3. This compares favourably to the alternative BM proposal which would have provided an additional 76,000 seats in total and 40,000 UK origin/destination passengers on their proposed frequency of three services per week.

121. The Authority therefore decides that BA should be awarded the four services they have bid for on Chennai. Should further rights to Chennai become available it would seem likely that at that point there would be benefits in introducing competition onto the route.

122. Turning to Bangalore, the Authority believes that the interests of users and overall economic efficiency would be best served by allowing a single carrier to build up the route by operating three services per week, rather than splitting the available rights when this market has yet to be developed and where it is not clear that competition can be sustained. The choice before the Authority is then between which of the three proposals would offer the best outcome.

123. The BA proposal was to offer three services per week to Bangalore, again using a Boeing 747-400 aircraft with an additional seat capacity of 110,000, carrying 50,000 UK origin/destination passengers in Year 3. The proposed schedule would see flights departing from Heathrow at 15:00 on Wednesdays, Fridays and Sundays and arriving at Bangalore at 05:45 the next day, with the return journey departing Bangalore at 08:10 and arriving at Heathrow at 14:00 on Mondays, Thursdays and Saturdays.

124. The BM proposal was also to operate three services per week, using an A330-200 aircraft, with an additional seat capacity of 76,000 carrying 45,000 UK origin/destination passengers by Year 3. The proposed schedule would be for flights to depart Heathrow at 13:45 on Tuesdays, Fridays and Sundays and arrive at Bangalore at 03:55 the next day, with return flights leaving Bangalore at 05:55 and arriving at Heathrow at 12:30 on Mondays, Wednesdays and Saturdays.

125. The Virgin proposal was to operate four services per week using A340-300 aircraft. Reducing this to three services per week would give an additional seat capacity of 80,000 and, with a similar pro-rata reduction, about 52,000 UK origin/destination passengers by Year 3. The four services per week schedule was for flights leaving Heathrow on Mondays, Wednesdays, Fridays and Sundays at 22:00 and arriving at Bangalore at 12:35 the next day, with the return flights being on Mondays, Tuesdays, Thursdays and Saturdays, leaving Bangalore at 16:25 and arriving at Heathrow at 22:00. The timings of the schedule look to be unattractive for international connections, particularly to North America. This explains the high percentage of the seats available for UK passengers and may introduce an element of risk in relation to a new market.

126. When comparing the relative merits of the three carriers bidding for the rights to Bangalore on the basis of their operating the three services per week that would be available once four services have been awarded to Chennai, the Authority notes that there would appear to be little to choose between them in terms of predicted benefits to UK consumers.

127. The Authority considers that the balance of arguments in this instance favours the BA proposal. The greater total capacity being made available on the route is one factor that favours the BA proposal ahead of the other two. Virgin's proposal for a higher number of frequencies offers some attractions, but this was not sufficient to disturb the decision to award four of the seven available services per week to the Chennai route, given the stronger apparent demand for services to Chennai and the greater level of uncertainty attached to the estimates of the market for services to Bangalore.

128. The Authority also sees some benefit in this new route being served by a carrier with very good connections from Heathrow to key markets such as the US, and to other international destinations and to domestic points. The strength of the IT industry in Bangalore, and the potential for business traffic to and from the US, gives this greater weight in this case. It could be an important factor in making this route sustainable particularly in the early years of its operation. The Authority believes that the ability to obtain revenue from this connecting traffic would help the route to develop more quickly and provide good arguments for further rights to this destination in the future.

129. The Authority considers that the timing of the Virgin schedule does not offer attractive connection opportunities for passengers wishing to travel between the US and Bangalore over Heathrow. Similarly, although BM's proposed service would offer good domestic and short-haul connections, it would offer more limited US connections than BA's.

130. Consequently, the Authority's decision is to award three services per week to Bangalore to BA.

OVERALL IMPACT OF DECISIONS

131. The overall effect of the Authority's decisions is to:

- enhance rivalry in the more established markets of Mumbai and Delhi, giving Virgin the opportunity to compete on a daily service to Delhi and providing for enhanced consumer choice and competition with both BM and Virgin entering the Mumbai market;
- enable the newer, thinner routes of Chennai and Bangalore to be built up through the provision of enhanced capacity from BA;
- bring a third UK carrier onto this long-haul market from Heathrow for the first time, which could provide a springboard for more competition on routes to India and other long-haul destinations in the future;
- create a situation where the total allocation of available rights to India is as follows:

Airline	Current distribution of rights	Award of rights	Distribution of rights after decision
BA	19	7	26
Virgin	0[9]	10	10
BM	0	4	4

132. The Authority considers that the total package of rights awarded in this way provides for the sound development of the UK's air transport industry and best discharges its statutory objectives, furthering the reasonable interests of users, enhancing competition where that is most appropriate and facilitating a healthy, multi-airline industry in the UK. With the prospect of further rights becoming available in due course, the Authority's decisions also position the UK industry to maximise the efficient usage of rights now available and to take advantage, to the benefit of passengers, of any new rights.

SEQUENCING OF RIGHTS

133. In considering the sequencing of rights awarded, the Authority has sought to balance the desirability of early usage in general, the greater benefits that are likely to flow from proceeding first with those routes where demand is highest, and the timing constraints flowing from individual airline proposals.

134. The Authority considers in this case that there is benefit in first allocating the new rights to those markets where demand appears to be greatest, and where the benefits to consumers of providing new services and greater competition will also be greatest, so leaving the rights that become available later to the markets where demand is less certain.

[9] Until 30 November 2004 Virgin operated 3 services to Delhi under a commercial arrangement with Air India

135. Consequently, the Authority has decided to award the rights in this order:

For Winter 2004:

Seven rights to operate to Delhi awarded to Virgin

The proposal that Virgin put forward suggested that Virgin could operate up to 7 services per week between London and Mumbai and Delhi during the Winter 2004 season. The Authority is therefore of the view that early utilisation of all the Delhi rights by Virgin would be both feasible and desirable.

For Summer 2005:

Four rights to operate to Mumbai awarded to BM

Three rights to operate to Mumbai awarded to Virgin

The Authority expects BM to operate from the beginning of the season, as they had proposed for their daily service, and for Virgin to do the same.

For Winter 2005:

Four rights to operate to Chennai awarded to BA

Three rights to operate to Bangalore awarded to BA

The Authority expects that these services will be operated from the beginning of the 2005 Winter season.

DECISION

136. In accordance with its proposal the Authority hereby varies the licences of British Airways, British Midland and Virgin Atlantic by adding the following licence conditions to licenses S/9, S13 and S/33.

British Airways Plc

For so long as the total number of flights which may be operated between the UK and India by UK airlines in any one week is limited to 40 in each direction, the number of services that might be operated by British Airways between the UK and India is limited to 26, as follows:

- 7 flights a week in each direction between the UK and Delhi;
- 7 flights a week in each direction between the UK and Mumbai;
- 3 flights a week in each direction between the UK and Kolkota;
- 2 flights a week in each direction between the UK and Chennai, increasing to 6 a week in each direction with effect from the start of the IATA Winter Season 2005/06;
- 3 flights a week in each direction between the UK and Bangalore with effect from the IATA Winter Season 2005/06.

British Midland Airways Ltd

For so long as the total number of flights which may be operated between the UK and India by UK airlines in any one week is limited to 40 in each direction, the number of services that might be operated by British Midland Airways between the UK and India is limited to 4 flights a week, as follows:

- 4 flights a week in each direction between the UK and Mumbai, with effect from the IATA Summer Season 2005.

Virgin Atlantic Airways Ltd

For so long as the total number of flights which may be operated between the UK and India by UK airlines in any one week is limited to 40 in each direction, the number of services that might be operated by Virgin Atlantic Airways between the UK and India is limited to 10 flights a week, as follows:

- 7 flights a week in each direction between the UK and Delhi;
- 3 flights a week in each direction between the UK and Mumbai with effect from the IATA Summer Season 2005.

137. 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 8 December 2004.

G J Elsbury
For the Civil Aviation Authority
December 2004