

Predatory entry? The Flybe case*

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* The views expressed are personal and do not necessarily reflect those of the OFT

1

Background and facts

- Flybe entered on to Newquay – London Gatwick route Feb 2009
- Complaint from ASW in March 2009
- Air Southwest (ASW) – small airline based at Plymouth airport with turnover of £29.3m and 220,000 domestic passengers in 2009. Parent SHH leases Plymouth Airport.
- Flybe – second largest UK domestic airline in 2009 with 5m passengers and turnover of £572.4m in 2008/09. HQ at Exeter Airport



2

Background and facts

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- According to ASW, Flybe expressed interest in buying ASW in 2008
- Eastern Airways bought ASW in 2010 but has left the Newquay-Gatwick route – remains on other Plymouth routes
- Flybe now the sole airline on Newquay – London Gatwick route

3

Key Issues

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- ‘Predatory entry’
 - Flybe was an entrant not an incumbent on the route where it has allegedly predicated
 - No legal precedent of cases where entry has been alleged to be abusive
- Abuse in a non-dominated market – ‘linked markets’
 - Flybe dominant in different markets to where the predation takes place
- ‘Penetration pricing’
 - Revenue < avoidable costs is not unusual in the first period after launching an airline route
 - Relevance of Akzo cost test precedent

4

Alleged theory of harm

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- **Protection of Flybe's base at Exeter Airport**
 - Flybe routes from Exeter overlap with ASW routes from Plymouth
 - In previous 2-3 years ASW had entered onto several of those routes from Plymouth
 - Flybe had tried to buy ASW with the intention of closing down Plymouth routes
- **Flybe entered ASW's core revenue generation route while Flybe thought ASW was in financially vulnerable position**
 - Flybe expected to benefit by cessation of flights from Plymouth Airport and diversion of passengers to Exeter
 - Flybe also anticipated its entry could scupper takeover of ASW by another airline

5

Market definition

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- Flybe operates 7 overlapping routes at Exeter with ASW at Plymouth
- All these routes also overlap with either EasyJet / Ryanair / Aurigny / ASW at Bristol
- Evidence overall suggests flights from Bristol Airport are only a constraint on certain routes

Sacrifice

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- Predation requires ‘sacrifice’, for example deliberately incurring losses, and ‘anticompetitive foreclosure’. Article 82 Guidance p20-22
- Evidence showed:
 - Substantial loss forecast by Flybe on the Newquay – London Gatwick route in year one (£2.4m)
 - Revenue not sufficient to cover AAC in year one
 - Flybe also launched other routes expecting and making losses not dissimilar to Newquay-Gatwick, no apparent story of dominance or wider exclusion on those routes.
- Akzo presumption that pricing below AVC is abusive, deliberately incurred losses
- But previous predation cases typically deal with a dominant incumbent responding to entry
- In this case Flybe entered on to route on which it was not dominant

7

Foreclosure

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- Substantial losses on Newquay Gatwick capable of forcing a financially constrained operator off the route.
- Newquay-Plymouth-Gatwick triangular route, a core route for ASW making potentially substantial contribution to overheads of ASW.
- Plymouth Airport runway meant limited options for new flights due to aircraft size.
- Could forcing ASW off Newquay Gatwick lead to closure of operations from Plymouth?
- Flybe expected diversion of passengers from Plymouth to Exeter. Possible benefit of £1m-£1.5m pa

8

Documentary support

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- Examples of emails from Flybe executives prior to launch:

- 'It is a one route airline in terms of profitability. The LGW route is a rich route which is the cornerstone of the airline... ASW and Sutton Harbour Group. Very vulnerable at the moment with the possibility of the group going into a loss situation. In no state to withstand a long term battle.'
- 'Another thought is for us to seek a meeting with ASW just before we announce and make an offer for the company with a guarantee that we will continue to operate the PLH-NQY service for 12 months which gives them time to organise a timely closure of PLH airport. We would benefit from the cessation of all other ASW routes which would benefit our network from EXT and potentially increase interline traffic on lgw route...'

9

Mergers and Predation

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- McGee (1958) – one reason predation is irrational is because merger is cheaper
- Aberdeen Journals – email showing considered possibility of acquiring rival
- Flybe interest in buying ASW

10

No grounds for action decision

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- Evidence not sufficiently strong for infringement finding but didn't want simply to close case on administrative priority
- Transparency benefits of setting out OFT's approach in this case and providing reasoned decision
- But where Reg 1/2003 is engaged by virtue of effect on EU trade, NCA's may not be empowered to take 'non-infringement' decisions in the context of Articles 101/102 TFEU, may only decide that there are no grounds for action (AG Mazák's opinion in *Tele2 Polska*)
- No published guidance as to what 'no grounds for action' really means

11