



Case C1018GJ

**Proposed codeshare and joint service arrangements for
scheduled air services between Guernsey and Jersey**

**Notified for exemption under Article 9 of the
Competition (Jersey) Law 2005**

Decision

I. INTRODUCTION AND EXECUTIVE SUMMARY

1. On 24 October 2013, the Jersey Competition Regulatory Authority (**JCRA**) and the Guernsey Competition and Regulatory Authority (the **GCRA**)¹ received an application (the **Application**) submitted by Aurigny Air Services Limited (**Aurigny**) and Blue Islands Limited (**Blue Islands**) for exemption under Article 9 of the Competition (Jersey) Law 2005 (the **Jersey Law**) and Section 6 of the Competition (Guernsey) Ordinance 2012 (the **Guernsey Ordinance**). The Application related to proposed arrangements (the **Proposals**) for codesharing with respect to airline services between Guernsey and Jersey and Jersey and Guernsey (the **Route**) and aircraft handling at Jersey and Guernsey Airports.
2. This Decision relates only to Article 9 of the Jersey Law, since CICRA has concluded that air services on the Route are already exempt from the Guernsey Ordinance under Section 56(2). To the extent competition issues are considered in relation to air transport services in Guernsey, this is done through a system of air route licences, administered by the Commerce & Employment Department and issued under *The Air Transport Licensing (Guernsey) Law, 1995*.
3. On 22 November 2013, CICRA issued a public consultation, inviting comments from interested parties regarding the Application and in particular the exemption criteria set out in Article 9(3) of the Jersey Law. The consultation period closed on 6 December 2013. CICRA received several representations in response to this consultation, which have been considered as part of CICRA's determination of this matter. A summary of responses received is included at Part III of this Decision.
4. The JCRA has analysed the potential effect of the Proposals on competition and consumers for the purposes of the assessment under Article 9. This investigation has involved the cooperation of Blue Islands, Aurigny, consumers and third parties.
5. As a result of this investigation, the JCRA has concluded that although the Proposals are subject to Article 8 of the Jersey Law, they satisfy the exemption criteria under Article 9 of the Jersey Law, subject to full compliance at all times by both Blue Islands and Aurigny to the conditions set out in Part VII of this Decision.
6. The exemption shall apply immediately, and terminate two years from the date on which the codeshare arrangements commence. The parties may, at their discretion, apply for an extension to the term of this exemption prior to the expiry date.

¹ The JCRA and GCRA are together referred to as the Channel Islands Competition and Regulatory Authorities (**CICRA**) and unless otherwise stated, all references to CICRA in this Decision are to each of the JCRA and GCRA.

II. OVERVIEW OF PROPOSALS

7. Under the proposed codeshare arrangement (the **Codeshare Agreement**), Blue Islands would operate Guernsey-Jersey and Jersey-Guernsey services year round using its existing ATR42 aircraft (46 seats), in accordance with a timetable agreed with Aurigny (and discussed further below). Aurigny would cease operating its own aircraft on this route. Aurigny currently uses a mixture of Trislander (15 seats) and ATR72 aircraft (between 66-72 seats) on the Route.
8. Pursuant to the Codeshare Agreement, Aurigny is required to purchase a defined block of seats, equivalent to [REDACTED]% of the passenger seating capacity of each scheduled flight (the **Aurigny Blocked Space**). Aurigny is required to pay, four weeks prior to each flight, a fixed charge of £[REDACTED] per seat (representing a charge of £[REDACTED] per seat in base charge and £[REDACTED] per seat for fuel). In addition, Aurigny is required to pay any applicable airport and passenger taxes directly to the relevant airport authority. The base charge may be increased annually by no more than Guernsey RPI, while the fuel charge can be adjusted quarterly, in accordance with changes in aviation fuel prices.
9. Under the terms of the Codeshare Agreement, whenever cargo space is available on the Blue Islands aircraft, Blue Islands shall make available to Aurigny, at Aurigny's request, any available space carriage of cargo and mail (**Contracted Cargo Space**) for sale to shippers by Aurigny. As consideration for the Contracted Cargo Space, Aurigny is required to pay Blue Islands an amount equal to [REDACTED]% of the rate charged to shippers by Aurigny less applicable costs or, if greater, £[REDACTED] per kilo.
10. Each airline is required under the Codeshare Agreement to market its share of the capacity of the aircraft completely independently of the other, applying its own fares and terms and conditions. The airlines' separate schemes for frequent flyer points and corporate deals would continue to apply to seats that they each sold on the Route.
11. The agreed year-round timetable would comprise 6 or 7 flights in each direction on weekdays, 4 flights in each direction on Saturdays and 3 flights in each direction on Sundays. All flights operated under the Codeshare Agreement would be marketed by Blue Islands as operating carrier under its designator (code) SI and by Aurigny as marketing carrier under its designator (code) GR.
12. The term of the proposed Codeshare Agreement is currently two years, with the option to extend by mutual agreement.
13. The proposed handling agreements (**Handling Agreement**) will be in standard International Air Transport Association (**IATA**) form for ground handling, under which Aurigny will provide or arrange on behalf of Blue Islands the following services:

- a. representation, administration and supervision;
 - b. passenger services;
 - c. ramp services;
 - d. load control, communications and flight operations;
 - e. support services; and
 - f. security.
14. The services will include processing of arriving and departing passengers and baggage as well as coordinating the physical turnaround of the aircraft and all communications associated with these in both Guernsey and Jersey.
15. Blue Islands will cease to use its existing handling agent in Jersey and Guernsey for services covered by the Handling Agreement.

III. RESPONSES TO CONSULTATION

16. A significant number of responses to the consultation were received, from individual and corporate users of services on the Route as well as from groups representing businesses in the Channel Islands, expressing a range of views. Set out below is a summary of the responses received:
- a. A number of respondents stated that they considered the proposed codeshare to be a good idea but that they expected costs and prices/fares to come down as a result. They felt that this aspect would need to be monitored and/or regulated in some way. This matter is considered further at paragraphs 51-53 below.
 - b. Three responses noted concerns that flight frequency will be substantially reduced and that this would impact on their businesses and flexibility of flights the current arrangements provide. Concerns were also expressed regarding the use of Blue Islands' ATRs rather than Aurigny's Trislanders, because of the length of time boarding takes on the ATRs compared with the Trislanders and because of perceptions that the ATRs were less reliable than the Trislanders. A response also suggested that Aurigny has traditionally provided ground handling services that are superior to those of Blue Islands' existing contractor.

The JCRA's consideration of concerns regarding frequency is set out below at paragraphs 36-40. In response to the other concerns, it should be noted that:

- Aurigny will provide ground handling services for the codeshare flights under the Handling Agreement; and
- The evidence provided by Aurigny as part of the Application clearly indicated that the Trislanders would, in any case, shortly be removed from service. Moreover, for reasons set out at paragraphs 42-43, the parties have contended that the service provided under the Proposals will be more reliable

than that currently provided by Blue Islands, and that the ATR42 in certain respects can provide a more resilient service than Trislanders.

- c. Some respondents were opposed to the Proposals on the basis they thought the Proposals would erase competition, increase fares and stop any potential new entrants to the market, with one response suggesting this was a merger through the back door. The JCRA's view regarding the effect of the Proposals on competition is at paragraph 46-50 below.
- d. Other respondents stated that they would rather two companies took an innovative view to rectifying a problem (not enough customers between them to fill all of their flights) and maintain a degree of competition rather than have one of the airlines pull out completely and thereby create a monopoly. Certain responses also added that the reduction of frequency of travel will have an impact on the options available, but that this was preferable to having only one airline operate the Route.
- e. Another respondent stated that while the Proposals were a reasonable means of addressing the problems faced by the parties on the Route, it was of the view that competition was unnecessarily constrained by the operation of the air route licensing system in Guernsey and, in particular, the status of the States of Guernsey as both shareholder of Aurigny and issuer of air route licences. The JCRA considers that the structure of the Guernsey air route licensing system lies outside the ambit of this Decision (particularly given the exemption in section 56(2) of the Guernsey Ordinance), and so has not considered that matter further.
- f. The response received from the Jersey Chamber of Commerce indicated that the Chamber believes the Proposals are an understandable way forward for both parties given the losses they are both incurring on the Route. The Chamber believes that if the Proposals secure daily multi-frequency operations on the Route with similar seat capacity to the existing operations, then the Proposals ought to be supported. The Chamber's response notes that similar arrangements have been used by other airlines in Europe but notes that the peculiarities and requirements of an inter-island route have to be appreciated. The Chamber also believes that there must be ample demonstration of the individual airlines' pricing policies being maintained separately and that this may be a role that CICRA may be best placed to undertake.

17. The JCRA has considered the responses, where relevant, in determining whether an exemption would meet the four criteria discussed below. The JCRA's consideration of certain of the issues raised is explained below in its consideration of the individual exemption criteria.

IV. THE RELEVANT MARKET

18. The approach to market definition in airline cases is well-established as being on a point-to-point (origin and destination) basis. A wider product market could possibly comprise the supply of all public transport services between Guernsey and Jersey, which would

include the Condor inter-island ferry service. However, the ferry service is a substitute for the air services on the Route only to a very limited extent, because of slower journey times and infrequent sailings. Therefore, the JCRA has concluded that ferry services lie outside the relevant product market.

19. It is arguable that cargo is likely to comprise a separate product market. However, the issues that cargo raises appear to be covered by an analysis of passenger air services. On this basis, the JCRA has concluded that the appropriate market for consideration in this Decision comprises scheduled air services on the Route.

V. ANALYSIS UNDER ARTICLE 8 OF THE JERSEY LAW

20. Article 8(1) of the Jersey Law states that an undertaking must not make an arrangement with one or more other undertakings that has the object or effect of hindering to an appreciable extent competition in the supply of goods or services within Jersey or any part of Jersey. Article 8(2) of the Jersey Law provides that Article 8 will be infringed by agreements which, amongst other things, “(b) limit or control production, markets, technical development, or investment or (c) share markets or sources of supply.”
21. The first question is whether the Proposals infringe Article 8 of the Jersey Law and hence are prohibited, unless subject to an exemption under Article 9 of the Jersey Law. If Article 8 does not apply to the Proposals, there is no need for an exemption. Article 60 of the Jersey Law requires that, so far as possible, the JCRA interprets these provisions consistently with the treatment of corresponding questions arising under competition law in the European Union.

Object or Effect of Hindering Competition

22. Fundamental to the Proposals is that the parties will share the market for the supply of scheduled air services on the Route by coordination of schedules and capacity. The Proposals will also give rise to a reduction in the number of flights that the parties will operate on the Route. As noted above, Article 8 applies in particular to limiting or controlling production, markets, technical development, or investment and sharing markets or sources of supply. The European Commission has held that close coordination and integration of, for example, scheduling, revenue sharing and capacity would, as a matter of fact, reduce competition among the parties to a codesharing agreement, as these parameters are key elements on which airlines normally compete with each other.²
23. Compared to the existing situation, the Proposals will clearly reduce the output and variety of services available in the relevant market, and will also reduce the quality of service, in that the frequency for journeys will reduce considerably, especially during the

² Case COMP/38.284 – *Societe Air France/Alitalia Linee Aeree Italiane S.p.A*, at paragraph 128

middle of the day. In the *Alitalia/Volare*³ case, the Italian Competition Authority objected to, for example, a reduction in the number of flights on some routes arising from the codeshare and the fact that the codeshare involved two major national carriers which were direct competitors on most of the routes before the codesharing agreement existed, and therefore found that the codesharing agreement in that case infringed the equivalent of Article 8.

24. The European Court of Justice has previously found⁴ that an object infringement of competition law can arise even if the parties have no subjective intention of restricting competition, but instead have the object of remedying the effects of a crisis in their sector. The Court concluded that the appropriate course was to consider whether the relevant agreement was eligible for exemption under the equivalent of Article 9 of the Jersey Law.
25. Considering the Proposals in light of previous decisions of both the European Commission and the European Court of Justice, the JCRA has concluded that it is more likely than not that the object of the Proposals is to limit production or to share markets, and that it can therefore conclude that the Proposals infringe Article 8 of the Jersey Law.
26. Even if the Proposals were not to be found to have the object of hindering competition, the JCRA considers that the Proposals are likely to have the effect of hindering competition compared with the present position. The parties are clearly existing competitors and together dominate the market. According to the Application, Blue Islands has a market share of 52% for 2013 and Aurigny, a 46% market share. While Flybe is conceivably a competitor, its market share is approximately 2%⁵ and the fact its Guernsey air route licence is limited to selling a maximum of 10% of the inter-island capacity on its triangulated services on the Route means that it can not offer any significant competitive constraint to either Blue Islands or Aurigny in the market. The JCRA is of the view that because the parties have very high market shares, there is a higher probability that the Proposals will have restrictive effects whether or not this is the intention of the parties.
27. The JCRA has noted that restrictive effects of codesharing agreements on competition are less likely to arise when commercial risk continues to be borne by both parties. Under so-called free flow codesharing agreements, the marketing carrier has access to the operating carrier's inventory of seats, but the commercial risk continues to fall almost completely on the operating carrier, since the marketing carrier merely functions as an agent. By contrast, under a so-called "hard blocked space" agreement, as proposed by Blue Islands and Aurigny, the operating and the marketing carrier are responsible for the sale of their allocated number of seats, and the marketing carrier has to pay the operating carrier the

³ 10 July 2003

⁴ Case C-209/07 – *Irish Competition Authority v Beef Industry Development Society Ltd and Barry Brothers (Carrigmore) Meats Ltd*

⁵ According to the Application, as Flybe does not dedicate any of this capacity to the inter-island market, it is not possible for the parties to calculate what capacity is made available, or the load factor achieved

agreed financial contribution for the seats, regardless of whether it is successful in selling them. As such, commercial risk lies with both parties, providing incentives for both airlines to compete for passengers to fill their share of seats on the plane⁶. However, the parties could agree to alter the Codeshare Agreement at any time, including modifying the percentage of Aurigny Blocked Space that must be purchased by Aurigny, which could reduce the extent of competition between them.

28. On the basis of the above, the JCRA concludes that the Proposals are on balance subject to the prohibition in Article 8(1) of the Jersey Law.

VI. ANALYSIS UNDER ARTICLE 9 OF THE JERSEY LAW

29. To qualify for an exemption under Article 9 of the Jersey Law, the JCRA must be satisfied that the Proposal meets all four of the exemption criteria listed in Article 9(3). The criteria are that the agreement or arrangement:
- a) *is likely to improve the production or distribution of goods or services, or to promote technical or economic progress in the production or distribution of goods or services;*
 - b) *will allow consumers of those goods or services a fair share of any resulting benefit;*
 - c) *does not impose on the business concerned terms that are not indispensable to the attainment of the objectives mentions in sub-paragraphs (a) and (b); and*
 - d) *does not afford the business concerned the ability to eliminate competition in respect of a substantial part of the goods or services in question.*
30. These exemption criteria are cumulative⁷. As such it is unnecessary to examine any remaining criteria once it is found that one of the criteria is not fulfilled. The application of these criteria to the Proposals is discussed below.

Improvement in the Distribution of Goods or Services

31. The first criterion, Article 9(3)(a), requires that the Proposals either improve the production or distribution of goods or services, or promote technical or economic progress in the production or distribution of goods or services. Stated simply the Proposals must be likely to produce either quantitative or qualitative efficiencies. Efficiencies may create additional value for consumers by lowering costs, improving the quality of a good or service provided, or by creating a new good or service.

⁶ European Competition Authorities, *Code-sharing agreements in scheduled passenger air transport – The European Competition Authorities’ perspective*, paragraphs 14 and 48

⁷ Case 161/84, *Pronuptia* [1986] ECR 353

32. In the parties' submissions, the Proposals are intended to create the following efficiencies:
- a. provide capacity, but not over-provide capacity, through the utilisation of the aircraft of only one of the parties and thereby increase load factors;
 - b. financial improvements to the parties on the operation of the Route;
 - c. a reduction in fuel usage due to fewer flights being operated, resulting in a decline of CO² emissions of 177 tons per annum; and
 - d. promotion of both technical and economic progress, as only modern ATR42 aircraft will be operated and fuel burn per revenue seat will therefore improve by in excess of 20%.

The JCRA does not consider that financial improvements to the parties on the operation of the Route could constitute, of themselves, an efficiency that could contribute to satisfying Article 9(3)(a). However, it has reviewed the evidence in respect of the other three claimed efficiencies arising from the Proposals.

33. According to the Application, Blue Islands and Aurigny duplicate each other's services in order, especially, to benefit from periods of high demand. These periods of high demand are typically between 7.45am and 9am and 4.30pm and 6pm on weekdays. It is argued that this duplication is necessary for the parties to maximise yields, utilise their aircraft effectively and to comply with the conditions of their air route licences. However, the parties submit this is an inefficient allocation of resources, as it results in substantial over-provision of capacity and so very low load factors, and costs each party more than it can recover from the Route's potential revenues.
34. By adding extra passengers to the other airline's flights, codeshare agreements can contribute to economies of scope and traffic density, thereby creating cost efficiencies and better utilisation of indivisibilities like an aircraft. For example, the Italian Competition Authority considered efficiencies in its assessment of codeshare agreements in *Alitalia/Volare*⁸ and *Alitalia/Meridiana*⁹. In these cases, the claimed efficiencies were measured mainly on the basis of load factors obtained after the agreement.
35. According to the Application, between them the parties currently provide a total of 240,000 seats annually on the Route. Based on preliminary results of summer 2013 carryings and actual winter 2012/13 carryings (when the same total capacity was offered), the take-up of the total capacity of 240,000 seats in 2013 would be [REDACTED] which expressed as a percentage of available seats (otherwise known as the load factor) would be only [REDACTED]%. There is no reason to question the operators' assumption that no

⁸ Decision in *Alitalia/Volare Group*, 10 July 2003.

⁹ Decision in *Alitalia/Meridiana*, 3 February 1999.

significant increase in demand can be expected and that therefore 240,000 seats would substantially exceed demand overall.

36. At present, Blue Islands operates 5 flights in each direction on weekdays and 4 and 3 flights at weekends, while Aurigny operates between 8 and 12 flights in each direction during weekdays and 5 flights each way at weekends. Set out below is the proposed new joint timetable:

Guernsey to Jersey			Jersey to Guernsey		
Depart	Arrive	Days	Depart	Arrive	Days
0750	0810	12345..	0755	0815	123456
0835	0855	123456	0915	0935	123456
1000	1020	...34..67	1030	10507
1200	1220	12...5..	1200	1220	...34..
1240	1300	...34...	1240	1300	12....5.
1510	1530	12345..	1430	1450	...34....
1710	1730	1234567	1630	1650	123456
1830	1850	1234567	1750	1810	1234567
			1850	1910	12345..7

37. The proposed timetable would provide 6 or 7 flights in each direction on weekdays and 4 and 3 flights per day in each direction at weekends. Flexibility will also exist within the aircraft programme to increase capacity at times of peak. This arrangement would produce 186,000 seats annually and the parties therefore submit that the proposed schedule will satisfy existing demand overall ([REDACTED] revenue seats). There would be a reduction in unutilised seats from [REDACTED]% to [REDACTED]% which means an increase in load factors from [REDACTED]% to [REDACTED]%. The JCRA accepts that increased load factors can be an efficiency gain under the first criterion.
38. However, several responses to the consultation raised concerns with the proposed new timetable: that there would be reduced flight frequency, and that the timetable would not offer sufficient capacity, especially during periods of high demand. Given the concerns raised regarding reduced frequency and capacity, the JCRA looked at whether the new timetable would satisfy current demand during peak times. Based on the load factor data provide by the parties, it appeared that demand would exceed supply at certain times (noting that demand will depend, in part, on the prevailing level of fares). The JCRA therefore asked the parties on what basis they had satisfied themselves that demand would be satisfied under the new timetable. The parties contended that based on typical demand patterns across the day sourced from the Civil Aviation Authority, they were satisfied the new timetable would provide capacity for the underlying demand on the Route for the majority of the time. Further, the parties argued that providing capacity sufficient to meet the demand on every occasion would render the operation uneconomic, because without

being full at times of peak demand, the parties would never achieve satisfactory load factors.

39. The parties also stated that over time, the joint operation will reveal the underlying market patterns which currently are masked by excess capacity, and confirmed that the pricing would be adjusted to better align time-sensitive and price-sensitive demand across the differently-timed flights. As such, this would reduce the number of occasions when demand outstripped supply, but would never eradicate them. The parties submitted that commercial air services often do not cater for all demand, and that it is not always viable, even in competitive scenarios, for capacity to be tailored to meet all demand at all times (even on the Route at present). The parties also contended that if there is an opportunity to add additional, profitable capacity, then that could be expected to come about, noting that the Codeshare Agreement provides for quarterly meetings between the Parties at which aspects of the operation may be reviewed.
40. The JCRA notes that flexibility will exist within the proposed joint timetable to increase capacity at times of peak demand and particularly to satisfy the peak demand patterns generated by high number of inter-island challenges in several sporting disciplines held across the year. The JCRA understands this will be achieved by an additional rotation or by switching the ATR42 to the ATR72 (66 seats), providing further capacity where it is deemed feasible. Moreover, it notes that the parties will retain a commercial incentive to increase supply to meet demand (although this incentive would be considerably greater if the parties maintained rival services). However, given the possibility of consumer detriment arising through passengers not being able to secure seats at peak times, on balance, the JCRA has decided that it should impose a condition related to capacity as part of this exemption decision. This condition is explained in more detail in paragraph 67 below.
41. According to the Application, the services on the Route are, and in the absence of the planned arrangement, would continue to be, environmentally inefficient, as they involve the operation of more flights and the burning of far more fuel than is necessary to satisfy market demand. The parties contend that savings in fuel of 70,000 litres per year (or 0.5 litres per passenger) would be achieved under the Proposals, resulting in a CO² emission reduction of 177 tonnes per annum. The JCRA accepts that under the Proposals, fuel consumption would be reduced, and that, following European Commission precedent, such an environmental benefit could constitute “technical or economic progress” for the purposes of the first criterion¹⁰.
42. The parties state that another benefit to consumers will be that the service will be operated using a modern ATR42 aircraft dedicated to inter-island services and backed up by a spare aircraft in the Blue Islands fleet, together with a further back-up ATR72 aircraft in the Aurigny fleet. The provision of dedicated aircraft and a larger-sized back-

¹⁰ European Commission, Case COMP.F.1/37.894 — *CECED Dishwashers*

up aircraft will mean that following periods of disruption, back-logs of stranded travellers will be repatriated and normal services resumed more quickly than in the past. The parties submit that further benefits to consumers will come through general passenger comfort, as the ATR42 operates with cabin crew, and allows greater space, seat pitch, headroom and overhead locker storage.

43. The parties also state the Proposals will ensure the continuance of the utilisation on the Route of the ATR42 aircraft, which has a significantly better operating window than the Trislander. For example, the cross-wind limits of a Trislander are 25 knots, but for an ATR42, 45knots. Moreover, the ATR42 remains in production, so equipment, support and training, appropriately licensed pilots/engineers and maintenance facilities are more readily available. The ATR is also equipped with auto-pilot facilities.
44. On the basis of the above and, in particular, the fact that the Proposals will increase load factors, produce a smaller impact on the environment, improve passenger comfort and may improve the resilience of the service, relative to the current position, the JCRA has concluded that this first criterion is satisfied.

Allow Consumers a Fair Share of the Benefits

45. The second criterion, Article 9(3)(b), requires that consumers receive a fair share of the benefits arising from the Proposals. If an improvement is seen as benefiting only the parties to the agreement, the criterion will not be satisfied. However, it is not required that consumers receive a fair share of every efficiency, and the form of compensation can be increased quality in exchange for slightly higher prices.¹¹
46. The parties argue the principal countervailing benefit to consumers will be the maintenance of competition and that the benefits from the efficiencies generated by the Proposals will be passed on to consumers primarily through the maintenance of competition between Blue Islands and Aurigny and the strengthening of the financial base of each company. The parties contend that consumers cannot expect to continue to benefit from the existing services as these are loss-making and not sustainable so far as either of the parties is concerned. (Each party is aware that the other incurs losses from its services on the Route, but is not aware of the actual losses sustained by the other as this is commercially-sensitive information.)
47. The counterfactual argued by the parties is that if the Proposals do not go ahead and one party withdraws from the Route, competition will be reduced dramatically and arguably there will be no competition whatsoever (on the basis that Flybe cannot offer any competitive constraint with only a 2% market share). Taking account of the information provided in the Application concerning the parties' historical financial performance on the Route and future forecasts, [REDACTED], the JCRA has accepted that it is probable

¹¹ European Competition Authorities, *ibid*, paragraph 58

that one or other of the parties would withdraw its service on the Route in the short-term (in the absence of the Proposals), and that whichever withdraws first would leave the other as solus operator on the Route.

48. A situation where the Route is served by a solus operator would not offer consumers competition. The JCRA has concluded that a benefit to consumers would arise through the maintenance of some competition, by safeguarding the operation of the Route by both Blue Islands and Aurigny pursuant to the Codeshare Agreement. Indeed, some of the responses to the consultation stated that it was best to maintain a degree of competition rather than have one of the airlines pull out completely and thereby create a monopoly.
49. The JCRA has considered whether it would be possible or likely that a new entrant would enter the market. No licence is required from the Jersey authorities, as Jersey has adopted an “open skies” policy. In respect of Guernsey, for a new entrant to operate the Route, it would be necessary to hold a Guernsey air route licence, for which application is made to Guernsey’s Commerce & Employment Department. Given the recent issues surrounding the Gatwick route operated by Aurigny, and the fact the States of Guernsey has recently amended its licensing policy in order to protect Aurigny’s position on the Gatwick route, and expressly accepted the reduction in competition that will inevitably result, there is at least some possibility that the States of Guernsey could take similar action in respect of the Route [REDACTED]. Notwithstanding this, there are no physical constraints on market entry. A prospective new entrant would be able to freely access landing slots, airport services and ground handling facilities (including maintenance) in both Guernsey and Jersey.
50. However, given the continuous losses for the parties in competition with each other on the Route (and noting that the parties are two local carriers benefiting from networks spanning the Channel Islands and with customer loyalty in their local markets), the JCRA considers it unlikely that a new entrant would seek to enter this market. As such, the Proposals would appear to represent the best opportunity available for maintaining some competition on the Route, at least in the short- to medium-term.
51. Some responses to the consultation raised concerns with regards to fares increasing as result of the Proposals. Following this, the JCRA queried with the parties whether they expected lower fares for consumers, given that the Proposals will lead to lower operating costs. The parties clarified that at this stage they did not expect to offer lower fares. Instead they were seeking to mitigate the losses made on the Route to ensure a sustainable service on the Route. They contended that customers’ interests will be served through the maintenance of competition which, they submit, would otherwise disappear in the absence of the Codeshare Agreement.
52. As noted above, the parties provided future forecasts which show financial improvements to both parties if the Proposals go ahead. The JCRA recognises the importance of the parties improving their financial performance and, on balance, the JCRA’s view is that

the best means of protecting consumers (including in relation to securing lower fares) is to ensure that competition remains as vigorous as possible on the Route.

53. Therefore, the JCRA proposes to impose certain conditions on its exemption decision, which in its view would serve to maximise the extent of competition between the parties under the Proposals, recognising that the extent of competition that can arise under a codesharing agreement will be more limited than where rival services are offered. On this basis, the JCRA has concluded that the second criterion is satisfied, subject to compliance at all times with the conditions listed below in Part VII of this Decision.

Contains No Indispensable Restrictions to Competition

54. Codeshare agreements will by their very nature require coordination to a degree by the parties concerned. However, the third criterion of indispensability requires that the Codeshare Agreement must be reasonably necessary in order to achieve the efficiencies. In addition, the restrictions that flow from the Codeshare Agreement must also be reasonably necessary for the attainment of the efficiencies.¹²
55. In the case of Blue Islands and Aurigny, the agreements relating to the Proposals do not appear to impose terms on either party that are beyond those necessary for the achievement of that purpose; that is, the coordination under the Codeshare Agreement is restricted to those factors that are essential for the codesharing to work. The parties are required to set prices and to market the services independently. Further, the parties will continue to compete on other routes, for example to various airports in the UK. The Application states that the parties do not intend to extend the Proposals beyond resolving the unsustainable provision of services on the Route.
56. The Handling Agreements are in standard IATA form for ground handling, under which Aurigny will provide or arrange on behalf of Blue Islands certain ground handling services including processing of arriving and departing passengers and baggage as well as coordinating the physical turnaround of the aircraft and all communications associated with these in both Guernsey and Jersey. It seems sensible that Blue Islands and Aurigny passengers and their baggage on the same flight are handled by the same handling agents. As noted above, certain responses to the consultation suggested that Aurigny has traditionally provided ground handling services that are superior to those of Blue Islands' existing contractor. If this is true, this concern might fall away, or at least be alleviated, given Aurigny will provide the ground handling services for the codeshare flights.
57. On this basis, the JCRA has concluded that the third criterion is satisfied.

No Elimination of Competition in respect of a Substantial Part of the Goods or Services in Question

¹² European Commission, *Guidelines on the application of Article 81(3) of the Treaty* [2004] OJ C101/97, paragraph 73

58. This criterion ‘depends on the degree of competition existing prior to the agreement and on the impact the restrictive agreement on competition, i.e. the reduction in competition that the agreement brings about.’¹³ It calls for an assessment of the potential market effects that will result from the Proposals.
59. This assessment requires the definition of the relevant product and geographic markets. As noted in Part IV of this Decision, the JCRA considers the relevant market to be the provision of scheduled air services on the Route.
60. The parties argue that they will not have the ability to eliminate competition because it is axiomatic to the Proposals that the parties continue to compete with each other. The JCRA has accepted that proceeding with the Proposals is the best chance of preserving a degree of competition for consumers, as it is probable that one or other of the parties would pull out, leaving a solus operator on the Route, which would eliminate competition almost entirely. Given that entry from a rival operator would appear to be unlikely, the JCRA is of the view that there is a better chance that some competition will be preserved, and that consumers’ interests will be better-served, under the Proposals.
61. Under the terms of the Codeshare Agreement, Aurigny is required to purchase a prescribed share of each flight operated by Blue Islands on the Route (known as the Aurigny Blocked Space). The JCRA believes the fact Aurigny is contractually required to purchase the Aurigny Blocked Space, and pay in advance for this space, will act as an incentive for Aurigny to compete for passengers to fill its portion of seats on the plane. By the same token, the JCRA is of the view that Blue Islands will also be incentivised to compete for passengers in order to fill its portion of the remaining seats on the plane. Further, the Codeshare Agreement provides that the parties will market and sell seats on the airplane on their own terms and conditions. It was suggested by third parties responding to the consultation that many other codeshare agreements in the airline industry provide that at a minimum period prior to departure (e.g. 48 hours), all unsold seats on a flight go back into a “pool”, for sale by either of the codeshare operators. Such an arrangement would reduce the extent of competition; however, the parties have confirmed that such an arrangement does not form part of the Proposals.
62. The JCRA is of the view that competition can be maximised, within the constraints of a codesharing agreement, by ensuring that the parties are each required to bear a level of commercial risk and an obligation to sell a portion of the seats. This view is in line with the view of the European Competition Authorities with respect to codeshare agreements.¹⁴
63. Notwithstanding the above, the JCRA has noted that the parties would have the ability to alter the percentage of seats that must be purchased by Aurigny, and thereby reduce the

¹³ *Ibid*, paragraph 107

¹⁴ European Competition Authorities, *ibid*, paragraph 48

extent of competition between the parties, by agreeing to amend the Codeshare Agreement. Thus, the exemption granted in respect of the Proposals is conditional on the elimination of the parties' ability to alter the percentage of the Aurigny Blocked Space, unless changes can be justified to the JCRA's satisfaction.

64. On balance, the JCRA has concluded that the Proposals will not afford the parties the ability to eliminate competition, subject to compliance at all times with the conditions listed below in Part VII of this Decision.

VII. THE DECISION

65. The JCRA concludes that the Proposals would infringe Article 8(1) of the Jersey Law.
66. The JCRA also concludes that the Proposals satisfy the criteria for exemption under Article 9 of the Jersey Law, subject to certain conditions imposed on the exemption decision under Article 9(6) and set out in paragraph 70 below. Specifically the conditions are intended to secure that the second and fourth exemption criteria are satisfied by ensuring that the parties continue to compete vigorously on the Route.
67. As discussed in paragraphs 38-40 above, the JCRA has decided that a condition should be imposed related to capacity issues. In deciding on the condition, the JCRA has taken account of the fact that levels of demand are, in and of themselves, contingent on price, which, for reasons explained in the next paragraph, the JCRA is not seeking to influence by way of conditions. The parties have argued, and the JCRA has accepted, that additional capacity could be expected to come about on the Route if profitable opportunities present themselves. The Codeshare Agreement provides for quarterly meetings between the Parties at which aspects of the operation may be reviewed. However, in order to reduce the likelihood that the Proposals will give rise to material consumer detriment through inadequate capacity, the Decision requires the parties to exercise reasonable endeavours to ensure that extra capacity is provided on the Route where required to meet levels of demand.
68. The JCRA considered, but ultimately decided against, a condition requiring fare increases to be notified to the JCRA. Most concerns expressed in the consultation responses related more to quality of service - for example, reliability and flight frequency - rather than fares. The JCRA has noted that the fare structures for both parties are multi-dimensional, and there would be considerable scope for the amounts paid by passengers to increase even without explicit fare changes. Furthermore, the JCRA is of the view that it would be inappropriate for it to undertake a quasi-regulatory prices surveillance role under the guise of an exemption decision, and that the best means of securing benefits for customers under the Proposals is to ensure that genuine competition between the parties is maintained, at least to the extent possible under a codesharing agreement.

69. The JCRA also considered, but again ultimately decided against, a condition prohibiting the parties objecting to any application made by other carriers under section 5 of *The Air Transport Licensing (Guernsey) Law, 1995* for a Guernsey air route licence to operate the Route (or an application by Flybe to change the conditions on its licence). The JCRA decided against this because its view is that such a condition would be unworkable, and could operate in a manner that unduly affects Blue Islands. Moreover, it recognises that there may be legitimate representations that the parties wish to make in response to an air route licensing application concerning the Route. However, the JCRA would expect that Guernsey's Commerce & Employment Department would have regard to the potential desirability of entry by rival operators when considering future air route licensing applications for the Route.
70. By this Decision, the JCRA hereby grants an exemption for the Proposals under Article 9 of the Jersey Law, subject to compliance by the parties with the following conditions:
- a. Blue Islands and Aurigny must not amend the Aurigny Blocked Space (as that term is defined in the Codeshare Agreement) without the written approval of the JCRA. If the parties wish to amend the Aurigny Blocked Space, they must make a submission to the JCRA at least 25 working days prior to the desired date for the amendment, providing full details of the amendment sought and the reasons for it. A period of at least six months must elapse between any submissions made by the parties under this condition. In considering whether to provide approval for an amendment to the Aurigny Blocked Space, the JCRA will have regard to:
 - i. the circumstances that have given rise to the submission;
 - ii. any changes in fares or quality of service (including schedule frequency and reliability) in the codeshare service on the route since (A) the date of the exemption decision, and (B) the commencement of the codeshare service;
 - iii. the likely effect of the amendment on the nature and extent of competition between the parties; and
 - iv. the likely effect of the amendment on fares and quality of service in the codeshare service on the Route;
 - b. Blue Islands and Aurigny must not indicate to passengers that bookings for the Route are not available from the other airline;
 - c. Aurigny must disclose clearly in its timetables and on its website that Blue Islands is the carrier of all flights on the Route;
 - d. Blue Islands and Aurigny must each price and sell the codeshare services independently of the other party;

- e. Blue Islands and Aurigny must exercise reasonable endeavours to ensure that extra capacity is provided on the Route where required to meet levels of demand; and
 - f. Blue Islands and Aurigny must provide such information and documents as the JCRA may reasonably require, subject to legally recognizable privilege and upon written request with reasonable notice, for the purpose of determining, monitoring or securing compliance with this Decision (including these conditions).
71. If it is determined that clarification of the process for submissions under condition (a) above, and the criteria to be applied by the JCRA in considering such submissions, is required, the JCRA would expect to issue a Guidance Note within a period of 3 months after the date of this Decision. Whether a Guidance Note is required will depend, in part, on whether the parties anticipate that any such submissions are likely to be made.
72. The JCRA notes that several of the conditions in paragraph 70 are already covered by the Codeshare Agreement. It could be argued that any exemption granted under Article 9 of the Jersey Law would only apply to the Codeshare Agreement as notified to the JCRA in the Application, and so any amendment to the terms of the Codeshare Agreement would potentially bring the Proposals outside the ambit of this Decision. The JCRA has taken the view that setting out those provisions that are essential to its Decision as conditions under Article 9(6) provides clarity both to the parties and to other persons with an interest in the Decision.
73. The exemption shall apply immediately, and terminate two years from the date on which the parties' codeshare arrangements commence (that is, the Implementation Date as defined in the Codeshare Agreement). The parties may, at their discretion, apply for an extension to the term of this exemption prior to the expiry date.
74. Compliance with the conditions set forth in paragraph 70 is binding on Blue Islands and Aurigny (except for paragraph 70(c), which is binding on Aurigny only), as well as on any successors or assignees.

10 January 2014

By Order of the Board of the JCRA