

Competition Law Hotline

December 04, 2013

COMPETITION COMMISSION OF INDIA APPROVES JET-ETIHAD COMBINATION!

- Proposed transaction between Jet and Etihad approved and CCI holds that the same is not anti-competitive.
- Origin and Destination pair cities between India and UAE/Europe examined and CCI holds that there is no adverse impact on competition from the proposed transaction between Jet and Etihad.
- Abu Dhabi as exclusive hub will offer connectivity to more than 80 cities which will be beneficial to air passengers in multiple cities in India.
- Cancellation of code share agreements will not affect competition due to presence of several strong competitors.
- Single member dissents observing that based on the material available, it was a fit case for directing investigation and submission of a report under the Competition Act.

INTRODUCTION

India's competition law regulator, the Competition Commission of India ("CCI") recently approved Etihad Airways PJSC's ("**Etihad**") investment in Jet Airways (India) Limited ("**Jet**")¹, making it the first-ever foreign direct investment ("**FDI**") by a foreign airline in an Indian carrier approved by the CCI. The Government of India ("**Government**") had liberalized its FDI policy on September 20, 2012 and set a 49% cap for foreign investments in civil aviation sector in India. Etihad had proposed to acquire 24% in Jet Airways in April, 2013. CCI approval came on November 12, 2013 ("**Ruling**"), after the transaction had been approved by the capital markets regulator Securities and Exchange Board of India ("**SEBI**"), the Foreign Investment Promotion Board ("**FIPB**") and Cabinet Committee of Economic Affairs ("**CCEA**"). After considering the impact of the Jet-Etihad combination ("**Proposed Combination**") on competition, CCI approved the Proposed Combination and held that the Proposed Combination was not likely to have 'appreciable adverse effect' on competition ("**AAEC**") in India. This is a landmark ruling as CCI has examined in far greater detail the impact of the Proposed Combination on air passenger services for Etihad and Jet and its consequential impact on competition in India than it has in other cases. Additionally, for the first time, a member has issued a dissenting opinion with respect to the Proposed Combination and this has also been briefly addressed. The Ruling adopts a fair and balanced approach in examining and analysing the information at hand and in making an assessment on competition and drawing conclusions on the impact of the Proposed Combination on the competition in the market. The test adopted by CCI should serve as a good indicator for future transactions and help standardise the tests adopted to substantiate commercial benefits of combinations.

Jet and Etihad ("**the Parties**") had executed an Investment Agreement, a Shareholders Agreement and a Commercial Co-operation Agreement ("**CCA**") ("**Transaction Documents**") on April 24, 2013. The Parties had filed a notice under Section 6(2)² of the Competition Act, 2002 ("**the Act**") with CCI on May 1, 2013.

The Parties were required to provide additional information/document(s) to CCI under the Competition Commission of India (Procedure in Regard to the Transaction of Business Relating to Combinations) Regulations of 2011 ("**Regulations**") and a final reply was filed by the Parties with CCI on September 9, 2013. The Parties sought CCI's approval for acquisition of 24% equity interest in Jet by Etihad and in relation to all the rights and benefits which the Parties had commercially agreed upon in the Transaction Documents and the Corporate Governance Code.³

ISSUE BEFORE CCI

The only issue before CCI was whether the Proposed Combination was likely to cause AAEC in India. Although CCI approved the Proposed Combination by its majority view ("**Majority Ruling**"), a single member issued a separate dissenting opinion ("**Dissenting Opinion**") which has also been considered below.

MAJORITY RULING

Notice under section 6(2) of the Act on the Proposed Combination was given to CCI on May 1, 2013. Subsequently, the Parties sought time to furnish additional information since the Transaction Documents were amended. The final set of information was submitted by the Parties in October and the Ruling was pronounced on November 12, 2013. Based on a review of the information that was submitted by the Parties, the Majority Ruling approved the Proposed Combination and made the following observations on the Proposed Combination:

Relevant Market

1. To examine the impact of the Proposed Combination, CCI first ascertained the relevant market. CCI concluded that the relevant market for passenger air transport services was normally defined on the basis of a point of origin and point of destination ("**O&D**") pair approach⁴ on a non-directional basis⁵ (demand based approach). Thus, each O&D pair constituted a separate market from the consumers' perspective. It was possible that two airports would be seen as part of the same market and in certain cases an O&D pair was substitutable.

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2. CCI also reasoned that consumers should consider direct flights and indirect flights as substitutable. CCI noted that several factors determined substitutability of direct and indirect flights and that it was possible that indirect flights offered by competitors could be considered as an alternative for passengers.
3. CCI also noted that in the demand based approach it was important to identify different classes of passengers and noted that different services would be substitutable for different class of passengers. CCI noted that there were time sensitive passengers and price sensitive passengers and it would be important to examine the impact of the Proposed Combination in respect of services to both class of passengers.
4. CCI concluded that for an assessment of the Proposed Combination the effect of the Proposed Combination on the service offered by both the Parties would have to be ascertained.
5. Based on these factors and also noting that Etihad was not providing services in the domestic sector, CCI concluded that the relevant market was the international air passengers market:
 - on the O&D pairs originating from and ending in 9 cities in India (Kochi, Bombay, Thiruvananthapuram, Bangalore, Kozhikode, Ahmedabad, Delhi, Hyderabad and Chennai) to/from United Arab Emirates;
 - on the O&D pairs originating from or ending in India to/from international destinations on the overlapping routes of the Parties to the combination.

In arriving at this conclusion, CCI made a distinction between different groups of passengers and observed that Indian passengers on the 9 direct overlapping O&D pairs were generally price sensitive and less time sensitive. Further, it was observed that the passengers living in the catchment areas of two or more airports would consider those airports as possible substitutes. For instance, in UAE, airports at Abu Dhabi, Dubai and Sharjah could be considered as substitutable with each other for the reason that these airports were within 2 hours distance from each other.

Competition assessment of O&D pairs between India and UAE

1. The seat allocation for India – UAE is based on a Bilateral Air Services Agreement between India and UAE (“BASA”) and is not an open sky policy as in the case of India – US, and hence there were limited number of seats.
2. CCI noted that there were 3.5 million O&D passengers (primarily price sensitive) per year and that Jet had only 20% share while Etihad had 5%. For each of the 9 O&D pairs, CCI noted that the presence of Air India as a credible competitor ensured that there were no competition concerns. The combined market share of the Parties for all 9 O&D pairs was only 36% which revealed considerable competition. Additionally, since for all 9 O&D pairs, passengers were predominantly price sensitive, increase in price would not be beneficial to the Parties.
3. CCI observed that since it was possible that the Parties and Air India would increase services between certain of the 9 O&D pairs and it was also possible that other airlines might show interest in the routes, any potential apprehension regarding reduced competition would stand mitigated.

Network effects

1. CCI noted that there were 38 routes to/from India to other destinations where Etihad and Jet flew and there was at least one competitor on each of these routes. On only 7 routes the combined market share was greater than 50% and out of these 7 routes, on 3 routes either Jet or Etihad individually had a market share of less than 5 per cent. For instance, on the Bombay – Brussels route, Jet had a market share of 72.90% and Etihad had a market share of 3.30%. Therefore, CCI concluded that the effect of Proposed Combination was marginal on the market and it did not affect competition in the market.
2. 6 out of the 7 routes mentioned above, where Jet-Etihad had an indirect overlap and the market share was greater than 50%, consisted of Brussels and 6 Indian cities as O&D pairs. On the basis of an analysis as was considered for UAE, CCI noted that when substitutability was considered, the combined market share of Jet-Etihad came down to 30%. For the last route where the market share was greater than 50%, there was at least one credible alternative and consequently, there was a carrier apart from Jet-Etihad to choose from.

CCI observed that the competition assessment is generally carried out beyond gateway traffic and is not restricted to O&D pairs when considering network effects. CCI noted that the airline systems are formed either through alliances or strategic equity partnerships. In the present case, a linked hub-and-spoke airline network forming an integrated system of complementary markets was envisaged under the Transaction Documents. It was seen that the complementary routes of Jet and Etihad only made the network effects more efficient. CCI noted the commercial benefits of Jet and Etihad combining resources and also observed that merely having high market share in an O&D pair did not mean absence of competition.

Abu Dhabi as the exclusive hub

1. As per the CCA, Jet was to use Abu Dhabi as the exclusive hub for services to and from Africa, North and South America and UAE and there would be certain O&D pairs for which Jet could not code share with other airlines. CCI noted that cancellation of existing code share agreements with Jet's existing partners would not lead to dominance of the Parties as there was strong competition from various airlines.
2. Based on the Proposed Combination, CCI noted that Jet was able to access the wide network of Etihad and passengers would have seamless connectivity to more than 80 cities.
3. Further, Abu Dhabi's proximity to India would enable the option of deploying smaller, narrow body aircraft from the secondary markets in which larger wide body aircraft would have been unviable. Additionally, by utilizing the hub in Abu Dhabi and the transfer of flows that it would create, Jet would be able to sustain larger aircraft on the routes from Delhi and Mumbai to North America which would increase the capacity and increase the choice available to the Indian consumer.

Potential efficiencies

CCI concluded that:

1. airline alliances lead to creation of new and improved services through expanded networks or seamless service (from demand side) and increase in the ability to produce the same services at lower cost taking advantage of traffic densities with improved utilization of capacity and lower transaction costs (from supply side).

2. the Proposed Combination would result in lower airfare for passengers travelling to smaller cities in India through one of the 9 major destinations served by Etihad.
3. post Proposed Combination, Jet and Etihad would coordinate pricing, fares and inventory/yield management and this could eliminate inefficiencies in pricing.
4. passengers from smaller cities would have greater access to international destinations without interlining to Delhi or Mumbai and thus save on air fares.
5. one of the most fundamental benefits was from economies of traffic density. CCI noted that it was industry practice for airline alliances to extend hub and spoke networks with large presence at both ends of the market and that this infrastructure would increase the traffic density on O&D pairs, facilitate operational efficiency and also help cater to a larger number of passengers.
6. airline alliances had an increased incentive to integrate their operations and provide a greater array of services and also qualitatively improve the standard of air travel for passengers. CCI noted that these additional benefits would flow to airlines and passengers without anti-competitive results.
7. lastly, CCI considered the importance of the proposed equity infusion and its implication for the Indian aviation sector as Jet had been beleaguered with debt in the past. The Proposed Combination was seen to be a partnership between Jet and Etihad which would allow Jet to continue to compete effectively in the relevant market in India and internationally.

Conclusion

1. CCI noted that as per the BASA, the number of seats per week was to be increased to 37,130 from IATA winter 2014 schedule. Jet and Etihad were estimated to have a 22% share of this potential market and CCI concluded that this market position did not reveal the possibility of any abuse.
2. CCI also observed that since most European airlines were not fettered by limited capacity as they flew under an open sky policy, it was possible for such airlines to bolster their services to and from India. In this regard, CCI noted that while the responses of competing airlines to the Proposed Combination could not be evaluated *ex-ante*, the response would undoubtedly be beneficial to airline passengers.

Based on the analysis above, CCI concluded that the Proposed Combination was not likely to have an AAEC and consequently approved the Proposed Combination. In contrast, the Dissenting Opinion has concluded that it was not possible to independently verify the details submitted by the Parties and consequently, the impact of the Proposed Combination could not be satisfactorily examined. Further, the negative impact of Jet exiting its code share agreements on competition could not be discounted. The Dissenting Opinion also notes that the O&D pairs examined might not justify complete substitutability and consequentially the conclusion of the Majority Ruling that there would be no impact on competition might not be accurate. In view of the same, the Dissenting Opinion concludes that possibility of AAEC cannot be ruled out.

OUR ANALYSIS

In this case, CCI was examining a merger or arrangement in the context of airlines for the first time. Although CCI did not quote any international pronouncements in the Ruling, the approach of CCI was similar to the approach followed by the European Commission in making a competition assessment in the context of mergers and operational arrangements between airlines in Europe. For instance, in the merger between British Airways and Iberia, the European Commission concluded that the merger would not affect competition and the merged entity would continue to face competition from other entities.⁶ In the case of merger between Northwest Airlines and Delta Airlines, the European Commission allowed the merger and noted that both airlines had benefit of complementarity in their resources.⁷ In the case of acquisition of Martinair by KLM⁸ the European Commission directed investigation and approved the same thereafter. Interestingly, in the case of the takeover of SN Brussels Airlines by Lufthansa⁹ after the European Commission highlighted apprehensions, Lufthansa made several commitments and concessions. After examining these concessions and commitments, the European Commission approved the acquisition subject to Lufthansa complying with the conditions.¹⁰

While the Majority Ruling was clearly satisfied with the material available to form an opinion for the purpose of section 31(1) of the Act, the Dissenting Opinion has reached the conclusion that an investigation ought to have been ordered under the Act. However, the rulings of the European Commission highlighted above reveals that if a party is granted an opportunity, apprehensions of the regulator can be allayed. As the Majority Ruling itself has noted, some information for purpose of competition assessment will be available only after the Proposed Combination comes into effect.

The approach of CCI provides clarity regarding the steps to be followed to analyse whether a combination is likely to cause AAEC and this analysis would help companies identify whether a proposed transaction would be permissible or not under the Act. The reasoning and conclusions of the Majority Ruling were grounded in uncontroverted facts and this is an extremely important aspect as it clearly places the onus on parties to substantiate their claims before CCI.

This pragmatic and balanced approach augurs well for companies that intend to enter into combinations either at the vertical or horizontal level and whether at the domestic or international level.

It is important to note that the issue of foreign investment in India is regulated primarily by the regulations under the foreign exchange laws ("FEMA"). As a listed company, Jet is also required to comply with various regulations issued by SEBI apart from compliance with requirements under the Companies Act, 1956 ("Companies Act") and possibly the Income Tax Act, 1961 ("IT Act"). The Ruling of CCI only approves the Proposed Combination from the perspective of competition in the market. Although the issue relating to conflicting jurisdictions by different regulators has not been addressed by the Supreme Court of India, the approval of one regulator is not binding and not an indication of compliance for the purpose of another regulator.

SUBSEQUENT EVENTS

After the Majority Ruling, the Parties filed for rectification of the Ruling as regards CCI's observations pertaining to Etihad's 'joint control' over Jet made therein.¹¹ The Parties stated that after the Proposed Combination, the board of directors of Jet would comprise of 12 directors of which 6 would be nominated by shareholders and other 6 would be

independent. Of the 6 shareholder nominees, Etihad would be able to nominate only 2 while Jet would nominate 4, including the chairman who would have a casting vote. Hence, the observations with respect to Etihad controlling Jet required rectification. This request was rejected by CCI on the ground that there was no mistake or factual error in the Majority Ruling. CCI held that while mistakes apparent on the record could be rectified, observations and decisions could not be challenged under section 38 of the Act.

From the perspective of the Act, an analysis of the issue of control (controlling the affairs or management of one enterprise by another enterprise jointly or singly) might be academic since the Parties had approached CCI under section 6(2) of the Act disclosing the Proposed Combination as a combination for the Act. However, the principle of control is extremely relevant and significant for compliance under FEMA, Companies Act and IT Act for disclosure and treatment of related party transactions.

Since CCI has refused to rectify the Ruling, the only option available to the Parties would be to file an appeal before the Competition Appellate Tribunal.

– Tanya Pahwa, M.S. Ananth, Shinoj Koshy & Pratibha Jain

You can direct your queries or comments to the authors

¹ Combination Registration No. C-2013/05/122 dated November 12, 2013.

² Section 6 (2) Subject to the provisions contained in sub-section (1), any person or enterprise, who or which proposes to enter into a combination, 13 [shall] give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the Proposed Combination, within 14 [thirty days] of—

(a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section 5, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;

(b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.

³ A governance code that had been agreed to be adopted pursuant to the Shareholders Agreement between the Parties. Further, the CCI approval for the execution of each of the Transaction Documents was a condition precedent to the Investment Agreement agreed upon between the Parties.

⁴ The CCI observed that the O&D approach had been applied by the European Commission as well as by many other competition authorities.

⁵ Since the relevant market should be defined on a non-directional basis, a Delhi (DEL) Chicago (ORD), Chicago-Delhi will be one of the relevant market O&D pair DEL-ORD.

⁶ European Commission - IP/10/938 14/07/2010, available at http://europa.eu/rapid/press-release_IP-10-938_en.htm.

⁷ European Commission - IP/08/1245 06/08/2008, available at http://europa.eu/rapid/press-release_IP-08-1245_en.htm. The European Commission noted similar commercial principles in the case of merger between United Airlines and Continental Airlines, European Commission - IP/10/1010 27/07/2010, available at http://europa.eu/rapid/press-release_IP-10-1010_en.htm.

⁸ European Commission - IP/08/1995 17/12/2008, available at http://europa.eu/rapid/press-release_IP-08-1995_en.htm,

⁹ European Commission - IP/09/129 26/01/2009, available at http://europa.eu/rapid/press-release_IP-09-129_en.htm.

¹⁰ Case No COMP/M.5335- LUFTHANSA/ SN AIRHOLDING, available at http://ec.europa.eu/competition/mergers/cases/decisions/M5335_20090622_20600_229007_EN.pdf.

¹¹ Combination Registration No. C – 2013/05/122 dated November 26, 2013. It was submitted that the Majority Ruling erroneously notes that Etihad had joint control over Jet when out of a board size of 12, Jet would be entitled to nominate 4 members and Etihad would be entitled to nominate only 2 members. The total control of the board would vest with Jet including the right to nominate individuals as independent directors. Further, the Chairman of the board would also be a Jet nominee and would have the casting vote. Also, it was submitted that the investment by Etihad in Jet is purely a strategic investment; hence acquisition of 24% of Jet's shares by Etihad was a non-controlling equity investment.

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