EN

Case No COMP/M.5841 - CATHAY PACIFIC AIRWAYS / AIR CHINA / ACC

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REGULATION (EC) No 139/2004
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
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PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties:

Dear Sir/Madam,

Subject: Case No COMP/M.5841 - Cathay Pacific Airways / Air China / ACC Notification of 10/05/2010 pursuant to Article 4 of Council Regulation No 139/2004[1]

1. On 10/05/2010, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 (the "Merger Regulation") by which the undertakings Cathay Pacific Airways Limited ("Cathay Pacific", Hong Kong) and Air China Limited ("Air China", China) acquire within the meaning of Article 3(1)(b) of the Merger Regulation joint control of Air China Cargo Co. Limited ("ACC", China), by way of purchase of shares.

I. THE PARTIES AND THE OPERATION

2. Cathay Pacific (IATA airline designator "CX") is an international airline based in Hong Kong and active in air transport of passenger and cargo services.

3. Air China (IATA airline designator "CA") is an international and domestic airline based in Beijing. Air China also controls Shenzhen Airlines, holding 51% of its shares, and thus indirectly controls Shenzen Airlines' subsidiary Jade Cargo International ("JI"), an international air cargo operator[2].

4. Air China Cargo ("ACC") is currently a 100% subsidiary of Air China offering air cargo services.

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1 OJ L 24, 29.1.2004, p. 1 ("the Merger Regulation"). With effect from 1 December 2009, the Treaty on the Functioning of the European Union ("TFEU") has introduced certain changes, such as the replacement of "Community" by "Union" and "common market" by "internal market". The terminology of the TFEU will be used throughout this decision.

2 Air China has a non controlling stakeholding in Cathay Pacific.

5. Through a capital increase, CX will acquire 49% of the economic interest and voting rights in ACC. Indeed, while CA will be the majority shareholder with 51% of the shares, CX will hold veto rights on […]. Thus, after the transaction, ACC will be jointly controlled by CX and CA.

6. Thus, the present transaction constitutes a change from sole control to joint control of ACC. The operation therefore constitutes a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

7. On 7 May 2010, the transaction was cleared by the Korean Fair Trade Commission. The transaction is still subject to review by the Chinese competition authorities.

II. EU DIMENSION

8. Cathay Pacific and Air China have a combined aggregate world-wide turnover of more than EUR 5 billion[3] [Cathay Pacific EUR 7 billion; Air China EUR 6.5 billion]. Each of these two undertakings concerned has a EU-wide turnover in excess of EUR 250 million […]. Neither Cathay Pacific nor Air China achieves more than two-thirds of its aggregate EU-wide turnover within one and the same Member State. The notified operation therefore has an EU dimension pursuant to Article 1(2) of the Merger regulation.

III. MARKET DEFINITIONS

9. The transaction concerns the market for air transport of cargo.

Substitutability between intercontinental cargo transport by air and by sea

10. In its previous cases the Commission considered that as concerns the substitutability of different means of transport for the purpose of transport of goods, sea transport is increasingly becoming an economically attractive option, however, many types of cargo still require transport by air rather than transport by sea due to their time-sensitive character[4]. The parties submit, in line with the Commission's precedents, that because all types of cargo are being transported some of which is both high value and relatively time sensitive or perishable, at this stage air transport of cargo is not substitutable with sea transport of cargo. Nevertheless, the precise product market definition can be left open for the purpose of this case as the present transaction does not give rise to competition concerns under any alternative market definition.

Distinction based on the nature of transported goods

11. In previous cases, the Commission left open the question whether the market for air cargo transport should be further sub-divided according to the nature of the cargo[5]. The Commission has nevertheless indicated that some types of goods, such as dangerous goods, may require special handling, meaning that they can be transported only on full-freighter aircraft[6]. The parties do not specialize on any specific submarket, and do not support such a market definition.

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3 Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Consolidated Jurisdictional Notice (OJ C95, 16.04.2008, p1).

4 COMP/M.5141 - KLM/ Martinair - §30.

5 COMP/M.5335 - Lufthansa/ SN Airholding - § 400; COMP/M.5141 - KLM/Martinair - § 42.

6 COMP/M.3280 - Air France/KLM - § 37.

12. A vast majority of the respondents to the market investigation in the present case considered that there is no grounds to distinguish the market according to the type of goods transported as most goods can be transported on any type of aircraft and there is no specialization of suppliers according this line. For example, a customer noted that, even for specific goods, "the buyers and the sellers of airfreight transportation services are essentially the same for different type of goods and therefore, they do not necessarily represent a separate market". Nevertheless, the precise product market definition can be left open for the purpose of this case as the present transaction does not give rise to competition concerns under any alternative market definition.

Continent-to-country approach

13. With respect to air cargo transport markets, the Commission has adopted a continent-to-continent approach for intercontinental transport of cargo. This is due to the fact that as concerns air transport of cargo the relevant catchment area broadly corresponds to continents, except for areas deprived of sufficient infrastructures. As a result, regarding air cargo transport to Asia, the Commission analyzed this market on a continent-to-country basis due to complicated customs facilities, insufficient infrastructures and restricted air feed capacity[7]. The parties share this approach.

14. Concerning Hong-Kong in particular, […] it executes its own air services agreements and has its own border, immigration, customs and other regulations. The Commission has already considered in previous decisions the route Europe-to-Hong Kong when using a continent-to-country approach[8]. Besides, most of the customers responding to the market investigation agreed with the continent-to-country approach for assessing air cargo transport to Asia. For instance, one of them explained that "customers still consider Hong Kong as a separate destination due to the different customs formalities and own laws". However, on the other hand, the majority of competitors consider that Hong-Kong is part of a broader Chinese market, or of the Pearl River Delta Region (hereafter "PRD"), which also incorporates Chinese airports such as Guangzhou or Shenzhen. This would stem from the fact that a large part of goods shipped from Hong Kong are first trucked from mainland China to Hong Kong. Nevertheless it can be left open for the purpose of the present case whether Hong Kong has to be considered as a separate country, as a part of China, or as a part of regional area within China (namely PRD), as the present transaction does not give rise to competition concerns under any alternative market definition.

Substitutability between direct and indirect flights as concerns air transport of cargo

15. According to previous Commission decisions, cargo is by definition less time-sensitive than passenger transport and thus may be routed with a higher number of stopovers, as a result of which any indirect route is generally substitutable to any direct routes[9]. The vast majority of the respondents to the market investigation agreed upon this approach. Nevertheless, the precise product market definition can be left open as the present transaction does not give rise to competition concerns under any alternative market definition.

Unidirectional nature of the air transport of cargo

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7 COMP/M.5141 - KLM/ Martinair - §37 – 39; COMP/M.5440- LUFTHANSA/ AUSTRIAN AIRLINES, § 30.

8 COMP/M.1855 - Singapore Airlines/Virgin Atlantic – §21, COMP/M.5141- KLM/ Martinair - §94.

9 COMP/M.3280 - Air France/KLM; COMP/M.3770 - Lufthansa/Swiss, COMP/M.5181 Delta Airlines / Northwest Airlines, COMP/M.5141 - KLM/Martinair.

16. Finally, the parties, in line with the Commission's practice[4], submit that air freight is by nature unidirectional given that the demand for air cargo transport can differ substantially between the ends of a route, and that capacity and prices are largely different on each leg of the route. The vast majority of the respondents to the market investigation share this view. Consequently, the air cargo transport market for the purpose of this decision will be assessed on a unidirectional basis.

IV. COMPETITIVE ASSESSMENT

Horizontal effects

17. With regard to horizontal effects, the only horizontal overlap as concerns direct routes occurs from Europe to PRD, where CA is active via its subsidiary JI[10]. Indeed, this region includes Hong-Kong as well as important Chinese cities (notably Guangzhou and Shenzhen). However, as specified in the table below the overlap is not very significant and JI has a limited fleet of only […] aircraft.

18. The following table indicates the market shares of the parties and of their main competitors on the direct/direct overlap routes, in case a continent-to-region market definition is adopted. It shows that the market shares are limited, while overall the level of concentration of the market is limited, with a substantial number of credible competitors.

Table 1

		Parties				Main competitors		
Overlap	Markets	CA[11]	JI	CX	Combined	CV	AF/KL	LH
Direct / Direct	Europe to Pearl River Delta	[0-5]%	[0-5]%	[20-30]%	[20-30]%	[5-10]%	[5-10]%	[5-10]%
	Pearl River Delta to Europe	[0-5]%	[0-5]%	[10-20]%	[10-20]%	[5-10]%	[5-10]%	[5-10]%

Sources: Form CO (market shares in tons), and market investigation
AF/KL: Air France KLM, LH: Lufthansa, CV: Cargolux

19. As shown in Table 1, the parties will continue to face strong competition on this route from other airlines in particular Cargolux, Air France/KLM, and Lufthansa. [12]

20. Furthermore, should a continent-to-country market definition be adopted, the present transaction would not give rise to horizontal overlaps (ie. to China and to Hong-Kong). Indeed, CA is flying from Europe to Hong Kong via mainland China (and vice versa) and its core activities consist in the operation of domestic flights. On the contrary, CX is precluded from providing direct air cargo transport services from mainland China to Europe (and vice versa) and between mainland China cities[13]. Thus, CX always flies from Hong Kong to Europe and vice versa. However, CX is active on an indirect basis (via Hong-Kong) on the Europe to mainland China routes, but with a marginal market share only. The following table indicates the market shares of the parties and of their main competitors on the direct/indirect overlap routes:

Table 2

10 There is no overlap in the Yangtze River Delta as CX does not operate flights on this route.

11 CA's market share include ACC

12 Other competitors are UPS, China Southern, Finnair etc.

13 According to the relevant Air services agreement, CX is precluded from providing air cargo transportation services from mainland China to Europe and vice versa.

Overlap	Markets	Parties: CA[11]	JI	CX	Combined	Main competitors: CV	AF/KL	LH
Direct / Indirect	Europe to mainland China	[20-30]%	[0-5]%	[0-5]%	[20-30]%	[5-10]%	[20-30]%	[10-20]%
	Mainland China to Europe	[10-20]%	[0-5]%	[0-5]%	[20-30]%	[5-10]%	[20-30]%	[10-20]%

Sources: Form CO (market shares in tons), and market investigation
AF/KL: Air France KLM, LH: Lufthansa, CV: Cargolux

21. As shown in Table 2, strong competitors such as Air France/KLM, Cargolux and Lufthansa are active on these routes.

22. Moreover, according to the parties, competition in air cargo transport between Europe and China/Hong Kong is and will remain intense. Strong competitors, such as AF/KLM in particular, are present on the market and will continue to exert competitive pressure on the parties post-transaction. In addition, the parties note that market shares of Chinese domestic airlines have been decreasing from 44% in 2000 to less than 20% in 2008. Furthermore, the market investigation has shown that this market is not characterized by important regulatory barriers. Indeed, new companies such as the newly created joint ventures Great Wall airlines, Shangai Airlines Cargo International and Grandstar Cargo International have entered this market recently.

23. The market investigation confirmed that the current level of competition on the relevant markets is high, and that the transaction would not bring significant changes to the competitive landscape. Competition on the markets to/from China and Pearl River Delta is fierce, as these are currently the fastest growing air cargo markets with new players emerging. For example, one competitor noted that he does not believe that "*Cathay Pacific and Air China will have the ability to increase prices for air cargo services. The air cargo market is fiercely competitive, and any attempt by a market player to raise prices or impose unfair conditions would result in customers switching to one of several other air cargo carriers either currently serving that route or to other carriers that can enter and provide service on that route*". Another competitor explained that "*due to massive capacities within the market ex Europe to China and due to short distances between the major European airport hubs (e.g. CDG, FRA, MIL, LUX) customers always have the possibility to purchase air cargo services from other airlines. All major European airlines (KLM / Air France / Cargolux / British Airways / Martinair) offer capacities to China. Big Price increases from the merger are not to be expected in the near future due to the fact that there are plenty of alternatives in the European air freight market*"[14].

24. The vast majority of the customers considered as well that the transaction will not have a significant impact on the market, and that should the new entity increase prices, they could easily switch to alternative suppliers. For example one of them argues that the parties "*will become stronger but there are still many other airlines on the same routes*". Another customer confirmed that he would still have choice from other airlines because "*There are many other airlines offering the service on the same routes*. Finally, a large freight forwarding company noted that the parties together would be stronger, but that "*market still offers plenty of alternatives. CX CA can raise their rates but still have to be competitive in the market place i.e. they cannot dominate pricing*", further stating that the newly created entity would remain "*subject to market conditions. Even combined they cannot dominate*

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[14] Some competitors, however, expressed some concerns about the transaction, but these appeared mostly related, on one hand, to the strong position of the parties on the domestic Chinese market (including China to Hong Kong); and on the other hand, to the limitations imposed by Chinese government regulations on air cargo.

market". For these reasons, it is clear that should the new entity increase prices, competitors would exert competitive pressure and provide additional capacity on the market.

25. Furthermore, CA and CX have a different network type: while the cargo business of CA is centred on the Yangtze River Delta, with a large Chinese domestic coverage, CX's network is focused on the Pearl River Delta and offers significantly less air cargo option to mainland China. Moreover, the market investigation gave no indication that CA and CX are each other's closest competitor.

26. In addition, China has been the market with the fastest growth in terms of international air cargo for the last ten years, with a compound annual growth rate of 18% between 2001 and 2008. Consequently, many non Chinese carriers extended their operations to/from China, as a result of which the market share of Chine airlines in the country's international air cargo market decreased from 44% in 2000 to less than 20% in 2008. As a result, the capacity on this market globally increased significantly, which led to decreased load factors for the operators (for example ACC load factor has been decreasing from [70-80]% in 2007 to an estimated [60-70]% in 2010 on the European routes). In line with the results of ACC, the market investigation indicated that the market seems to be in a global overcapacity situation for the Europe to China route, while the situation appeared balanced for the China to Europe route.

27. Nevertheless, some competitors expressed concerns about the transaction. According to them, the proposed transaction would create a very strong player on the routes between Europe and mainland China, and between Europe and PRD. On these two routes, though, the combined market shares of the parties are below 30%, and the increment brought by the transaction is limited (less than 5%). Some competitors also indicated that the transaction would create a very strong player in Hong Kong. However, CA is not active in Hong Kong and therefore, the transaction will not have any specific effects on the market shares of the Parties in Hong Kong.

28. In conclusion, in the light of the above, the transaction will not give rise to competition concerns in any of the markets for air cargo transport services between Europe and mainland China, between Europe and Hong-Kong, and between Europe and PRD.

29. On the basis of this information, the Commission finds that with regard to non coordinated effects, the notified concentration does not raise serious doubts as to its compatibility with the internal market.

Coordination of the mother companies

30. CA and CX are both active in (i) passenger air transport services, (ii) maintenance and servicing activities and (iii) air cargo transport. However, it is unlikely that the transaction will lead to coordination of the parent companies. First, the activities of the parent companies in passenger services are complementary from a geographical point of view and their activities in maintenance are marginal. Furthermore, the turnover of the proposed joint venture is marginal compared to the global turnover of CA and CX (according to the business plan, the projected turnover of ACC in 2011 represents around [10-20]% of both CA and CX 2009 turnover). Finally, the market investigation did not indicate any increased risk of coordination of the parent company linked to the creation of the proposed joint-venture.

V. CONCLUSION

31. For the above reasons, the European Commission has decided not to oppose the notified operation and to declare it compatible with the internal market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of the Merger Regulation.

For the European Commission,

(signed)

Joaquín ALMUNIA
Vice-President of the European Commission