Business Consolidation by Japan Airlines Co. Ltd. and Japan Airsystem Co. Ltd. Through establishment of a holding company – a summary

March 15, 2002
Fair Trade Commission

The Fair Trade Commission (FTC), received a request for prior consultation from Japan Airlines Co. Ltd. (hereinafter referred to as "JAL") and Japan Airsystem Co. Ltd. (hereinafter referred to as "JAS") for prior consultation regarding the proposed consolidation of their business operations through a newly-created holding company. The FTC has been examining the issue of whether or not the proposed consolidation would substantially restrain competition within certain specified areas of trade.

Based on the explanations so far offered by the parties to the proposed scheme, it is feared that if implemented such a business consolidation may result in a substantial restraint of competition within the area of domestic air passenger transport business, etc., for the following reasons:

1） The number of major airlines (i.e., JAL, JAS and ANA) will be reduced from three to two, as a result of which the fare-setting actions by major airlines that have already been conducted in a "concerted" manner in the past will be further facilitated.

2） As the number of airlines operating on an air route decreases, the proportion of routes where Specified Flights Discount Fare is offered for all flights becomes smaller and the rates of such discounts become lower; hence competition will be seriously affected by a reduction in the number of major airlines.

3） In addition to the above mentioned circumstances, it is difficult for newcomers to enter the market due to factors such as limitations on the number of slots at congested airports etc. For this reason, the entry of new players is unlikely to act as a deterrent to concerted fare-setting actions.

4） As a result of the foregoing, general consumers who have no bargaining power over the fares set by airlines are likely to suffer greater disadvantage than others.

Accordingly, the FTC conveyed its concerns to the two airlines today.

1. Concerted fare-setting actions

As a result of the number of major airlines reducing from three to two, their fare-setting actions, that have already been conducted in a concerted manner in the past, will be further facilitated.

Generally speaking, where room for increasing supply or admitting new entrants is limited, there will be a greater risk of price competition being averted between competitors if the number of competing carriers is reduced from three to two. More specifically, when there are only two competing carriers, each of them will have to deal with just one competitor and will likely try to avoid a price war detrimental to both.

In the past the major domestic air transport companies (hereinafter referred to as "airlines") resorted to concerted fare-setting actions such as raising their Ordinary Fares (a benchmark for all air fares) to the same level, or setting discounted fares simultaneously, at similar prices with almost the same terms and conditions as their competitors. Reducing the number of major airlines through consolidation will make it even easier for the carriers to resort to such concerted fare-setting actions.

In particular, at Haneda and Itami Airports which account for 70% of all passengers traveling by air, airlines are not permitted to increase the frequency of flights at their discretion due to limitations of slot availability. This makes it difficult for them to expand their business through competitive price-setting, prompting them instead to intensify their concerted fare-setting actions as mentioned above.

In addition, the parties to the proposed consolidation maintain that they have no alternative but to follow the fares set by All Nippon Airways (hereinafter referred to as "ANA") who has the power to control prices. However, the fact that the two new airlines (referred to below who are much smaller in size than the parties to the proposed consolidation, are actually setting competitive prices, albeit on certain specific air routes only, indicates that there is no reason why the parties are unable to engage in competitive fare-setting actions.

2. Impact on competition of a reduced number of major airlines

A smaller number of major airlines is likely to seriously affect competition, in view of the fact that, as the number of carriers serving any particular air route decreases, the chance of Specified Flights Discount Fare being offered for all flights decreases and the rate of such a discount is lowered.

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A comparison between the number of carriers serving each air route and the state of use of Specified Flights Discount Fare demonstrates that the fewer the number of carriers,

the smaller the chance of such a Discount Fare being proposed on all flights.
Furthermore, a comparison between the number of carriers serving a particular route and the average rate of reduction under such Specified Flights Discount Fares indicates that, basically, the average rate of discount decreases as the number of carriers operating on the route decreases.

3. The limited pressure of competition from newcomers

Competitive pressure from newcomers is limited because new entry is difficult in the area of domestic air passenger transport business owing to such factors as the limited number of slots permitted at congested airports, etc. For this reason the entry of newcomers can hardly be expected to act as a deterrent to concerted fare-setting actions on the part of major airlines.

In principle, foreign airlines are legally barred from entering the domestic air passenger transport business.
Also, due to such factors as the existing limitations on the availability of airport facilities and aircraft maintenance capabilities as well as the number of slots at congested airports, it is difficult for newcomers to enter the domestic air passenger transport business. Under these circumstances, the ability of the two new airlines to engage in an expansion of their business is extremely limited, and their impact on air routes other than certain specific routes is minimal. It has to be concluded, therefore, that new entries can hardly be expected to accelerate competition.

4. The great disadvantage that the proposed consolidation would cause to general consumers

General consumers, who have no option but to accept air fares set by airlines due to lack of bargaining power, would suffer greater disadvantages if concerted fare-setting actions by airlines were further facilitated.

While the prices of air travel quoted to travel agencies vary from agency to agency depending on their bargaining power, the air fares intended for general consumers, who are given no room for price negotiations, are applied uniformly, leaving no option for consumers but to accept the fares set by airlines. For this reason general consumers would suffer greater disadvantages if airlines are able to engage in concerted fare-setting actions even more easily than before.

Business Consolidation by Japan Airlines Co. Ltd. and Japan Airsystem Co. Ltd. Through establishment of a holding company

Item 1: The outline of the proposed consolidation plan

With the aim of building a business structure capable of coping with the challenge of global competition, Japan Airlines Co. Ltd. (hereinafter referred to as “JAL”) and Japan Airsystem Co. Ltd. (hereinafter referred to as “JAS”) are now contemplating the creation of a holding company to become the parent of the two airlines in October, 2002. Furthermore, JAL and JAS are also planning to consolidate their businesses in the year 2004 by re-organizing the two companies into separate entities carrying out different lines of business.

Item 2: Examination from the viewpoint of Anti-Monopoly Act

1. Particular fields of trade

In this particular case, our examination focused on the domestic air passenger transport business area (hereinafter referred to as “domestic air transport business area”), the business area of transporting air passengers leaving from or arriving at Haneda Airport (hereinafter referred to as “Haneda-based air transport business area”), the business area of transporting air passengers leaving from or arriving at Itami Airport (hereinafter referred to as “Itami-based air transport business area”) and the area of specific domestic air routes (i.e. the routes operated by JAL and JAS concurrently).

Our examination did not focus on the areas of international air passenger transport business or of international air cargo transport business and domestic air cargo transport business, since more than one powerful competing air carrier in international transport businesses exists and domestic air cargo business is conducted in conjunction with air passenger transport business.

Note: By virtue of the revised Civil Aeronautics Law in effect since February, 2000, the system of route-by-route licensing based on supply/demand adjustments was abolished and replaced by a business-by-business permission system. As a result of this amendment the carrier wishing to conduct air transport business is now able, once the business is permitted by the Minister of Land, Infrastructure and Transport, to open a new air route at its discretion subject to a filing made to that effect. However, a separate permit must be obtained from the said Minister for use of congested airports like Haneda and Itami or for changing existing air routes departing from and arriving at these airports. Haneda and Itami Airports are hereinafter referred to as “congested airports”.

2. Expected effects on each area of trade

(1) Domestic air transport business area and Haneda & Itami- based air transport business area

The consolidation will push up the aggregate share of the two parties in each business area in terms of the number of passengers carried and the number of flights to a level which, if combined with the share of their main competitor All Nippon Airways (hereinafter referred to as "ANA"), would account for nearly all the business conducted in the respective business areas (see Annex 1).

Note: The shares of JAL, JAS and ANA include those of their subsidiaries; hereinafter the same.

(2) Specific domestic air routes

The proposed consolidation would result in monopoly or duopoly on nearly all the 32 air routes operated by the two airlines concurrently (see Annex 1)

Note: The total number of passengers carried on these 32 routes amounts to about 60% of total domestic air passengers. Also, approximately two-thirds of the said 32 routes are via congested airports.

3. Impact on competition examined

(1) Concerted fare-setting actions

a. How fares are actually set:

Concerted fare-setting actions, as described below, have already been practiced in the past by major airlines such as JAL, JAS and ANA (hereinafter referred to as the "Big Three"). Should the "Big Three" become the "Big Two" as a result of the consolidation, it will become easier for them to resort to such concerted fare-setting actions.

(a) The circumstances that facilitate such concerted fare-setting actions:

By virtue of the revised Civil Aeronautics Law in effect since February 2000, the previous system of approving airfares has been replaced by a file-and-use system, thereby enabling diverse discounted fares to be set.

However, the fares (including discounted fares) are publicized in advance and apply equally to all passengers; hence competing air carriers can easily ascertain the prices charged by their competitors and generally follow suit by setting similar fares.

(b) Ordinary Fares

The "Big Three" raised the level of the Ordinary Fares, a benchmark for all air fares, by approximately 15% for air travel taking place on all air routes from April, 2000. The new fares set by the “Big Three” are almost identical.

(c) Discounted Fares

Discounted Fares are set by the “Big Three” almost simultaneously, at almost the same price and with similar terms and conditions.

Also, according to the history of fare-setting by domestic air transport companies (hereinafter referred to as “airlines”) and the outcome of hearings given to the parties and travel agencies, concerted fare-setting actions are found to take place, for example, in such cases where JAL and JAS follow in the footsteps of ANA by filing a fare increase immediately after ANA’s filing, matching the amount of ANA’s increase.

(d) Concerted actions to match new airlines’ fares

The “Big Three” are setting fares in concert in order to match the cheaper prices offered by the two new airlines.

Specifically, prior to the entry of the two new airlines (see Note) in 1998, the “Big Three” offered Specified Flights Discount Fares only for certain early morning and night flights on Haneda-Sapporo and Haneda-Fukuoka Routes. However, when the new airlines inaugurated their services, the “Big Three” applied Specified Flights Discounts Fares mainly to those flights with similar departure times of the new airlines’ services, with fares at almost the same level as the new airlines’ Ordinary Fares. Furthermore, when the new airlines doubled the number of their flights in July, 2000, the “Big Three” reacted by offering Specified Flights Discount Fares for all their flights at the same fare as the new airlines’ Ordinary Fares, etc.

Note: Hokkaido International Airline Co. (ADO) and Skymark Airlines Co. LTD. (SKY)

b. Limitations on fare-setting actions at congested airports

As the demand for departures and arrivals at congested airports (see Note) surpasses the feasible number of takeoffs/landings of aircraft, the competent authorities are allocating a quota for the maximum permissible number of slots (the number of takeoffs/landings allowed) available to each airline (such allocated quotas are not to be reviewed until 2005). This means that airlines may decide on their route and the frequency of flights only within the framework of the allocated quota of slots, making it difficult for them to expand their business through competition. This is a factor that aggravates the airlines’ behavior of setting fares in concert.

Note: The number of passengers using Haneda and Itami Airports accounts for approximately 70% of all passengers in domestic air transport business.

c. What the parties maintain in regard to fare-setting actions:

In regard to the concerted fare-setting actions described above, the parties maintain that they have no alternative than to follow ANA in fare-setting since it is ANA who has the power to control prices.

Considering, however, the fact that the two new airlines, who are much smaller in size than JAL and JAS, are actually setting competitive prices, albeit only on certain specific air routes, there is no reason why it should be difficult for JAL and JAS to adopt competitive prices against ANA, contrary to what the parties maintain.

(2)The degree of impact on competition if the “Big Three” becomes the “Big Two”

Judging from the past pattern of Specified Flights Discount Fare-setting by the “Big Three” as described below, a reduction in the number of major carriers would cause considerable impact on competition.

a. The relationship between the reduction in the number of carriers serving a particular air route and the pattern of setting Specified Flights Discount Fares

The relationship between the number of carriers serving each air route and the pattern of setting Specified Flights Discount Fares indicates that the proportion in which Specified Flights Discount is applied to all flights becomes smaller as the number of carriers serving that particular route decreases. It also indicates that, while the proportion of routes for which no Specified Flights Discount is available is only about 10% on the routes flown by more than one carrier, the proportion rises to as much as about 50% on the routes monopolized by just one carrier (see Annex 2).

A similar analysis of such relationship based on the number of flights shows similar trends.

Furthermore, an analysis of the relationship between the number of carriers and the average rate of Specified Flights Discounts shows that the average rate of discounts is lowered as the number of carriers serving the route becomes smaller.

In view of the foregoing, a reduction in the number of major carriers from three to two is likely to cause a significant impact on competition.

b. Difficulty of entering other carriers’ routes

If the number of major carriers is reduced to two because of a consolidation, there will no longer be a chance for JAL to enter the routes operated by JAS and ANA or by JAS only, or for both JAL and JAS to enter the routes operated by ANA only. This will therefore decrease the chances for airlines to compete by means of entering other carriers’ routes.

Airlines will find it especially difficult to compete by means of entering other carriers' route in cases where the congested airports are involved because of limitations placed on the number of permitted slots.

(3) Limited competitive pressure from newcomers

It is difficult for newcomers to enter the domestic air transport business due to the reasons outlined in (a)-(d) below. For the same reasons there is limited room for the two new airlines to expand their business and their stimulating effect on competition is confined to specific routes only. As the competitive pressure from the newcomers is so limited, they are unlikely to act as a deterrent to concerted fare-setting actions on the part of major airlines.

a. Difficulty in entering domestic air transport business

The entry into domestic air transport business by newcomers is hampered by the limited availability of airport facilities such as boarding bridges and passenger check-in counters and of aircraft maintenance capabilities. Furthermore, the entry of foreign airlines into this area is, in principle, prohibited under Civil Aeronautics Law. Under such circumstances it will be difficult to expect new carriers to provide a stimulating effect on competition.

b. Difficulty in entering the routes that use congested airports

At congested airports where the available number of slots is already limited, a certain number of slots are being reserved for the potential entry of new carriers in the future. However, this number is considerably small. Hence, it is particularly difficult for newcomers to enter the routes that utilize congested airports.

c. The limited effects of new entries

Even if newcomers are admitted they would have to face the limited availability of airport facilities, the need to secure aircraft maintenance services and also, particularly at congested airports operation within the allocated number of slots. Although a certain number of slots are reserved for the potential entry of new carriers in the future, such a quota does not include allocations for the two new airlines. The two new airlines also face difficulties in constructing their own computer reservation system (CRS) and mileage service. For these reasons, although they are yielding positive effects on competition on the particular routes they have entered, they face difficulties in the further expansion of their business and the effects of their activities on other routes are still limited.

d. Overall business capabilities

By forming an extensive network including overseas routes, JAL and JAS will gain a competitive advantage over other air carriers including the two new airlines in providing services such as mileage service program, etc.

(4) The significant disadvantage that the proposed consolidation would cause to general consumers

General consumers, who have no freedom to negotiate prices and therefore no choice but to accept the fares set by airlines, are likely to suffer considerable disadvantages if the concerted fare-setting actions by major airlines are made easier as a result of the consolidation.

4. Impact on travel industry

In view of the fact that a large part of air transport services is arranged through the intermediary of travel agencies, the FTC conducted a survey by means of hearings and questionnaires in order to seek the views of the travel industry regarding the possible impact of the proposed consolidation on tourism.

The survey revealed that about a half of the travel agents surveyed feel that they will be affected by the consolidation in some way or other. Specifically, they expressed concerns such as : "The fares will remain on the high side"; "Cheap group discount fares may cease to be offered"; "Airlines will be put in a stronger position when negotiating quotas for group tours, possibly narrowing down their array of available products"; "Quotas for group tours may be reduced following a possible amalgamation of successive flights on trunk routes" (see Annex 3).

Item 3 : Conclusions

Judging from the explanations given so far by the parties in regard to the proposed consolidation and the outcome of the survey conducted by the FTC (hearings and questionnaires), the proposed consolidation, which reduces the "Big Three" to the "Big Two" and pushes up the shares of the parties substantially in the business areas defined in Item 2-1 above, is likely to give the parties a power to control the market or make it easier for them to resort to concerted fare-setting actions. This gives rise to the apprehension that they may put up a common front with their major competitor, ANA. Considering that newcomers will provide only limited competitive pressure and are unlikely to act as a deterrent to the concerted fare-setting behavior on the part of major airlines, the proposed consolidation is likely to result in a substantial restraints of competition and the FTC has taken steps to convey such areas of concern to the parties concerned.

ANNEX 1

1. The expected market shares of major airlines after the consolidation in the domestic air transport business area and Haneda/Itami – based air transport business area

1) Domestic air transport business area

	Share in terms of number of passengers	Share in terms of number of flights
Parties to consolidation	Approx.50%	Approx.50%
ANA	Approx.50%	Approx.40%

2) Haneda-based air transport business area

	Share in terms of number of passengers	Share in terms of number of flights	Share in terms of slots quota
Parties to consolidation	Approx.50%	Approx.50%	Approx.50%
ANA	Approx.45%	Approx.45%	Approx.45%

3) Itami-based air transport business area

	Share in terms of number of passengers	Share in terms of number of flights	Share in terms of slots quota
Parties to consolidation	Approx.50%	Approx.60%	Approx.50%
ANA	Approx.50%	Approx.40%	Approx.45%

2.The expected situation of various domestic air routes after the consolidation

	Number of routes	Number of routes where the combined share in terms of passengers carried exceeds 50%	Number of routes where the combined share in terms of number of flights exceeds 50%
Monopolized routes	6	6	6
Routes served by 2 airlines	24	13	17
Routes served by 3 airlines	2	2	2
Routes served by 3 airlines	32	21	25

Note : “Routes served by 3 airlines” mean those routes which used to be served by 4 airlines but will be flown by 3 airlines after the consolidation.

ANNEX 2

Table 1: Pattern of offering Specified Flights Discount Fare according to the number of carriers serving the routes (figures indicate the number of routes)

Number of carriers serving the route	Offered on all flights	Offered on certain flights only	Not yet offered	Total
Monopolized routes	86	7	85	178
Percentage	48.3	3.9	47.8	100.0
Routes served by 2 airlines	21	13	3	37
Percentage	56.8	35.1	8.1	100.0
Routes served by 3 or more airlines	19	4	3	26
Percentage	73.1	15.4	11.5	100.0

Table 2: Pattern of offering Specified Flights Discount Fare according to the number of carriers serving the routes (figures indicate the number of flights)

Number of carriers serving the route	Offered	Not yet offered	Total
Monopolized routes	355	301	656
Percentage	54.1	45.9	100.0
Routes served by 2 airlines	324	114	438
Percentage	74.0	26.0	100.0
Routes served by 3 or more airlines	566	92	658
Percentage	86.0	14.0	100.0

Table 3: Average rate of Specified Flight Discount according to the number of carriers serving the routes

Number of carriers serving the route	Average rate (in percentage) of reduction with Specified Flight Discount Fares
Monopolized routes	12.0
Routes served by 2 airlines	18.9
Routes served by 3 or more airlines	26.0
Routes served by 4 or more airlines	38.7

Note 1: These tables reflect the fare table prevailing in the normal season of January, 2002. The patterns change if the survey is conducted in other seasons.

Note 2: The indicated numbers of flights on the routes in question, the numbers of flights for which Specified Flight Discounts are offered and the rates of discount are those of JAL, ANA and JAS (including subsidiaries).

Note 3: The indicated numbers of carriers serving the routes are those of carriers actually operating the routes at present.