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## **Airline Consolidation: A Study of the American-US Airways Merger, Other Major Mergers from the Past Two Decades, and Their Effect on Consumers**

*“I’ve got stuff about airline mergers, which just shows that my stand-up is getting more insane by the minute.”<sup>1</sup>*

### I. INTRODUCTION

The airline industry is the top intercity transportation choice for United States consumers.<sup>2</sup> Since its inception, the airline industry experienced a variety of changes in its regulation.<sup>3</sup> The importance of government interference becomes paramount when various consolidation mechanisms over the years have resulted in a reduction in the total number of air travelers.<sup>4</sup> This Note will focus on mergers in the airline industry and how they may affect consumers.<sup>5</sup>

The merger between AMR, Corporation (American) and US Airways (USAir) attracted wide media attention as well as a multitude of Congressional hearings.<sup>6</sup> The board of directors for each airline approved the merger, so the last hurdle appeared to be a challenge from the Department of Justice (DOJ).<sup>7</sup> The DOJ contended that the two airlines merging would severely harm consumers.<sup>8</sup> In response, the two airlines put forward three main defenses: the merger is complementary, the merger has significant customer benefits, and the

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1. Chris Mincher, *Lewis Black*, A.V. CLUB (May 20, 2008), <http://www.avclub.com/article/lewis-black-14244>, archived at <http://perma.cc/B3UN-UK22>.

2. BUREAU OF TRANSP. STAT., U.S. DEP’T OF COM., NAT’L TRANSP. STAT., tbl.3-16 (2014), [http://www.rita.dot.gov/bts/sites/rita.dot.gov.bts/files/publications/national\\_transportation\\_statistics/html/table\\_03\\_16.html](http://www.rita.dot.gov/bts/sites/rita.dot.gov.bts/files/publications/national_transportation_statistics/html/table_03_16.html), archived at <http://perma.cc/635F-D6QX> (showing airline consumption at higher levels than railroad and intercity bus).

3. See *infra* Part II.B (detailing thirty years of airline deregulation).

4. See *infra* Part II.A & Part II.B (discussing purpose and reasoning behind government regulation).

5. See *infra* Part II.C (discussing consolidation of airline industry).

6. See *infra* Part II.A (detailing variety of news sources and Antitrust committee hearings).

7. See Elai Katz, *Latest Airline Merger Challenged in Court*, N.Y.L.J. (Sept. 19, 2013), <http://www.newyorklawjournal.com/id=1202619794105/Latest-Airline-Merger-Challenged-in-Court?slreturn=20150825160354>, archived at <http://perma.cc/T87B-LX78> (reporting DOJ challenge of proposed merger).

8. See Amended Complaint at 15-16, *United States v. US Airways Grp., Inc.*, 979 F. Supp. 2d 33 (D.D.C. Sept. 5, 2013) (No. 13 CV-01236) [hereinafter Amended Complaint] (alleging likelihood of higher fares, higher fees, and more limited service following merger).

merger enhances competition in the airline industry.<sup>9</sup> Subsequently, the DOJ announced a proposed settlement that would divest slots and gates at highly concentrated airports around the country to low cost carrier airlines (LCCs).<sup>10</sup> However, the DOJ did not address the airports where American and USAir would hold over sixty percent of the market share and instead primarily focused on the East Coast corridor between Washington, DC and Boston.<sup>11</sup> This Note will argue that the DOJ settlement with American-USAir did not go far enough to protect consumers in Boston, Charlotte, and Washington, DC.<sup>12</sup>

The airline industry underwent significant consolidation during the last decade.<sup>13</sup> The number of major airlines decreased from nine to five.<sup>14</sup> The American-USAir merger would further reduce that number from five to four.<sup>15</sup> The effect on consumers is largely unknown, but past mergers provide examples for discussion.<sup>16</sup>

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9. See Defendant US Airways Grp., Inc.'s Answer to Amended Complaint at 3-4, *United States v. US Airways Grp., Inc.*, 979 F. Supp. 2d 33 (D.D.C. Sept. 10, 2013) (No. 13 CV-01236) [hereinafter Answer to Amended Complaint] (detailing three defenses).

10. See Press Release, U.S. Dep't of Justice, Justice Dep't Requires US Airways and American Airlines to Divest Facilities at Seven Key Airports to Enhance System-wide Competition and Settle Merger Challenge (Nov. 12, 2013), <http://www.justice.gov/opa/pr/2013/November/13-at-1202.html>, archived at <http://perma.cc/YXE3-4GTT> [hereinafter DOJ November 2013 Press Release] (releasing official terms of merger regarding LCCs).

11. See *id.*; BUREAU OF TRANSP. STAT., U.S. DEP'T OF TRANSP., <http://www.transtats.bts.gov/carriers.asp?pn=1>, archived at <http://perma.cc/34JD-VF2H> (last visited June 1, 2015) [hereinafter AMERICAN 2013 SNAPSHOT] (showing American's top domestic hubs) (please select American from dropdown menu next to "Select a Carrier"); BUREAU OF TRANSP. STAT., U.S. DEP'T OF TRANSP., <http://www.transtats.bts.gov/carriers.asp?pn=1>, archived at <http://perma.cc/2LL6-36UX> (last visited June 1, 2015) [hereinafter USAIR 2013 SNAPSHOT] (showing USAir's top domestic hubs) (please select US Airways from dropdown menu next to "Select a Carrier").

12. See DOJ November 2013 Press Release, *supra* note 10; see also BUREAU OF TRANSP. STAT., U.S. DEP'T OF TRANSP., <http://www.transtats.bts.gov/airports.asp?pn=1>, archived at <http://perma.cc/5N6B-MEE3> (last visited June 1, 2015) [hereinafter BOSTON 2013 SNAPSHOT] (showing top domestic carriers in Boston) (please select Boston Logan from dropdown menu next to "Select an Airport"); BUREAU OF TRANSP. STAT., U.S. DEP'T OF TRANSP., <http://www.transtats.bts.gov/airports.asp?pn=1>, archived at <http://perma.cc/T2MY-AFVJ> (last visited June 1, 2015) [hereinafter CHARLOTTE 2013 SNAPSHOT] (stating market share for top carriers in Charlotte) (please select Charlotte from dropdown menu next to "Select an Airport"); BUREAU OF TRANSP. STAT., U.S. DEP'T OF TRANSP., <http://www.transtats.bts.gov/airports.asp?pn=1>, archived at <http://perma.cc/92RA-GCJZ> (last visited June 1, 2015) [hereinafter WASHINGTON RONALD REAGAN 2013 SNAPSHOT] (showing top carriers at Ronald Reagan Washington National) (please select Ronald Reagan Washington National from dropdown menu next to "Select an Airport").

13. See Amended Complaint, *supra* note 8, at 13 (summarizing consolidation of industry since 2005).

14. See *id.* (detailing decrease in major airlines).

15. See Chris Isidore, *US Airways-American Airlines to Merge*, CNNMONEY (Feb. 14, 2013), <http://money.cnn.com/2013/02/14/news/companies/us-airways-american-airlines-merger/>, archived at <http://perma.cc/8F57-E4L8> (showing effect of four "mega-airlines" on industry).

16. See, e.g., Scott Mayerowitz, *What the American-US Airways Merger Means for You*, HUFFINGTON POST (Nov. 12, 2013), [http://www.huffingtonpost.com/2013/11/12/american-us-airways-merger-travelers\\_n\\_4261562.html](http://www.huffingtonpost.com/2013/11/12/american-us-airways-merger-travelers_n_4261562.html), archived at <http://perma.cc/35JN-GJPY> (discussing potential for airfare increases and past history of mergers); Steven Pearlstein, *Why the Justice Dep't Blocked the American-US Airways Merger*, WASH. POST: WONKBLOG (Aug. 15, 2013), <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/08/15/why-the-justice-department-blocked-the-american-us-airways-merger/>, archived at <http://perma.cc/8XJF-SVCX> (drawing

Part II.A of this Note will discuss the traditional definition of competition.<sup>17</sup> Part II.B will then discuss airline deregulation and merger guidelines.<sup>18</sup> Part II.C will sample past mergers by examining their effects on consumers and the industry as a whole.<sup>19</sup> Part II.D will discuss LCCs and their interaction with megacarriers.<sup>20</sup> Next, Part III will analyze these concepts by focusing on the recent merger between American and USAir.<sup>21</sup> Finally, Part IV will conclude that the merger between American and USAir will ultimately hurt consumers.<sup>22</sup>

## II. HISTORY

### A. Competition Defined

Original theories of competition did not solidify until the 1950s, when Professor Joe S. Bain proposed the entry barrier analysis.<sup>23</sup> The doctrine examined the connection between entry barriers and how potential competition could coerce incumbents into decisions regarding “economies of scale, cost advantages, and product differentiation.”<sup>24</sup> Bain’s theory led economists to develop contestable market theory.<sup>25</sup> The theory views potential market entry as an affirmative control on prices, assuming the entry on the market is free and quick.<sup>26</sup> The theory also applies to airline markets where any increase in an incumbent’s price can be captured by an entrant instantaneously.<sup>27</sup> An incumbent’s response in the airline industry is usually very quick.<sup>28</sup> In a

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attention to customers potentially losing on Advantage Fare discounts from American); Brad Seitz, *The Myth and Reality of Airline Mergers and Higher Fares*, BUS. TRAVEL NEWS (Aug. 30, 2013), <http://www.business-travelnews.com/More-News/The-Myth-And-Reality-Of-Airline-Mergers-And-Higher-Fares/?ida=Airlines&a=proc>, archived at <http://perma.cc/4LUK-CDWG> (discussing study showing price increases in eighty-seven percent of markets following mergers); James B. Stewart, *For Airlines, It May Be One Merger Too Many*, N.Y. TIMES (Aug. 16, 2013), [http://www.nytimes.com/2013/08/17/business/for-airlines-it-may-be-one-merger-too-many.html?\\_r=0](http://www.nytimes.com/2013/08/17/business/for-airlines-it-may-be-one-merger-too-many.html?_r=0), archived at <http://perma.cc/H7DW-PBLN> (detailing effects on fares after United-Continental merger).

17. See *infra* Part II.A.

18. See *infra* Part II.B.

19. See *infra* Part II.C.

20. See *infra* Part II.D.

21. See *infra* Part III.A-B.

22. See *infra* Part IV.

23. See Darren Bush & Salvatore Massa, *Rethinking the Potential Competition Doctrine*, 2004 WIS. L. REV. 1035, 1038-39 (2004) (setting forth brief background on Bain’s thesis).

24. *Id.* at 1039 (explaining theory behind Bain’s doctrine).

25. See *id.* at 1040 (explaining development of contestable market theory).

26. See *id.* (explaining contestable market theory).

27. See Bush & Massa, *supra* note 23, at 1040-41 (defining hit-and-run entry); see also Eli A. Friedman, Comment, *Airline Antitrust: Getting Past the Oligopoly Problem*, 9 U. MIAMI BUS. L. REV. 121, 128 (2001) (suggesting barriers to entry too high in airline industry).

28. See Bush & Massa, *supra* note 23, at 1041 (suggesting quick response by incumbents). The DOJ typically demands an explanation when the incumbent airline adds a service or directly competes with a new entrant. See Friedman, *supra* note 27, at 129 (explaining rationale behind DOJ’s regulation of incumbent response to new entrant). In addition, the DOJ decides whether the price increase or decrease is rational given

concentrated industry, such as the airline sector, with a small number of competitors dominating the market share, the potential entrant's ability to set the price lower than a monopolist or oligopolistic rate is beneficial to consumers.<sup>29</sup>

### B. Airline Deregulation and Merger Guidelines

#### 1. Clayton Act in Merger Context

Congress passed the Clayton Act in 1914 as a supplement to the Sherman Act of 1890.<sup>30</sup> Section 7 of the Clayton Act is mainly directed to probe and prevent activities that may restrain trade, regardless of whether or not those activities actually do restrain trade.<sup>31</sup> Section 1 of the Sherman Act focuses on a plaintiff's assertion that consumers will be harmed due to a per se restraint of trade among competitors.<sup>32</sup> Price fixing or horizontal divisions of the market are considered per se violations of the Sherman Act.<sup>33</sup> Joint ventures also fall within Section 1 of the Sherman Act.<sup>34</sup> Section 2 addresses monopolization and attempted monopolization cases.<sup>35</sup> More specifically, Section 2 of the Sherman Act protects potential competitors from being victims of a monopolist's attempt to prevent it from entering the market.<sup>36</sup>

The Clayton Act and its subsequent amendments sought to remedy the area

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the circumstances. *See id.* The analysis focuses on whether the price differentiation benefits consumers, or whether the irrational increase in the short term can be recovered in the long term. *See id.* at 129-30. Price differentiation generally results in the DOJ upholding the price increase, while an increase results in the DOJ's interference. *See id.* at 130.

29. *See* Bush & Massa, *supra* note 23, at 1042-43 (discussing efficiencies new market entrants achieve).

30. *See* Ruwantissa Abeyratne, *Competition in Air Transport—The Need for a Shift in Focus*, 33 TRANSP. L.J. 29, 42-43 (2006) (explaining rationale behind instituting Clayton Act); *see also* Bush & Massa, *supra* note 23, at 1043 (listing relevant antitrust regulations).

31. *See* 15 U.S.C. § 18 (2012) (explaining acquisition of corporation stocks).

32. *See* Bush & Massa, *supra* note 23, at 1043 (offering chart summarizing each relevant regulation).

33. *See id.* at 1095 (stating potential per se violations). Uncommitted entrants are important actors in determining whether a Section 1 violation exists. *See id.* at 1043. An example may be two or more competitors, acting in concert, boycott new entrants or other competitors in the industry. *See id.* at 1045. Section 1 recognizes that when the group involves a buyer and seller, the group becomes "vertical in nature" and becomes "subject to the rule of reason." *Id.* Rule of reason focuses on whether the challenged acquisition fosters progressiveness, which is broadly defined as technological innovation as well as marketing and service innovation. *See id.* at 1043 n.30 (explaining antitrust rule as progressive).

34. *See id.* at 1097 (discussing Section 1 analysis of joint ventures). Rule of reason is reversed from per se cases when applied to joint ventures. *See id.* Defendants would argue that outside competitors are ready to oversee the prices, while plaintiffs would likely maintain that outside competitors are either non-existent or would not enter the market in proper time or fashion. *See id.* Joint venture analysis closely mirrors that of Section 7 of the Clayton Act discussed below. *See id.* (discussing close relation of joint venture analyses under Sherman and Clayton Acts).

35. *See id.* at 1103 (giving definition of monopolization and purpose behind Section 2).

36. *See* Bush & Massa, *supra* note 23, at 1103 (explaining monopolist deterrence of new competitors). Furthermore, the potential competitor may be part of a checks-and-balances effect on the asserted monopolist. *See id.* By having a check on the potential monopolist, the competitor can discipline the prices, increase innovation, or maintain appropriate output. *See id.*

where the Sherman Act fell short.<sup>37</sup> Specifically, Congress broadened the Clayton Act's coverage of "restructuring of markets caused by illegal mergers."<sup>38</sup> Viewed in context with the Sherman Act, a purpose of Section 7 of the Clayton Act is to prevent concentration and the tendency to monopolize to ensure that consumers' alternatives do not disappear through a merger.<sup>39</sup> Furthermore, Congress intended to protect competition against increasing concentration achieved through mergers.<sup>40</sup>

## 2. Various Courts' Interpretations of Potential Entrant

The Supreme Court of the United States provides little guidance on what characteristics and capabilities the potential market entrant needs to prevail on its claim.<sup>41</sup> One such guideline was issued in *United States v. Marine Bancorporation, Inc.*,<sup>42</sup> where the Supreme Court held that two preconditions must exist for a potential competitor to violate Section 7 of the Clayton Act.<sup>43</sup> First, "the acquiring firm must have other feasible means to enter the market, such as an acquisition of a smaller firm."<sup>44</sup> Second, other alternatives must "offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects."<sup>45</sup>

Two cases from lower courts offer conflicting views on what characteristics are necessary to become a potential competitor within Section 7 of the Clayton Act.<sup>46</sup> In one such case, *United States v. Phillips Petroleum Co.*,<sup>47</sup> the government opposed Phillips—an outside purchaser's—acquisition of the

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37. See Jonathan L. Disenhaus, Comment, *Competitor Standing To Challenge a Merger of Rivals: The Applicability of Strategic Behavior Analysis*, 75 CALIF. L. REV. 2057, 2069-70 (1987) (offering legislative history analysis of Clayton Act).

38. *Id.* at 2070 (stating congressional intent behind additional coverage). Congress broadened the scope of Section 7 to evaluate all merger transitions under the *substantially to lessen competition* standard employed by the Clayton Act, instead of using the standard language found in the Sherman Act: *in restraint of trade*. *Id.*

39. See *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 367 (1963) (describing area of competition overlap). Additionally, the Court noted the inquiry should not only take into account the immediate effect of the merger but also the prediction of competitive conditions in the future. See *id.* at 362.

40. See *United States v. Von's Grocery Co.*, 384 U.S. 270, 277 (1966) (discussing congressional intent); *Brown Shoe Co. v. United States*, 370 U.S. 294, 318 (1962) (emphasizing congressional mandate curbing concentration in industry at its incipiency).

41. See Bush & Massa, *supra* note 23, at 1058 (suggesting little guidance from Supreme Court).

42. 418 U.S. 602 (1974).

43. See *id.* at 633 (stating requirement of preconditions); see also Bush & Massa, *supra* note 23, at 1056-57 (discussing previously cited case and two preconditions).

44. Bush & Massa, *supra* note 23, at 1057 (discussing first precondition).

45. *Marine Bancorporation*, 418 U.S. at 633 (stating second precondition). The Court left open the characteristics and capabilities of potential entrants, perhaps suggesting a case-by-case approach by lower courts. See Bush & Massa, *supra* note 23, at 1058-59 (discussing lower courts in conflict about defining potential competitor).

46. See Bush & Massa, *supra* note 23, at 1058-59 (explaining lower court applications of potential competitor doctrine).

47. 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd*, 418 U.S. 906 (1974).

Western Manufacturing and Marketing Division of Tidewater Oil Company.<sup>48</sup> Tidewater was ranked seventh in motor gasoline sales in California, while Phillips was the tenth largest oil producer in the country.<sup>49</sup> The court also found numerous barriers to entering the market in California given the lack of existing refineries and the cost associated with building a refinery.<sup>50</sup> The district court's analysis focused on four grounds: Phillips's size and ability, interest in entering the market, strong economic incentives to enter the Californian market, and feasibility of entering the market.<sup>51</sup> The district court then compared Phillips's attempt to enter the market with Humble Oil Company's attempt between 1957 and 1963.<sup>52</sup> The district court concluded that a unilateral entry into the Californian market was feasible without obtaining the seventh largest producer in California.<sup>53</sup>

The Second Circuit offered an opposing view in *Tenneco, Inc. v. Federal Trade Commission*.<sup>54</sup> Tenneco, the fifteenth largest automotive parts corporation in the United States, attempted to merge with Monroe, the second largest manufacturer of automotive shock absorbers in the United States.<sup>55</sup> The Second Circuit analyzed the merger by assuming the validity of the actual potential competition doctrine.<sup>56</sup> Furthermore, the Federal Trade Commission (FTC) must show that the relevant market is oligopolistic and that there was an alternative path for Tenneco to enter the market "either de novo or through toehold acquisition."<sup>57</sup> The Second Circuit held that the shock absorber market was oligopolistic, but it also held that the FTC failed its burden to substantially

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48. *See id.* at 1228-29 (setting out government allegations against Phillips).

49. *See id.* at 1229-30.

50. *See id.* at 1241, 1254 (discussing obstacles associated with entering Californian oil market).

51. *See* Bush & Massa, *supra* note 23, at 1060-61 (discussing district court's reasoning).

52. *See Phillips Petroleum Co.*, 367 F. Supp. at 1247 (introducing Humble Oil efforts of entering Californian market). The court then compared the two cases and concluded that Phillips could have followed a similar path to enter the Californian oil market. *See id.* Humble made numerous efforts to purchase refining stations in California prior to acquiring the same Tidewater division that Phillips attempted to purchase. *See id.* Humble also drew an antitrust challenge from the government, but, unlike Phillips, Humble withdrew its bid to acquire Tidewater and embarked upon a \$300 million unilateral expansion into California. *See id.*

53. *See id.* at 1247-48 (concluding Humble and Phillips had similar circumstances). The district court described four elements essential to the feasibility analysis: availability of gasoline suppliers prior to construction or purchase of a West Coast refinery; availability of other market outlets; availability of other crude oil suppliers for a West Coast refinery; and the feasibility of construction or acquisition of a West Coast refinery. *See id.* at 1248. The court determined that Phillips could have obtained enough oil gasoline in California to effectuate a unilateral entry. *See id.*

54. 689 F.2d 346 (2d Cir. 1982); *see also* Bush & Massa, *supra* note 23, at 1062 (classifying *Tenneco* as opposite result to *Phillips*).

55. *See Tenneco, Inc.*, 689 F.2d at 350, 364 (discussing companies involved in merger).

56. *See id.* at 352 (explaining requirements for violation). "The theory of the [actual potential competition] doctrine is that competition in the market would be enhanced by the addition of the new competitor and therefore the elimination of such a potential competitor would substantially lessen competition within the meaning of s 7." *United States v. Siemens Corp.*, 621 F. 2d 499, 504 (2d Cir. 1980); *see also Tenneco, Inc.*, 689 F.2d at 352.

57. *Tenneco, Inc.*, 689 F.2d at 352.

show that Tenneco was an actual potential entrant that would likely increase competition in the market.<sup>58</sup> The difference between *Tenneco* and *Phillips* appeared to be in the exactness of how the potential entrant would affect the market.<sup>59</sup> The court in *Phillips* assumed that the potential entrant exerted “some influence over the . . . marketplace even in the absence of specific evidence,” while the *Tenneco* court required “specific proof of action taken by an incumbent in the market in response to its perception that another firm may enter and compete.”<sup>60</sup>

### 3. Deregulation

The government heavily regulated the airline industry between 1938 and 1978, specifically due to “excessive and destructive competition.”<sup>61</sup> The Civil Aeronautics Board (CAB) controlled entry, routes, and fares.<sup>62</sup> CAB awarded city pairs based on demand.<sup>63</sup> Competition also revolved around more comfortable seating and richer dining options, but CAB did not allow the competition to be reflected in lower rates.<sup>64</sup> The notion behind the airline industry’s deregulation was in part due to inefficiencies and wastefulness.<sup>65</sup> Deregulation of the airline industry was also in part due to strong academic support and observations of less-regulated markets in California and Texas.<sup>66</sup>

The airline industry in the United States was deregulated in 1978.<sup>67</sup> Section 102(a)(3) of the Airline Deregulation Act of 1978 noted that the government would ensure “availability of a variety of adequate, economic, efficient, and low-price services by air carriers without unjust discriminations . . . .”<sup>68</sup> Following the deregulation, new airlines entered the market and prices dropped accordingly.<sup>69</sup> The new entrants increased concentration within the industry

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58. *See id.* at 353.

59. *See* Bush & Massa, *supra* note 23, at 1064 (discussing difference in approach between two courts).

60. *Id.* The Second Circuit determined that mere recognition of other firms, such as Tenneco, was not enough. *See id.*

61. Richard D. Cudahy, *The Airlines: Destined To Fail?*, 71 J. AIR. L. & COM. 3, 8 (2006).

62. *See id.* (exploring nature of CAB’s authority). Fares were regulated based on distance flown. *See id.* at 9. Competition also centered on the frequency of flights, which together with higher competition would result in airlines flying more frequently with lower passenger loads. *See id.* Such competition tended to reduce efficiency. *See id.*

63. *See id.* at 9 (noting importance of city pairs during regulation period).

64. *See id.* (showing CAB’s determination of keeping prices remunerative). Despite CAB’s efforts, airline profits were not very high. *See id.*

65. *See* Cudahy, *supra* note 61, at 9 (suggesting economic criticism of government regulation led to deregulation).

66. *See* Michael E. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy*, 4 YALE J. ON REG. 393, 394 (1987) (introducing rationale behind deregulation).

67. *See* Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (1978). The legislature stated its purpose is “to encourage, develop, and attain an air transportation system which relies on competitive market forces . . . .” *Id.*

68. *Id.* § 102(a)(3).

69. *See* Severin Borenstein, *The Evolution of U.S. Airline Competition*, 6 J. ECON. PERSP. 45, 47 (1992)

particularly between 1984 and 1990.<sup>70</sup> New entry skyrocketed, ticket prices substantially decreased, and as a result, airlines experienced very high profits.<sup>71</sup>

#### 4. *Development of the Hub-and-Spoke System*

The airline market structure changed following the deregulation.<sup>72</sup> Airlines began to organize themselves in particular airports, offering most of their services from those areas.<sup>73</sup> The hub-and-spoke system concentrated most of an airline's activities at a few *hub* cities, which involved the airline servicing destinations in the system via nonstop or one-stop flights through the hub between cities on the *spokes*.<sup>74</sup>

Professor Severin Borenstein offered a brief analysis of two 1986 mergers, which entailed the two airlines significantly increasing their market power in airports around the country.<sup>75</sup> NW became the owner of a majority of air traffic in Minneapolis, St. Paul International Airport (MSP), and TWA owned a similar proportion of the traffic at St. Louis International Airport (STL).<sup>76</sup> Borenstein then showed a significant price increase in the two major hubs following the two mergers.<sup>77</sup> Borenstein's observations gave rise to two possible advantages of a dominant airline controlling a hub: the use of marketing devices allows an airline to increase its popularity within the hub's geographical area, and the airport dominance stems off competition.<sup>78</sup> Another result of the two mergers was the reduction of service at airports in which the two merging airlines previously competed.<sup>79</sup> The airline industry began

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(describing early effects of deregulation).

70. *See id.* at 47-48 (showing data of increased concentration following deregulation).

71. *See id.* at 47 (showing benefits of new entrants following deregulation). The success of deregulation was brief because of the oil crisis in 1979. *See id.*

72. *See* Severin Borenstein, *Airline Mergers, Airport Dominance, and Market Power*, 80 AM. ECON. REV. 400, 400 (1990) (suggesting laissez-faire economics affected airline industry).

73. *See id.* at 400-01 (showing airlines becoming dominant in particular airports). In particular, a dominant airline could use marketing devices to attract more passengers from a given area for its frequent flyer programs and city-pairs that competitors possibly do not offer. *See id.* at 403.

74. *See* Levine, *supra* note 66, at 411 n.83 (defining hub-and-spoke system).

75. *See* Borenstein, *supra* note 72, at 400 (offering merger analysis with focus on increased market power). Northwest (NW) merged with Republic Airlines (RC) while Trans Airlines (TWA) merged with Ozark (OZ). *See id.* The NW-RC and TWA-OZ mergers left the two remaining airlines with control over three quarters of major hub airports. *See id.*

76. *See id.* (giving brief history of two mergers).

77. *See id.* at 401-02 (providing tables with average prices after mergers). Borenstein showed that, before the merger, MSP and STL were among the least expensive hubs in the nation, but by 1987, both hubs became approximately the same, cost-wise, as the other dominant airports in the United States. *See id.* at 401.

78. *See id.* at 402. The price increases at MSP and STL hubs occurred during negotiations of the merger as well as after the agreements were signed. *See id.*

79. *See* Borenstein, *supra* note 69, at 57 (suggesting redundancies in service caused reduction). The increase in prices there, however, was balanced by a decrease in prices when the passengers connected in MSP or STL to different destinations. *See id.* The two mergers increased the overall number of cities served from the two hubs without passengers needing to change airlines. *See id.* Borenstein concluded that short-term effects of the hub mergers were largely negative, even accounting for production efficiencies. *See id.* at 58.



developing similar hub-and-spoke systems to further improve on city-pair route levels.<sup>80</sup>

The major airlines own one or more hub and offer a number of connections to their city pairs.<sup>81</sup> A hub tends to support only one major airline, leading to lowered competition on direct routes to and from the hub.<sup>82</sup> A potential drawback of the hub-and-spoke model is that a larger number of passengers change planes instead of flying nonstop.<sup>83</sup> Airline hubs, however, eliminated the need to change airlines for long distance flights as well as increased the choice of departure times.<sup>84</sup> The DOJ criticized hubs in the merger context for their effect on market power.<sup>85</sup>

### 5. *The DOJ and Merger Guidelines*

The Department of Transportation (DOT) initially had responsibility to regulate the mergers, but such responsibility was subsequently placed on the DOJ.<sup>86</sup> The DOJ has the authority to regulate mergers.<sup>87</sup> The DOJ and the FTC addressed their enforcement policy concerning horizontal acquisitions and mergers through the Horizontal Merger Guidelines (the Guidelines).<sup>88</sup> Market

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80. *See id.* at 48-49 (comparing concentration on short distance and long distance flights). A city-pair is a combination of departure and arrival cities. *See* Amended Complaint, *supra* note 8, at 10 (explaining city-pairs). A hub-and-spoke operation allows long-distance passengers to change planes at a hub owned by the airline. *See* Borenstein, *supra* note 69, at 49.

81. *See* Borenstein, *supra* note 69, at 48-49 (detailing hub-and-spoke system as major airlines' general practice).

82. *See id.* at 49 (explaining hub-and-spoke system decreased concentration on longer routes).

83. *See id.* (opining hub-and-spoke system leads to less nonstop flights); *see also* Bradley H. Weidenhammer, Note, *Compatibility and Interconnection Pricing in the Airline Industry: A Proposal for Reform*, 114 YALE L.J. 405, 424-25 (2004) (suggesting hub-and-spoke system as entry deterrent).

84. *See* Borenstein, *supra* note 69, at 49-50 (showing decline in change of airlines and increase in choice of departure times). The proportion of trips requiring a change of airline fell from 11.2% in 1978 to 1.2% in 1987 and 1990. *Id.* at 50. The hub system also facilitated the growth of smaller airports such as Oakland and Orange County, California because the passengers could change planes in San Francisco or Los Angeles. *Id.*

85. *See id.* at 50 (commenting on recent mergers criticized by DOJ). Many analysts saw the cost savings implications of hub-and-spoke system, but few recognized the market power aspect. *See id.* at 54. Typically, destination to one of the hubs does not have much competition from other airlines. *See id.* For example, United only offers three nonstop flights to Delta's hub in Atlanta, and all three originate from United's three hubs. *See id.* The hubs are typically located at the center of the country. *See id.* A hub is typically dominated by one or two airlines and protects from some degree of market competition through price control, which was not foreseen prior to deregulation and as a result, hubs have significantly altered airlines' deregulated market strategies. *Id.* at 56.

86. *See* Svetlana Mosin, Comment, *Riding the Merger Wave: Strategic Alliances in the Airline Industry*, 27 TRANSP. L.J. 271, 274 (2000) (providing brief history of government regulation).

87. *See id.* (discussing DOJ's authority).

88. *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES 1 (Aug. 19, 2010), <http://www.ftc.gov/os/2010/08/100819hmg.pdf>, archived at <http://perma.cc/CSB2-V4CH> [hereinafter GUIDELINES] (examining purpose behind Guidelines). The Guidelines serve the congressional intent of preventing anticompetitive mergers at their incipiency. *See id.* The Guidelines further seek to outline analytical techniques and main types of evidence the agencies use when determining competitive effects of horizontal mergers. *See id.* In addition, the Guidelines assist the business community and antitrust

participants, market share, and market concentration are important parts of the analysis in the Guidelines.<sup>89</sup>

The Guidelines define the market participants differently than courts in relation to potential competition doctrine.<sup>90</sup> The Guidelines allow for greater inclusion of market participants when analyzing the merger.<sup>91</sup> Market share is then closely related to market participants because Section 7 of the Clayton Act presumes mergers are illegal if the merged entity's market share is larger than twenty-five percent.<sup>92</sup> When analyzing mergers, the courts and agencies rely on economic theories to properly account for change in price and profits in concentrated industries.<sup>93</sup>

The DOJ follows a five-part process to evaluate whether a proposed merger will create or enhance market power.<sup>94</sup> First, the DOJ determines whether the new merger would increase concentration within geographic markets.<sup>95</sup> Second, the DOJ evaluates competitive effects of the merger, such as potential rise in prices or restriction of output or service.<sup>96</sup> Third, the DOJ considers whether there are any new entrants to the market.<sup>97</sup> Fourth, the DOJ considers potential competitive benefits of the merger that could not be obtained

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practitioners, as well as the courts when interpreting and analyzing horizontal mergers. *See id.*

89. *See id.* at 15-19 (detailing how agencies look at individual categories). A market participant is any firm that currently earns revenues in a given market. *See id.* at 15. The market share is "based on [each airline's] actual or projected revenues in the relevant market." *Id.* at 17. Lastly, market concentration is often a very useful tool for the agencies. *See id.* at 18. The agencies often use the Herfindahl-Hirschman Index (HHI) to calculate market concentration. *See id.* Overall, "[t]he higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns . . ." *Id.* at 19.

90. *See* Bush & Massa, *supra* note 23, at 1081-82 (introducing Guidelines in potential competition doctrine context). The Guidelines define a market participant as a firm currently earning revenues in a relevant market or one that has committed to entering it in the near future. *See* GUIDELINES, *supra* note 88, at 15. A significant difference from the courts' previous interpretation of a market participant, is the Guidelines' view that firms on the fringe of the market and could enter without suffering significant sunk costs, are still market participants. *See id.* at 15-16. Sunk costs are the acquisition costs that cannot be recuperated outside the pertinent market. *See id.* at 16.

91. *See* GUIDELINES, *supra* note 88, at 15 (authorizing inclusion of firms on fringe).

92. *See* Thomas A. Piraino, Jr., *A New Approach to the Antitrust Analysis of Mergers*, 83 B.U. L. REV. 785, 790 (2003) (showing Supreme Court's presumption at twenty-five percent).

93. *See id.* at 790-91 (stating theoretical approach by courts and agencies). The reduction of firms in the market leads to easier opportunities for the remaining competitors to alter prices or output. *See id.*

94. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-845, AIRLINE INDUSTRY: POTENTIAL MERGERS AND ACQUISITIONS DRIVEN BY FINANCIAL AND COMPETITIVE PRESSURES 34 (2008), <http://www.gao.gov/new.items/d08845.pdf>, archived at <http://perma.cc/P4GT-HVCE> [hereinafter GAO JULY 2008 REPORT] (summarizing five-part process DOJ follows).

95. *See id.* (outlining DOJ considerations). The DOJ determined that city-pair markets are the relevant markets given that the airlines compete the most there. *See id.* at 35.

96. *See id.* Specifically, the DOJ looks at whether the merger results in one of the competitors leaving the market, thereby increasing the market power of the merged entity. *See id.*

97. *See id.* at 34. The Guidelines require that the new entry be "timely, likely, and sufficient." *Id.* at 36 (internal quotation marks omitted). The DOJ looks at whether a new entrant would have a hub in one of the city-pairs to offer a competitive price after the merger. *See id.*

otherwise.<sup>98</sup> Fifth, the DOJ considers whether the merger prevents one of the airlines from failing.<sup>99</sup>

The DOJ's fifth consideration can overcome the antitrust concerns if the appropriate elements are established.<sup>100</sup> Specifically, the Guidelines call for four elements: the firm would be insolvent in the near future; no potential reorganization under chapter 11 bankruptcy; the firm explored reasonable, alternative methods unsuccessfully; and without the merger, the assets would exit the market.<sup>101</sup> Prior to the enactment of the Guidelines, the Supreme Court recognized the importance of public policy considerations when reviewing the failing firm defense.<sup>102</sup> There are a couple variants to the failing firm defense, such as the weakened division and weakened firm defenses.<sup>103</sup> The failing firm defense has the practical advantage of expediting the deal in situations where it would otherwise be blocked, saving expenses.<sup>104</sup>

### C. The DOJ and Airline Mergers Post-2000

#### 1. American-Trans World Airlines Merger

In January 2001, American proposed the acquisition of TWA after the latter declared bankruptcy.<sup>105</sup> Following the merger and purchase of assets from

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98. See GAO JULY 2008 REPORT, *supra* note 94, at 34. In particular, the DOJ looks at any market efficiencies or "anticompetitive reductions in output or services." *Id.* at 36-37. The DOJ asks the merging airlines to supply the proposed efficiencies, which are then evaluated based on whether they could be achieved by more practical means than a merger. See *id.* at 37.

99. See *id.* (outlining DOJ considerations). The Guidelines favor a merger preventing one firm's assets from completely exiting the market if merger is not approved. See *id.*

100. See GUIDELINES, *supra* note 88, at 32 (discussing failing firm defense).

101. See *id.* (setting forth elements in three parts); Joel G. Chefitz, *A Tale of Two Mergers: American/TWA and United/USAir*, 14 DEPAUL BUS. L.J. 215, 217 (2002) (breaking down Guidelines' third element into two parts).

102. See *Int'l Shoe Co. v. Fed. Trade Comm'n*, 280 U.S. 291, 302-03 (1930) (setting forth public policy consideration); Chefitz, *supra* note 101, at 217 (discussing *International Shoe* as seminal case on failing firm defense). The Court considered both the public and private effect of the failing firm potentially exiting the market. See Chefitz, *supra* note 101, at 217.

103. See Chefitz, *supra* note 101, at 217-18 (discussing two alternatives). The Guidelines recognize the weakened division variant, which requires an additional two-part analysis. See GUIDELINES, *supra* note 88, at 32; Chefitz, *supra* note 101, at 217 (discussing two parts as one). The weakened division must have "persistently negative cash flow on an operating basis" and the owner of the division must have made a substantive good-faith effort to seek alternate offers. GUIDELINES, *supra* note 88, at 32. The Supreme Court recognized the weakened firm defense in 1974. See *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 503-04 (1974); Chefitz, *supra* note 101, at 217-18 (discussing *General Dynamics* case). The company must show that it faced a possibility of business failure and that it was unsuccessful in merging with another company. See *Gen. Dynamics Corp.*, 415 U.S. at 506-07.

104. See Chefitz, *supra* note 101, at 218 (discussing practical advantages).

105. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-01-370T, AIRLINE COMPETITION: ISSUES RAISED BY CONSOLIDATION PROPOSALS 4 (2001), <http://www.gao.gov/assets/110/108712.pdf>, archived at <http://perma.cc/92Q7-DN98> [hereinafter GAO FEBRUARY 2001 REPORT] (stating parameters of proposed merger); Bob Jamieson & Clarissa Douglas, *American Airlines to Buy TWA*, ABC NEWS (Jan. 8, 2001), <http://abcnews.go.com/Business/story?id=88814>, archived at <http://perma.cc/39X3-3NTD> (describing TWA as

United and US Airways, the *new American* would have approximately 120,000 employees and operate five hubs.<sup>106</sup> The transaction involved a \$4.2 billion acquisition, with \$742 million in cash and \$3.5 billion in assumed liabilities.<sup>107</sup>

The DOJ chose not to challenge the merger, noting TWA's bankruptcy proceeding.<sup>108</sup> The failing firm defense appeared to motivate the DOJ's decision given the merger's effect on concentration and competition in the market.<sup>109</sup> American's purchase of TWA decreased competition in 367 markets, while affecting eleven million passengers.<sup>110</sup> TWA's lawyers successfully established the four requirements for the DOJ by asserting: TWA would not meet its financial obligations; TWA would not be able to reorganize successfully under chapter 11 if it pursued bankruptcy individually; TWA explored both prebankruptcy and bankruptcy options of selling to other bidders; and but for the merger, substantial assets, including the STL hub, would exit the market entirely.<sup>111</sup> The STL hub played a major role given its yearly \$8 billion contribution to the local economy and its preservation of 20,000 jobs.<sup>112</sup> Public policy considerations and the exit of potential assets were important factors in rendering the DOJ decision.<sup>113</sup>

## 2. *United-USAir Attempted Merger*

On May 24, 2000, United and USAir agreed to a merger.<sup>114</sup> United would acquire USAir for \$11.6 billion, specifically paying \$4.3 billion to common

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longest continuously flying airline in United States).

106. See GAO FEBRUARY 2001 REPORT, *supra* note 105, at 4 (stating parameters of new American).

107. See Chefitz, *supra* note 101, at 215-16 (introducing American-TWA transaction). The new American was set to operate five hubs, with nearly 1,000 aircraft. See GAO FEBRUARY 2001 REPORT, *supra* note 105, at 4.

108. See Press Release, U.S. Dep't of Justice, Justice Dep't Announces It Won't Challenge American Airlines/TWA Acquisition (Mar. 16, 2001), <http://www.justice.gov/opa/pr/2001/March/112at.htm>, archived at <http://perma.cc/28RE-2RTY> (stating official DOJ position on acquisition by American); see also Chefitz, *supra* note 101, at 215-16 (stating failing firm defense as cause behind DOJ's decision).

109. See GAO FEBRUARY 2001 REPORT, *supra* note 105, at 6 (discussing anti-competitive effects of TWA-American merger); *supra* notes 88, 95 and accompanying text (discussing Guidelines five-part test and failing firm defense). Keeping in mind the four elements for the failing firm defense, Chefitz recognized the importance of a multifaceted approach, multifaceted team, clear strategy, and clear presentation of the four elements stated in the Guidelines. See Chefitz, *supra* note 101, at 220-24 (discussing successful failing firm defense approach).

110. See GAO FEBRUARY 2001 REPORT, *supra* note 105, at 6 (discussing market concentration effects of acquisition). The new American would then dominate 552 markets while affecting approximately 27.5 million passengers. See *id.* at 8 tbl.1 (summarizing data in comparative table). While the competition would decrease in 367 markets, the competition would only increase in 161 markets. See *id.* Consequently, the market share of the new American was 22.6%. See *id.* at 6.

111. See Chefitz, *supra* note 101, at 223-24 (discussing approach lawyers take).

112. See *id.* at 224 (stating significance of STL hub). In addition to showing economic effect, the acquisition team showed that the deal would preserve services to other communities. See *id.* Furthermore, the disappearance of a major airline would also hamper competition in STL. See *id.*

113. See *id.* (recognizing public considerations and potential STL hub decline as two key factors).

114. See GAO FEBRUARY 2001 REPORT, *supra* note 105, at 3 (introducing United-USAir merger).

stockholders and assuming the rest in USAir's debt.<sup>115</sup> The impact of United's and USAir's proposed merger would have been more far-reaching than the one contemplated by American and TWA.<sup>116</sup> In addition, only sixty-five more markets would see an increase in competition, but 2.9 million passengers would still be affected by the merger.<sup>117</sup>

Prior to the deal's breakup, the Government Accountability Office (GAO) stated that the new United would so significantly alter the balance in the industry that other airlines would have to consolidate as well.<sup>118</sup> In its official press release, the DOJ stated that the proposed merger would have created monopoly or duopoly on over thirty routes.<sup>119</sup> The five-factor test in the Guidelines was not met because the merger would reduce competition in several concentrated markets.<sup>120</sup> The DOJ stated that United's divestiture offering was not an adequate substitute for loss of competition in major markets in the United States.<sup>121</sup> The DOJ also rebutted United's claim that the merger would create greater economies of scale.<sup>122</sup>

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115. *See id.* (setting out specifics behind merger). The new United would have around 145,000 employees and operate eight hubs, reaching every state. *See id.* Similar to the merger settlement the DOJ approved in the American-TWA transaction, new United would divest some of its assets to American in the Ronald Reagan Washington National Airport (Reagan National) while also giving up some of its assets in the Washington-New York-Boston shuttle services. *See id.* at 3-4.

116. *See id.* at 6, 8 (detailing market share and dominated markets). New United would have the largest share of any U.S. carrier with 27.2%, and new American would have 22.6%. *See id.* at 6. In terms of markets and passengers, new United would dominate an astounding 1,156 markets while affecting 61.1 million passengers. *See id.* at 8.

117. *See id.* at 8 tbl.1 (showing little effect on increasing competition).

118. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-01-212, AVIATION COMPETITION: ISSUES RELATED TO THE PROPOSED UNITED AIRLINES-US AIRWAYS MERGER 14 (2000), <http://www.gao.gov/assets/230/229924.pdf>, archived at <http://perma.cc/A5QJ-YD2R> [hereinafter GAO DECEMBER 2000 REPORT] (explaining implications of new United). New United would have earned approximately \$26.6 billion in 1999, about \$8.9 billion more than American and \$12 billion more than Delta. *See id.* New United would control roughly 25.6% of all passengers boarding an airplane and about 29.5% of the total revenues. *See id.* at 12-13.

119. *See* Press Release, U.S. Dep't of Justice, Dep't of Justice and Several States Will Sue To Stop United Airlines from Acquiring US Airways (July 27, 2001), [http://www.justice.gov/archive/atr/public/press\\_releases/2001/8701.htm](http://www.justice.gov/archive/atr/public/press_releases/2001/8701.htm), archived at <http://perma.cc/HN74-W6SB> [hereinafter DOJ July 2001 Press Release] (stating official DOJ position).

120. *See id.* (discussing affected markets). Specifically, the DOJ referenced the East Coast markets that would be harmed through the control of major hubs, such as Pittsburgh, Philadelphia, Washington-Dulles, and Charlotte. *See id.*

121. *See id.* (suggesting United did not offer sufficient concession); GAO DECEMBER 2000 REPORT, *supra* note 118, at 8-9 (listing United's proposed terms of agreement). Additionally, United's proposal effectively created a joint agreement with American to fly and price highly concentrated New York, Washington, and Boston routes. *See* DOJ July 2001 Press Release, *supra* note 119.

122. *See* Alberto G. Rossi, Comment, *Grounding Future Consolidations: United-US Airways Cancel Flight*, 54 ADMIN. L. REV. 883, 892-93 (2002) (stating DOJ's position on proposed merger). More importantly, the DOJ and analysts in the industry were concerned with reduction in quality of service given a lack of potential competitors in concentrated markets. *See id.* at 893. If the DOJ allowed the mergers of American-TWA and United-USAir, then there would be fewer competitors in 267 markets affecting nearly 10.3 million passengers. *See* GAO FEBRUARY 2001 REPORT, *supra* note 105, at 9 tbl.2.

### 3. *The Delta Air Lines-NW Merger*

The merger between Delta Air Lines (Delta) and NW was announced on April 14, 2008 and created the largest airline in the world.<sup>123</sup> At the time, Delta was the third largest United States airline based on passenger revenue miles, and operated four hubs.<sup>124</sup> On the other side of the equation, NW was the seventh largest airline in the United States, operating three hubs.<sup>125</sup> At the time of the merger, six major network carriers based their operations on a hub-and-spoke network.<sup>126</sup>

The five-part test the DOJ employed focuses on the concentration in a relevant market post-merger and how the merger may affect consumers in price and flight availability.<sup>127</sup> City-pair analysis is an important part of the antitrust inquiry, specifically dealing with the concentrated market's part of the hub-and-spoke network.<sup>128</sup> Moss—providing a table with concentration statistics' change in HHI, and an account of the Guidelines' thresholds—found that the merger would exceed those thresholds in both primary and secondary hubs.<sup>129</sup> Additionally, the merged airline would significantly increase HHI on nonstop

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123. See Diana Moss, *The Merger of Delta Air Lines and Northwest Airlines: An Antitrust White Paper 1* (July 10, 2008) (working paper on file with American Antitrust Institution), available at [http://www.antitrustinstitute.org/files/AAIWhite%20Paper\\_Delta\\_NW\\_071020081922.pdf](http://www.antitrustinstitute.org/files/AAIWhite%20Paper_Delta_NW_071020081922.pdf), archived at <http://perma.cc/DTE3-UNUH> (discussing merger between Delta and NW). The merger came at a time when the United States airline industry faced vigorous international competition and losses in profits. See *id.* at 1-2.

124. See *id.* at 4 (introducing characteristics of two merging airlines). The four hubs were Atlanta, Cincinnati, New York-JFK, and Salt Lake City. See *id.* As of 2006, Delta dominated these hubs, holding seventy-one percent of Atlanta's market, ninety-three percent in Cincinnati, and seventy-one percent in Salt Lake City. See GAO JULY 2008 REPORT, *supra* note 94, at 28 fig.13 (showing variance in dominated airports between 1998 and 2006).

125. See Moss, *supra* note 123, at 4 (introducing NW's characteristics). The two merging airlines were part of SkyTeam international alliance, which was also one of two such alliances given "U.S. antitrust immunity to jointly set fares and coordinate operations." *Id.* The NW operated two hubs in Detroit, at which it dominated seventy-six percent market and MSP, at which it dominated seventy-eight percent of the market. See GAO JULY 2008 REPORT, *supra* note 94, at 28 (showing variance in domination in selected airports between 1998 and 2006).

126. See Moss, *supra* note 123, at 4 (discussing major network airlines remaining in United States in 2008).

127. See *id.* at 4-5 (discussing Guidelines' emphasis on market concentration). Typically, a large increase in concentration combined with a post-merger market leads to less competition. See *id.* at 5. The Guidelines' inquiry focuses on whether a price increase by a hypothetical monopolist would push a consumer to seek alternative products, thus rendering the price increase unprofitable. See *id.* at 4-5; see also *supra* notes 90-95 and accompanying text (discussing five-part test in Guidelines).

128. See Moss, *supra* note 123, at 5 (discussing city-pair relevance to antitrust analysis). The Delta-NW merger would create seven hubs, whereas the new Delta would have over a seventy percent share of the relevant market. See *id.* Delta and NW also operate secondary hubs, which they primarily use for "significant but less extensive operations." *Id.* at 5-6. Delta's secondary hubs are Boston, Los Angeles, New York-LaGuardia, and Orlando. *Id.* at 6. NW operates three secondary hubs in Honolulu, Indianapolis, and Seattle-Tacoma. See *id.* In these secondary markets, the share ownership for NW ranges from six percent in Honolulu to twenty-three percent in Indianapolis, while Delta's shares range from twelve percent in Los Angeles to twenty percent in New York-LaGuardia. See *id.*

129. See *id.* (providing concentration statistics in merging airlines' hubs).

flights between the hub cities.<sup>130</sup> Furthermore, the merger allowed the two previous competitors to combine their hub-and-spoke networks to access previously inaccessible markets.<sup>131</sup>

The understated effect of the Delta-NW merger was the reduction in inter-system competition in Midwestern and Southeastern markets.<sup>132</sup> As stated previously, a dominant airline in a concentrated market can have both unilateral and coordinated effects on prices and frequency of flights.<sup>133</sup> At the time, new Delta was the largest airline in the United States, and had market power in its newly expanded hub-and-spoke system.<sup>134</sup> While Moss's criticism focused on Delta's increased market power, the DOJ's press release primarily focused on market efficiencies and subsequent benefit to passengers.<sup>135</sup> Moss criticized the DOJ's position by rejecting the improvements in the economies of scale and density as well as the costs of integration.<sup>136</sup> While the DOJ did not release the

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130. *See id.* at 7 tbl.2 (showing significant increases in concentration). The increase in HHI ranges from 576 in the Detroit-Salt Lake City city-pair to 4,997 in the Detroit-Cincinnati city-pair. *See id.* After finding increases in HHI, the presumption is that the merger would harm competition and passengers. *See id.*

131. *See id.* at 8 (discussing network benefits of merger). More connectivity also means more benefits for the passengers, such as more nonstop destinations, more frequent-flyer benefits, and more frequent flights. *See id.* The understated effect of a merger is that passengers may be less likely to switch to a different airline, when the added frequent-flyer benefits of the merged airline outweigh the increase in price. *See id.* at 8-9.

132. *See Moss, supra* note 123, at 9-10 (discussing inter-system competition). Inter-system competition involves airlines competing directly in relevant markets. *See id.* at 8. The DOJ recognized the importance of competition between systems in its trial brief by specifically emphasizing the importance of airlines matching sales or price increases almost instantaneously in relevant markets. *See id.* at 9. A system is composed of "two or more complementary markets, linked together via interfaces that promote compatibility." *Id.* The Delta-NW merger eliminated a close competitor in the Midwest and Southeast. *See id.* at 10 fig.1 (directing attention to effects on two respective markets). The two airlines overlap in several markets. *See id.* Furthermore, the overlap and elimination of one system casts doubt on the airlines characterizing the merger as complementary. *See id.*

133. *See id.* at 11 (discussing potential for remaining firms' unilateral and coordinated efforts). One less competitor could lead to an increase in price or a dominant airline's reduction in service. *See id.* at 12. In particular hubs, fewer carriers may also undercut the dominant airline's usual response to price increases or reduction in service. *See id.*

134. *See id.* at 11 (discussing unilateral power of new Delta). The merged airline could unilaterally increase prices on nonstop flights between hubs or reduce particular flights between hubs. *See id.* In addition, the merged airline could raise—already very high—barriers to entry in city-pair markets. *See id.* The competition for corporate accounts is very high for city-pairs, and the new Delta could hold a significant percentage of the market by offering better discounts and acquiring more accounts. *See id.*

135. *See id.* at 11 (directing attention to adverse competitive effects); Press Release, U.S. Dep't of Justice, Statement of the Dep't of Justice's Antitrust Div. on Its Decision To Close Its Investigation of the Merger of Delta Air Lines Inc. and Northwest Airlines Corp., (Oct. 29, 2008), [http://www.justice.gov/archive/atr/public/press\\_releases/2008/238849.htm](http://www.justice.gov/archive/atr/public/press_releases/2008/238849.htm), archived at <http://perma.cc/46QF-HZKR> [hereinafter DOJ October 2008 Press Release] (emphasizing market efficiencies leading to consumer benefits).

136. *See Moss, supra* note 123, at 13-15 (discussing high integration costs and economies of scale and density). Economy of scale relies on a larger fleet and network to marginally reduce the cost of serving an additional passenger, while economy of density reduces the costs on a particular route for an additional passenger. *See id.* at 13. Costs of integration may actually be larger than the efficiencies the merger claims. *See id.* at 15. The combined airline would have 80,000 employees with different reservation systems, maintenance operations, labor contracts, and flight schedules. *See id.* at 15. The difference in fleets between Delta and NW is also understated because of the inefficiencies associated with employee-training required on

details behind its investigation, its primary reliance on improved efficiencies and lack of evidence of lessened competition can be inferred from its press release.<sup>137</sup>

#### 4. *The United-Continental Airlines Merger*

Following consolidation trends, United and Continental Airlines (Continental) announced their agreement to merge and retain the name United.<sup>138</sup> The merger between the two airlines would create an airline that would surpass the Delta-NW merger.<sup>139</sup> Prior to merging, United operated five hubs in Washington-Dulles, Chicago, San Francisco, Denver, and Los Angeles; Continental operated hubs in Houston, Newark, and Cleveland.<sup>140</sup> The combination of the two airlines would control a large percentage of those hubs, ranging from seventy-seven percent of the Houston hub to twenty-three percent in Los Angeles.<sup>141</sup> The DOJ looked at overlapping city-pair combinations between the two combining airlines and, while the overlap is considerable, it is mostly mitigated by the presence of another competitor.<sup>142</sup> Moreover, the two airlines shared twelve nonstop, overlapping flights, seven of which had no other competitors.<sup>143</sup> The two airlines were also both part of Star Alliance to

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varying kinds of aircraft. *See id.*

137. *See* DOJ October 2008 Press Release, *supra* note 135 (referencing substantial efficiencies of merger and small possibility of lessened competition). Specifically, the fourth factor in the Guidelines played an important role in effectuating the merger. *See* DOJ October 2008 Press Release, *supra* note 135 (characterizing efficiencies as competitive benefits).

138. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 10-778T, AIRLINE MERGERS: ISSUES RAISED BY THE PROPOSED MERGER OF UNITED AND CONTINENTAL AIRLINES 3 (2010), <http://www.gao.gov/assets/130/124/803.pdf>, archived at <http://perma.cc/YV3M-SKUW> [hereinafter GAO MAY 2010 REPORT] (introducing merger between two airlines). The proposed merger had a value of \$8 billion; approximately fifty-five percent would go to United shareholders and forty-five percent would go to Continental shareholders. *See id.* The GAO report mentioned that the airline industry was undergoing a significant amount of consolidation since deregulation in 1978. *See id.* The report also mentioned periods of instability in the industry, especially following the terrorist attacks of September 11, 2001 and the direct assistance from the government following the terror. *See id.* at 5.

139. *See id.* at 13 tbl.1 (showing new United as largest passenger airline in United States). In 2009, the combined airline would rank first in total capacity and a close second in total assets. *See id.* In addition, the United-Continental merger would create the largest airline workforce based on 2010 employment data. *See id.* at 12. The merged airline would also have 692 total aircraft. *See id.* at 14 tbl.4 (explaining implications of merger).

140. *See id.* at 19 tbl.5 (describing implications of merger).

141. *See id.* (showing market share at respective hubs).

142. *See* GAO MAY 2010 REPORT, *supra* note 138, at 15 (discussing presence of overlap between two airlines). Based on 2009 passenger data, of the 13,515 airports that serve at least 520 passengers per year, there would be a loss of one competitor in 1,135 of those airport-pair markets. *Id.* at 15-16. In those airport-pair markets, the merger would affect roughly 35 million passengers. *See id.* at 16. United, however, would serve only ten markets. *See id.* Conversely, in 431 of the 1,135 markets that lost one competitor, an LCC would compete with United. *See id.*

143. *See id.* at 17-18 (discussing nonstop overlaps). The report, however, does mention the possibility of at least one competitor at one of the endpoints in six of the seven overlaps. *See id.*



compete internationally.<sup>144</sup>

During the DOJ review, calling out the domination of a highly concentrated Newark market, where Continental held a large market share prior to its merger with United, was a key criticism.<sup>145</sup> The merger was announced in May 2010 and was cleared by the DOJ following transfer of assets in August 2010.<sup>146</sup> The DOJ was primarily concerned with Newark and having a competitor, especially LCCs.<sup>147</sup> As a result of the merger, United's share in Newark fell slightly under fifty percent.<sup>148</sup> Five of the top ten destination airports departing from Newark were part of the hub-to-hub network created by the United-Continental merger.<sup>149</sup>

### 5. *The American-USAir Merger*

On February 13, 2013, American and USAir announced an agreement to merge.<sup>150</sup> The new airline would retain the name American, stay in its Dallas-Fort Worth headquarters, and be financed by all stock transaction valued at \$11 billion.<sup>151</sup> The estimated annual benefit from the increased network following the merger was estimated at approximately \$1.4 billion.<sup>152</sup> The American-USAir merger would create the largest airline in the United States based on the

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144. *See id.* at 20 (discussing Star Alliance). The government granted Star Alliance immunity from antitrust challenges with some exclusions, including several international destinations that concerned the DOT. *See id.*

145. *See* Press Release, U.S. Dep't of Justice, United Airlines and Continental Airlines Transfer Assets to Southwest Airlines in Response to Dep't of Justice's Antitrust Concerns (Aug. 27, 2010), <http://www.justice.gov/opa/pr/2010/August/10-at-974.html>, archived at <http://perma.cc/K83E-49TZ> [hereinafter DOJ August 2010 Press Release] (stating Newark as primary concern); Jad Mouawad, *United-Continental Merger Clears Federal Hurdle*, N.Y. TIMES (Aug. 27, 2010), [http://www.nytimes.com/2010/08/28/business/28air.html?\\_r=0](http://www.nytimes.com/2010/08/28/business/28air.html?_r=0), archived at <http://perma.cc/C2SV-U4X4> (summarizing DOJ's concerns over Newark); GAO MAY 2010 REPORT, *supra* note 138, at 19 (showing United controlling seventy-three percent share at Newark).

146. *See* Mouawad, *supra* note 145 (detailing quick turnaround from announcement to DOJ clearance).

147. *See id.* (listing divestiture of slots to Southwest as turning point); DOJ August 2010 Press Release, *supra* note 145 (emphasizing importance of LCC entering market and competing with new United).

148. BUREAU OF TRANSP. STAT., U.S. DEP'T OF TRANSP., <http://www.transtats.bts.gov/airports.asp?pn=1>, archived at <http://perma.cc/7YVW-4ETR> (last visited June 1, 2015) (showing market share for top airline carriers in Newark from December 2012 to November 2013) (from the "Select a month" drop menu, select "November 2013"; from the "Select an airport" drop menu, select "Newark").

149. *See id.* (listing top ten destinations in United States from December 2012 to November 2013).

150. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-403T, AIRLINE MERGERS: ISSUES RAISED BY THE PROPOSED MERGER OF AMERICAN AIRLINES AND US AIRWAYS 12 (2013), <http://www.gao.gov/assets/660/655314.pdf>, archived at <http://perma.cc/33Y6-ATVV> [hereinafter GAO JUNE 2013 REPORT] (introducing merger between two airlines).

151. *See id.* (discussing financial aspects of deal). American shareholders would retain seventy-two percent of ownership, while USAir shareholders would have twenty-eight percent. *See id.*

152. *See id.* at 15 tbl.12 (explaining financial implications of merger). In addition, the merger was estimated to generate \$1.12 billion in revenue synergies "from improved network connectivity," increased customer loyalty, and better aircraft use. *Id.* at 13. Finally, the merger would reduce costs by combining complementary assets. *See id.* at 14. Airline executives expected "\$640 million in cost savings from reducing overlapping facilities at airports and in combining purchasing, technology, and corporate activities." *Id.*

data from four quarters ending in October 2012.<sup>153</sup> Prior to the merger, American operated six primary hubs: Dallas, Miami, Chicago-O'Hare, New York-LaGuardia, Los Angeles, and New York-JFK.<sup>154</sup> USAir operated hubs in Charlotte, Philadelphia, Phoenix, and Washington, DC.<sup>155</sup> The proposed merger would create a dominant airline with over forty percent market share in six of the ten hubs.<sup>156</sup> More importantly, new American would dominate in the three airports with a slot-controlled system, which restricted access to new entrants.<sup>157</sup> The two airlines overlap on twelve nonstop routes based on numbers from October 2012, and seven nonstop flights had no other competitors on a nonstop basis.<sup>158</sup> The merger would reduce one effective competitor in 1,665 airport-pair markets out of 13,963, while affecting more than fifty-three million passengers.<sup>159</sup>

The DOJ and eight attorneys general filed suit against the merger, arguing that new American would presumptively create illegal change in market share on over 2,000 city-pair markets.<sup>160</sup> The two sides, however, settled following pressure from the DOJ to divest certain slots and facilities from new American to LCCs.<sup>161</sup> Specifically, the DOJ wanted the American-USAir team to divest slots at Reagan National and New York-LaGuardia to LCCs.<sup>162</sup> The DOJ

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153. *See id.* at 15 (discussing new American becoming largest airline in United States). Moreover, the new airline would have the largest workforce, comprised of 101,197 full-time employees and 1,215 aircraft in need of integration. *Id.* at 16-17 tbls.3-5 (explaining economic implications of proposed merger).

154. *See* GAO JUNE 2013 REPORT, *supra* note 150, at 23 tbl.6 (showing domestic market share).

155. *See id.* (showing domestic market share).

156. *See id.* (demonstrating domestic market share).

157. *See id.* at 23 tbl.7 (showing significant presence in three of four slot-controlled airports). Washington DC's Reagan National was a primary concern because new American would control sixty-eight percent of the total slots with no major competition. *See id.* New American would also control almost thirty-three percent of New York-LaGuardia, while Delta would own a forty-six percent share. *See id.*

158. *See* GAO JUNE 2013 REPORT, *supra* note 150, at 19-20 (showing lack of competition on some nonstop airport pairs). The report also notes that, unlike the United-Continental merger where there were other alternate endpoints in the region, there are fewer alternate endpoints for passengers to choose from. *Id.* at 20; *see also* Ely Portillo, *Consumer Advocates Still Fighting US Airways/American Merger*, CHARLOTTE OBSERVER (Feb. 10, 2014), available at <http://www.charlotteobserver.com/news/business/article9096173.html>, archived at <http://perma.cc/NU2M-DWY6> (stating negative impacts of merger specifically affecting Charlotte-Dallas and Fort Worth city-pair).

159. *See* GAO JUNE 2013 REPORT, *supra* note 150, at 21-22 (showing decrease in competition in airport-pair markets). In comparison to the United-Continental merger, new American would affect 530 more airport pairs, while creating new competition with at least a five percent market share in 210 airport-pairs, affecting 17.5 million passengers. *Id.* at 21.

160. *See* Amended Complaint, *supra* note 8 (listing city-pairs in appendix).

161. *See* U.S. Wants AA, *US Airways to Divest for Merger*, UNITED PRESS INT'L (Nov. 4, 2013), [http://www.upi.com/Top\\_News/US/2013/11/04/US-wants-AA-US-Airways-to-divest-for-merger/UPI-7441138350200/](http://www.upi.com/Top_News/US/2013/11/04/US-wants-AA-US-Airways-to-divest-for-merger/UPI-7441138350200/), archived at <http://perma.cc/HVSS-XQQW> (discussing DOJ's pressure on American-USAir to divest certain slots); DOJ November 2013 Press Release, *supra* note 10 (discussing divestiture regarding LCCs).

162. *See* DOJ November 2013 Press Release, *supra* note 10 (discussing divestitures of slots). The American-USAir team would have to divest 104 slots at Reagan National and thirty-four slots at New York-LaGuardia. *See id.* Moreover, the DOJ would oversee transfer of rights and interests of two airport gates and associated ground facilities at Boston-Logan, Chicago-O'Hare, Dallas-Love Field, Los Angeles, and Miami.

settled the proposed merger by focusing on LCCs enhancing abilities to compete in markets where there is restricted access to new entrants.<sup>163</sup> Another important consideration for the DOJ was the fact that American was under bankruptcy protection since November 2011 and able to exit its protection when a federal judge approved the merger with USAir.<sup>164</sup>

#### D. Low-Cost Carriers

##### 1. Defining the Concept

Following deregulation, a multitude of LCCs emerged to compete with major airlines.<sup>165</sup> An LCC is an airline that “enjoy[s] the advantage of having lower costs than major carriers,” and operates a *point-to-point network* by offering lower wages than the industry standard, which allows them to offer lower fares.<sup>166</sup> In addition, LCCs can offer lower prices than other airlines because they offer fewer amenities and have reduced operating costs.<sup>167</sup> For example, Southwest Airlines (Southwest) does not have reserved seating and boards its passengers based on when passengers arrive at the gate.<sup>168</sup> The primary advantages for LCCs over major airlines are lower fares and more

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*See id.*

163. *See id.* (emphasizing LCCs gaining system-wide competition). The DOJ will see an unprecedented control of the settlement proceedings with rights to appoint a trustee to oversee whether divestitures are proper under the terms of the settlement. *See id.* New American would be prohibited from reacquiring the divested slots during the term of the settlement and would have to give advanced notice on any future acquisition of slots at Reagan National. *See id.*; see also Ashley Halsey III, *Justice Set To Approve Merger of American Airlines, US Airways*, WASH. POST (Nov. 12, 2013), [http://www.washingtonpost.com/local/trafficandcommuting/justice-set-to-approve-merger-of-amr-us-airways/2013/11/12/2531b9f0-4bab-11e3-9890-a1e0997fb0c0\\_story.html](http://www.washingtonpost.com/local/trafficandcommuting/justice-set-to-approve-merger-of-amr-us-airways/2013/11/12/2531b9f0-4bab-11e3-9890-a1e0997fb0c0_story.html), archived at <http://perma.cc/M35P-QG23> (discussing effect on Washington’s market following settlement announcement); Bart Jansen, *Justice Settles Merger Lawsuit with AA, US Airways*, USA TODAY (Nov. 12, 2013), <http://www.usatoday.com/story/travel/flights/2013/11/12/justice-merger-american-us-airways/3506367/>, archived at <http://perma.cc/RK5T-X3ZN> (discussing divestitures of slots at Washington-Reagan and New York-LaGuardia); Jad Mouawad, *Merger of American and US Airways is Waved Ahead*, N.Y. TIMES (Nov. 27, 2013), [http://www.nytimes.com/2013/11/28/business/airlines-clear-final-merger-obstacle.html?\\_r=1](http://www.nytimes.com/2013/11/28/business/airlines-clear-final-merger-obstacle.html?_r=1) &, archived at <http://perma.cc/DJK8-WRRP> (discussing previous substantial mergers as well as current merger’s settlement).

164. *See* GAO JUNE 2013 REPORT, *supra* note 150, at 11-12 (explaining American under bankruptcy protection). *But see* Pearlstein, *supra* note 16 (suggesting American would come out stronger post-reorganization).

165. *See* Paul Stephen Dempsey, *Airline Deregulation and Laissez-Faire Mythology: Economic Theory in Turbulence*, 56 J. AIR L. & COM. 305, 403 (1990) (discussing emergence of LCCs following deregulation). Dempsey noted that high entrance barriers at various fortress hubs prevent new entrants from competing with major airlines. *See id.* at 403-04. Specifically, frequent-flyer programs, travel agent commission overrides, and reservation systems prevented new LCCs from competing with the major airlines. *See id.*

166. *United States v. AMR Corp.*, 335 F.3d 1109, 1112 (10th Cir. 2003) (defining LCCs).

167. *See* Dennis J. Keithly, *To Trap the White Tiger and Unicorn, the Government Needs Better Traps: An Examination of the Viability of Predatory Pricing Claims in the Airline Industry*, 69 J. AIR L. & COM. 837, 846 (2004) (noting LCCs offer fewer amenities and lower overhead costs to cut expenses).

168. *See id.* (discussing Southwest’s reservation and boarding policies). Other LCCs operate fewer routes and most do not offer in-flight meals. *See id.*

frequent flights.<sup>169</sup> The market share of LCCs grew from ten percent in 1990 to twenty-five percent in 2004.<sup>170</sup>

## 2. *Emergence of Southwest as a Major Competitor to Megacarriers*

Southwest began as an airline that operated primarily in Texas, offering service to Houston and San Antonio in the early 1970s.<sup>171</sup> Over the course of three decades, Southwest never posted loss in profits and continued to grow.<sup>172</sup> Southwest became the third largest domestic airline in the United States, behind only American-US Airways and Delta.<sup>173</sup> Not only has Southwest remained profitable for the duration of its existence, but it also consistently rates among the top airlines with exemplary baggage handling and customer service.<sup>174</sup>

One reason for Southwest's relative success is its ability to keep costs low.<sup>175</sup> Southwest keeps its Revenue Passenger Miles (RPM) close to its Average Seat Miles (ASM) to continue its profits.<sup>176</sup> To illustrate, "[t]he closer RPM is to ASM, the more of the airline's capacity is being used, and the more revenue the airline enjoys."<sup>177</sup> In 2003, Southwest made about \$16.46 per customer based on a 1,000 mile trip, while major competitors were losing about \$1.54 per customer.<sup>178</sup> Additionally, Southwest practices fuel hedging, which locks in a fuel price for a specific amount of time.<sup>179</sup> Southwest also has a fast

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169. *See id.* at 847 (discussing advantages LCCs have over major airlines). Lower fares tend to attract non-business customers. *See id.* More flights allow for more last-minute bookings with less expensive penalties than major airlines. *See id.* Further, LCCs tend to operate fewer gates at the terminals they serve, which creates another advantage. *See id.*

170. *See id.* (detailing growth of LCC market share). In 2014-2015, Southwest, JetBlue, Alaska, ExpressJet, SkyWest, and Spirit accounted for 33.5% of domestic market share. *See* BUREAU OF TRANSP. STAT., U.S. DEP'T OF TRANSP., <http://www.transtats.bts.gov>, archived at <http://perma.cc/7KX6-EKV5> (last visited June 1, 2015) [hereinafter JUNE 2015 LCC SNAPSHOT] (categorizing domestic market share for LCCs).

171. *See* Keithly, *supra* note 167, at 848 (discussing inception of Southwest).

172. *See id.* (stating Southwest posted profits for thirty-one consecutive years). In 2003, Southwest posted profits of \$442 million. *See id.* Following the events of September 11, 2001, Southwest continued to operate with the same personnel while also posting profits. *See id.*

173. *See id.* (detailing Southwest's growth); JUNE 2015 LCC SNAPSHOT, *supra* note 170 (showing Southwest as one of top three airlines based on domestic market share).

174. *See* Keithly, *supra* note 167, at 848 (noting Southwest as top airline in customer satisfaction).

175. *See id.* at 849 (detailing reasons behind Southwest's profitability).

176. *See id.* at 848-50 (discussing RPM and ASM). ASM are defined as the "total of all the seats available on every airline route, multiplied by the length of the route." Jon Bonné, *Making Sense of the Airline Business: Fewer Frills and a Focus on Economic Fundamentals*, NBC NEWS (Jan. 23, 2003), [http://www.nbcnews.com/id/3073566/ns/business-us\\_business/t/making-sense-airline-business/#.U01oMV7ClgM](http://www.nbcnews.com/id/3073566/ns/business-us_business/t/making-sense-airline-business/#.U01oMV7ClgM), archived at <http://perma.cc/EG4N-Y5ZX>. RPM is the second part of the equation and is defined as "the number of seat-miles for which the airline is actually filling a seat and making money." *Id.*

177. Keithly, *supra* note 167, at 848-49. The comparison shows an airline's revenue on each mile it flies. *Id.* at 849. Keithly shows Southwest made 11.67 cents per mile, while United made 11.1 cents per mile. *Id.*

178. *See id.* (comparing major airlines' profits with Southwest profits).

179. *See id.* at 850 (discussing fuel hedging). For example, at one point in time, Southwest enjoyed a speculative price of \$24 per fuel barrel via the practice of fuel hedging, while the actual market price per barrel was \$35. *Id.*

plane turnaround time with twenty minutes at the gate, which ranks the quickest among Southwest competitors.<sup>180</sup> Finally, Southwest found a formula that enables the airline to operate in the highly competitive market; a market in which major airlines engage in predatory pricing that normally drives out competition from its hubs or geographical markets.<sup>181</sup>

### 3. *Predatory Pricing by Major Airlines*

Predatory pricing is briefly outlined in the Sherman Act.<sup>182</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*<sup>183</sup> is the guiding case on the subject.<sup>184</sup> The Supreme Court clarified predatory pricing elements in the Sherman Act and proceeded to discuss the cost requirement in particular.<sup>185</sup> Predatory pricing is defined as “setting prices below actual costs coupled with a reasonable prospect of recovering profits lost during the predatory period by increasing prices after the competition has folded, been driven out of the market, or acquiesced and raised prices.”<sup>186</sup> The Court held that there was no definitive method of measuring cost, and it declined to follow the average variable cost as defined by the parties.<sup>187</sup> Thus, the cost requirement is difficult to calculate given the complexity of finding the difference between change fixed and variable costs.<sup>188</sup> Courts typically do not accept fixed costs when looking at whether predatory pricing occurred.<sup>189</sup>

Predatory pricing in the airline industry occurs when one airline lowers prices in a particular market in response to a new airline entering that market.<sup>190</sup> After the court determines what fixed and variable costs are, it decides whether variable costs exceed the prices set for the route.<sup>191</sup> A recent example of a predatory pricing claim is *United States v. AMR Corp.*, where the government challenged American’s predatory practices by formulating four

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180. *See id.* (detailing quick turnaround times).

181. *See* Keithly, *supra* note 167, at 852 (discussing Southwest and surrounding predatory pricing set by major airlines). In comparison to Southwest’s remarkable success, newly formed airlines or other smaller LCCs can suffer greatly from major airlines’ predatory schemes. *Id.*

182. *See* 15 U.S.C. § 2 (2012) (stating predatory pricing requirements).

183. 509 U.S. 209 (1993).

184. *See* Keithly, *supra* note 167, at 838 (acknowledging *Brooke Grp. Ltd.* as “preeminent case in predatory pricing law . . .”).

185. *See Brooke*, 509 U.S. at 223-24 (exploring unlawful predatory pricing schemes).

186. Keithly, *supra* note 167, at 839. In addition, the competition at a particular market must be harmed, not just inconvenienced. *Id.*

187. *See Brooke*, 509 U.S. at 222-23 n.1 (defining appropriate cost measure in instant case as average variable cost).

188. *See* Keithly, *supra* note 167, at 840. Examples of fixed cost include management expenses, property taxes, and depreciation. *Id.* Variable costs in the airline industry are typically fuel and salary expenses for the crews handling additional flights. *Id.*

189. *See id.* (stating courts often reject fixed costs as measure).

190. *See id.* at 843 (introducing predatory pricing in airline industry).

191. *See id.* (explaining standard courts follow).

tests to show increased capacity in certain city-pairs.<sup>192</sup> The court went on to reject all four tests based on the inclusion of fixed costs in each of the tests and flawed application to the particular facts of this case.<sup>193</sup>

*AMR Corp.* illustrates a fact pattern similar to other predatory pricing schemes when a major airline experiences an LCC entering a particular city-pair market.<sup>194</sup> The LCC enters the market, lowers ticket prices, and increases its capacity to compete with the major airline.<sup>195</sup> When Vanguard Airlines entered its city-pair market, American increased its capacity and lowered its prices to the point where the LCC could not compete with it.<sup>196</sup> To summarize, American enjoyed a monopoly price before Vanguard entered the market; then, American decreased its prices and raised its capacity when Vanguard entered the market; and finally, American raised its prices gradually to a rate higher than when it enjoyed monopoly on the particular city-pair, supposedly to recoup lost profits.<sup>197</sup> The government feared that American could categorize its behavior as multimarket recoupment, which occurs “when the alleged predatory pricer sets its prices on its product below cost in some markets, and recoups the loss from other markets while developing a reputation as a predator that will aggressively defend all of its markets.”<sup>198</sup> This practice allows a major airline to drive out an LCC from particular city-pairs while recouping its losses in other city-pairs unaffected by the particular LCC.<sup>199</sup> When the LCC can compete with a major airline in various city-pairs, the passengers enjoy lower costs and increased capacity.<sup>200</sup>

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192. See *AMR Corp.*, 335 F.3d at 1116-20 (stating government’s four tests). The main argument behind the government’s challenge of AMR’s actions was adding capacity without increasing the revenue. *Id.* at 1113-14. The government argued such strategy lacked financial sense, unless there was another reason behind the move such as driving out an LCC from the city-pair markets in question. *Id.* at 1114.

193. See *id.* at 1120-21 (holding government’s tests invalid as matter of law). The court mentioned that there was no issue of material fact as to the first prong in *Brooke*, therefore, analyzing the test’s second prong was unnecessary. *Id.* at 1121.

194. See Keithly, *supra* note 167, at 843-44 (discussing American entering city-pair markets and offering lower prices).

195. See *id.* (stating LCC operations in new city-pair market).

196. See *id.* at 844 (discussing American and Vanguard competition in Dallas-Fort Worth and Wichita city-pair). The facts indicated that prior to Vanguard entering the market, American charged an average fare of \$99 to \$108. See *id.* at 844. After Vanguard entered the market, American’s fare ranged from \$52 to \$75. See *id.* After Vanguard left the city-pair market, American raised its fare to a pricing range of \$88 to \$123. See *id.* (analyzing American’s fare hike once market cleared).

197. See *id.* (summarizing American’s predatory scheme).

198. Keithly, *supra* note 167, at 844 (discussing multimarket recoupment).

199. See *id.* at 844-45 (stating effects of multimarket recoupment). The Supreme Court has not yet addressed multimarket recoupment. See *id.*

200. See *id.* at 845 (discussing effects on public). When the LCC is driven out, however, the prices return to precompetition or higher rates. *Id.*

### III. ANALYSIS

The Clayton Act and the Guidelines create the standard the DOJ uses when analyzing proposed mergers.<sup>201</sup> The two schemas specifically intersect when a new market participant enters the market following a merger.<sup>202</sup> Market participants are then analyzed based on their market share at a particular hub or geographical area to determine the impact of the proposed merger.<sup>203</sup> The Guidelines and Section 7 of the Clayton Act focus on the merger's future ramifications and attempt to determine whether the new merger will be detrimental to the consumer.<sup>204</sup> Recently, the DOJ allowed the airline industry to go from nine major airlines to three, resulting in only LCCs as primary competitors.<sup>205</sup>

#### A. New Consolidation Standard

Over the last two decades, major airline mergers created the largest airline in the United States.<sup>206</sup> The number of major airlines reduced from nine to five since the early 2000s.<sup>207</sup> Each merger involved consolidation at major hubs around the United States, which affected millions of customers and thousands of daily routes.<sup>208</sup> The airlines were then able to use the increased market share at individual hubs to further dominate the relevant market.<sup>209</sup>

#### B. American-USAir Continuing the Trend

American and USAir combined their operations and created the largest airline in the world.<sup>210</sup> The DOJ's initial complaint alleged that the merger was anti-consumer and anti-competitive.<sup>211</sup> The DOJ and GAO report specified

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201. See GAO JULY 2008 REPORT, *supra* note 94, at 34 (discussing Guidelines' five-part test); Piraino, *supra* note 92, at 790-91 (discussing Section 7 of Clayton Act and theoretical approach of governmental agencies); *supra* notes 37-38 and accompanying text (discussing Section 7 of Clayton Act and its purposes).

202. See Piraino, *supra* note 92, at 790-91 (discussing market participants relation to merger analysis).

203. See GAO JULY 2008 REPORT, *supra* note 94, at 34 (discussing first part of DOJ analysis).

204. See Piraino, *supra* note 92, at 790-91 (discussing analytical approach of Guidelines).

205. See Amended Complaint, *supra* note 8, at 13 (discussing airline industry consolidation); DOJ November 2013 Press Release, *supra* note 10 (detailing Southwest as primary competitor to American-USAir at Reagan National).

206. See Amended Complaint, *supra* note 8, at 13 (discussing consolidation of airline industry).

207. See *id.* (emphasizing reduction of major airlines over past decade).

208. See *supra* Part II.C and accompanying text (discussing major mergers and effects on market share at hubs created by merged airlines).

209. See Borenstein, *supra* note 72, at 402 (discussing adverse effects of mergers on concentrated market); Moss, *supra* note 123, at 8 (opining Continental could access new markets with increased share within hub-and-spoke network).

210. See GAO JUNE 2013 REPORT, *supra* note 150, at 15 (observing new American as largest airline in United States).

211. See Amended Complaint, *supra* note 8, at 15-19 (discussing anti-consumer effects of proposed merger).

numerous violations of city-pair domination and significant alterations to market power at various hubs.<sup>212</sup> For example, new American greatly increased its market share at Charlotte, LaGuardia, Miami, and other hubs.<sup>213</sup> The TWA-American merger revealed a similar picture, in which the merged airline controlled a significant market share in hubs belonging to the increased network.<sup>214</sup>

The DOJ's settlement indicates that the market share at key constrained airports played an important role.<sup>215</sup> Specifically, the divestiture of slots at the Reagan Airport dominated the headlines following the announcement of the settlement between the DOJ and American-USAir team.<sup>216</sup> In its press release, the DOJ primarily focused on divestiture and assignment of gates and facilities at some of the hubs that new American would obtain following the merger.<sup>217</sup>

Contrary to the Guidelines, the DOJ appeared to overlook the adverse competitive effects at multiple hubs that would become part of the new American network.<sup>218</sup> While the DOJ negotiated divestiture at some hubs in the American network, the DOJ did not address the increased market power in Charlotte and did little to reduce the market power at Washington-Reagan, New York-LaGuardia, or Chicago-O'Hare airports.<sup>219</sup> In the DOJ's original complaint, the government showed over a thousand city-pairs that would see a per se illegal increase in HHI.<sup>220</sup> The settlement announcement, however,

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212. See GAO JUNE 2013 REPORT, *supra* note 150, at 23 tbl.6 (showing domestic market share at hubs and key airports); Amended Complaint, *supra* note 8, at 45-57 (showing HHI violations in city-pairs).

213. See AMERICAN 2013 SNAPSHOT, *supra* note 11 (showing market shares at top domestic airports for American); USAIR 2013 SNAPSHOT, *supra* note 11 (showing market shares at top domestic airports for USAir).

214. See *supra* Part II.C and accompanying text (discussing hubs associated with major mergers).

215. See DOJ November 2013 Press Release, *supra* note 10 (stating divestitures of slots and gates at specified airports). The airports in Boston, Chicago, Dallas, Los Angeles, Miami, New York, and near Washington, DC, will undergo significant changes with the DOJ's direct oversight. See *id.*; see also GAO JUNE 2013 REPORT, *supra* note 150, at 19 (detailing impact of potential merger between two airlines). There are twelve nonstop city-pair routes that overlap because of the merger. See *id.* For seven of those pairs, there would be no competitors on a nonstop basis. See *id.* Further, Southwest is the only LCC. See *id.* at 20. Unsurprisingly, the proposed merger focused on seven of the airports mentioned in GAO June 2013 report. See DOJ November 2013 Press Release, *supra* note 10; GAO JUNE 2013 REPORT, *supra* note 150, at 20.

216. See Halsey, *supra* note 163 (discussing effect on Washington's market following announcement of settlement); Jansen, *supra* note 163 (discussing divestitures of slots at Washington-Reagan and New York-LaGuardia); Mouawad, *supra* note 163 (discussing previous big mergers and current merger's settlement).

217. See DOJ November 2013 Press Release, *supra* note 10 (emphasizing divestiture of slots).

218. See GAO JULY 2008 REPORT, *supra* note 94, at 34 (summarizing five elements in Guidelines); DOJ November 2013 Press Release, *supra* note 10 (discussing divestiture of slots and impact on consumers in affected markets).

219. See Halsey, *supra* note 163 (stating new American market share decreasing at Reagan National); DOJ November 2013 Press Release, *supra* note 10 (emphasizing importance of Washington-Dulles and New York-LaGuardia to settle). The DOJ November 2013 Press Release did not mention Charlotte as one of the airports that was part of the settlement agreement despite a 58.92% market share by US Airways between December 2012 and November 2013. DOJ November 2013 Press Release, *supra* note 10; CHARLOTTE 2013 SNAPSHOT, *supra* note 12 (showing USAir dominating market share).

220. See Amended Complaint, *supra* note 8, at 45-57 (detailing city-pairs where increase in HHI illegal per se).



makes no mention of city-pairs and HHI increase violations.<sup>221</sup>

Overall, there appears to be an agreement between the DOJ and the American-USAir team that deals with a small fraction of new American's operation while leaving major hubs, such as Charlotte and Dallas Fort-Worth, untouched.<sup>222</sup> Charlotte was one of USAir's primary hubs prior to the merger and appears to be a hub where new American would also have a significant share of the market.<sup>223</sup> Prior mergers between Delta and NW reveals a similar picture in Atlanta (Delta's major hub before the merger), Minneapolis (NW's major hub prior to the merger), Detroit (NW's major hub), and Salt Lake City (NW's major hub).<sup>224</sup> The hubs, however, stayed true to their purpose and retained general control of the total market share.<sup>225</sup> A similar situation could arise with the new American controlling thousands of city-pairs; for example through and ability to exercise price control as well as airline departure times and takeoff frequency.<sup>226</sup> Consumers could face increased fares between new American hubs given the market share control at those airports.<sup>227</sup>

#### IV. CONCLUSION

The merger between American and USAir underscored a trend in the airline industry: rampant consolidation through horizontal mergers. Each time a merger was successful, the resulting airline became the largest in the world, or at least the largest in the United States. There appears to be very little data on how consumers are affected each time the number of competing airlines is reduced, but using market share numbers and HHI reveals a similar picture in each merger: the merged airline has a higher market share at each hub and is able to determine prices for consumers on city-pairs within the hubs that it operates. The deal between the DOJ and American-USAir team does not protect the interests of consumers in a wide range of city-pairs and hubs that the

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221. See DOJ November 2013 Press Release, *supra* note 10 (making no mention of HHI violations between city-pairs).

222. See AMERICAN 2013 SNAPSHOT, *supra* note 11 (stating American's top five market shares); DOJ November 2013 Press Release, *supra* note 10 (making no mention of Charlotte or Dallas-Fort Worth markets).

223. See USAIR 2013 SNAPSHOT, *supra* note 11 (stating USAir's top five market shares); CHARLOTTE 2013 SNAPSHOT, *supra* note 12 (noting market share for top carriers).

224. See Moss, *supra* note 123, at 6-7 (providing concentration statistics and relevant increases in merging airlines' hubs).

225. See Borenstein, *supra* note 72, at 400-02 (discussing merger leading to increased control and price increases for consumers).

226. See *id.* at 401-02 (discussing price increases and ability to control time and/or frequency of flights); Amended Complaint, *supra* note 8, at 45-57 (showing HHI increases in thousands of city-pairs). An independent study also confirmed a price increase in eighty-seven percent of the checked markets between 2007-2012, through consideration of prices before and after the mergers. See Seitz, *supra* note 16.

227. See Mayerowitz, *supra* note 16 (discussing potential for airfare increases and past history of mergers); Portillo, *supra* note 158 (stating negative impacts of merger specifically affecting Charlotte-Dallas and Fort Worth city-pair); see also Seitz, *supra* note 16 (showing increase in prices in 87% of markets following mergers).

new American would operate. The focus on Reagan National instead of larger hubs, such as Charlotte and Miami, does not give adequate protection to consumers. Thus, as a result of the new American merger, consumers will see an increase in prices from American, especially in city-pairs operated through the expanded hub network.

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