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LATIN AMERICAN COMPETITION FORUM

Session IV: Competition Issues in the Air Transport Sector

Contribution from the US Federal Trade Commission and the US Department of Justice

13-14 Septembre 2011, Bogotá (Colombia)

The attached document from the US Federal Trade Commission and the US Department of Justice is circulated FOR DISCUSSION under Session IV of the Latin American Competition Forum at its forthcoming meeting to be held on 13-14 September 2011 (Colombia).

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Session IV: Competition Issues in the Air Transport Sector

-- CONTRIBUTION FROM THE US FEDERAL TRADE COMMISSION AND THE US DEPARTMENT OF JUSTICE --

1. A Brief History of Antitrust Enforcement in the Airline Industry

1. Since Congress enacted the Airline Deregulation Act of 1978, the Antitrust Division of the U.S. Department of Justice ("Division") has pursued an active program of antitrust enforcement in the airline industry. During the first years following deregulation, antitrust jurisdiction was divided between the Division and the Civil Aeronautics Board (CAB). Though airlines were generally subject to the antitrust laws, the CAB retained jurisdiction to review mergers and acquisitions. When Congress abolished the CAB in 1985, the Department of Transportation (DOT) was given the CAB's merger review authority. From 1985 through 1988, the Division played a significant role by investigating the likely competitive effects of proposed mergers and submitting comments to DOT.

2. Effective December 31, 1988, Congress transferred jurisdiction over airline mergers from DOT to the Department of Justice. In the Division's merger review, it works closely with the DOT to benefit from DOT's substantial data and expertise in the airline industry. Since receiving jurisdiction for antitrust review of airline mergers, the Division has actively worked to ensure that mergers that would threaten to harm competition are not permitted to proceed. Several such airline mergers are discussed below.

3. Most recently, for example, the Division announced in April the closing of its investigation into the acquisition of AirTran Airways by Southwest Airlines Company, both low-cost carriers. The Division concluded that the merged firm would be able to offer new service on routes that neither served, including new connecting service through Atlanta from cities served by Southwest to cities served by AirTran. The Division said that the presence of low cost carriers like Southwest and AirTran had been shown to result in lower fares on routes previously served only by incumbent legacy carriers. Although there were overlaps between Southwest and AirTran on certain nonstop routes, the Division did not challenge the acquisition after considering the consumer benefits from the new service. Also, the airports affected by the overlaps were not subject to restrictions on slots or gate availability.

4. In August 2010, the Division announced that it had closed its investigation into the proposed merger of United Airlines Inc. and Continental Airlines, in light of an agreement by United and Continental to transfer takeoff and landing rights (slots) and other assets at Newark Airport to Southwest. The proposed United/Continental merger combined the airlines' largely complementary networks, resulting in overlap on a limited number of routes where United and Continental offered competing nonstop service. The largest such routes were between United's hub airports and Continental's hub in Newark, where Continental has a high share of service and where there was limited availability of slots, making entry by other airlines particularly difficult. The Division concluded that the transfer of slots and other assets at Newark to Southwest, a low cost carrier that had only limited service in the New York metropolitan area and no Newark service, resolved its principal competition concerns and would likely significantly benefit consumers on overlap routes as well as on many other routes.

5. In October 2008, the Division announced the closing of its investigation of the proposed merger of Delta Air Lines Inc. and Northwest Airlines Corporation. The Division determined that the merger was likely to produce substantial and credible efficiencies that would benefit U.S. consumers and was not likely to substantially lessen competition. The two airlines competed with a number of other airlines in the provision of scheduled air passenger service on the vast majority of nonstop and connecting routes where they competed with each other. In addition, the merger likely would result in efficiencies such as cost savings in airport operations, information technology, supply chain economics, and fleet optimization that would benefit consumers. Consumers are also likely to benefit from improved service made possible by combining under single ownership the complementary aspects of the airlines' networks.

6. In 2001, the Division announced its intent to challenge the merger of United Airlines and US Airways, then the second and sixth largest airlines in the United States, after concluding that the merger likely would reduce competition and result in higher fares on routes throughout the United States and internationally. The Division concluded that United's proposal to divest assets at Washington's Reagan National Airport and American Airlines' promise to fly five routes on a non-stop basis were inadequate to replace the competition that would have been lost due to the merger. In response, the parties abandoned their merger plans.

7. In October 1998, the Division sued to block Northwest Airlines from buying a controlling stake in Continental Airlines. Northwest and Continental were the fourth and fifth largest airlines in the United States at the time. They competed on hundreds of routes across the country, and the proposed transaction would have substantially diminished the airlines' incentives to compete against each other. The Division rejected Northwest's plan to put its Continental stock in a "voting trust" for six years as insufficient to prevent the competitive harm likely to result from the acquisition. In November 2000, after trial had begun, Northwest announced it was selling Continental the shares that would have given it control, retaining only a five-percent share. Because the sale of control remedied the competitive harm, the Division dropped its lawsuit.

8. In addition to challenging transactions that would adversely affect market structure, the Division has investigated and challenged collusion in violation of section 1 of the Sherman Act. In an ongoing criminal probe of major international airlines for fixing rates for cargo shipments (including medicines, food, and consumer electronics) and rates for passenger transportation, more than $1.8 billion in criminal fines have been imposed, 22 airlines and 21 executives have been charged, and four executives have been sentenced to serve prison time. Charges are pending against the remaining executives. Finally, in 1992, the Division sued Airline Tariff Publishing Co. (ATPCO) and eight major airlines, alleging that the airlines used the ATPCO electronic fare submission and dissemination system to fix prices, which the Division concluded had cost consumers up to $2 billion in travel expenses.

9. In addition to pursuing these enforcement matters, the Division also engages in competition advocacy in various matters before the Department of Transportation. For example, the Division has filed comments in DOT proceedings considering whether to approve and grant immunity to all or part of international airline alliances, matters over which DOT retains authority under 49 U.S.C. §§ 41309 and 41308, respectively. It participates with the Departments of Transportation, State, and others in efforts to open international airline markets, and has advocated for addressing airport congestion issues through efficient market-based mechanisms.

2. Evaluating Mergers and Acquisitions among Air Carriers

10. The Antitrust Division reviews airline mergers under section 7 of the Clayton Act. Section 7 prohibits the acquisition of stock or assets "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." The primary focus is to determine the likely competitive effects of a proposed merger in the future.

11. The Division applies the 2010 DOJ/FTC Horizontal Merger Guidelines to mergers in the airline industry. In airline mergers, the definitions of product and geographic market converge: relevant airline markets are likely to consist of scheduled passenger airline service between a point of origin and a point of destination, generally referred to as city pairs. Thus, for example, a relevant market might be Atlanta to Minneapolis-St. Paul. This market makes intuitive, as well as economic, sense. If you want to fly from Atlanta to Minneapolis-St. Paul for a business meeting or vacation, you are not likely to regard a flight from Atlanta to Detroit or Milwaukee, for example, as a reasonable alternative if the fare increases from Atlanta to Minneapolis-St. Paul. The Division would thus be concerned about a transaction that significantly reduces competition in city pair markets.

12. The relevant market may, however, also be narrower than all scheduled airline service in a city pair. Certain cities (*e.g*., New York, Chicago, Los Angeles) have multiple airports and, depending on the facts, it may not always be the case that all of those airports are in the same relevant antitrust market for certain consumers. Also, it may be the case that non-stop and connecting (one-stop) service may not be in the same relevant antitrust market. Many city pairs are served by some carriers on a non-stop basis and by other carriers on a connecting basis. This circumstance poses the following question: Do passengers regard connecting service as a reasonable alternative to non-stop service, such that the availability of connecting service would constrain the price of non-stop service?

13. In the Division's experience, passengers traveling for leisure--on vacation, for example--are more likely to consider connecting service as a good alternative to non-stop service because they are less time sensitive (in other words, their demand is more elastic). But business travelers may be significantly less likely to regard connecting service as a reasonable alternative because they place a higher value on getting to their destination quickly (their demand may be relatively inelastic). A carrier offering the only non-stop service on a route could raise fares to those time-sensitive travelers without losing them to another carrier's connecting service. There thus may be circumstances in which a transaction will be competitively problematic because of its impact on non-stop service in city pair markets, even if other carriers provide service in those markets on a connecting basis.

14. In considering the possible competitive effects of an airline merger, the Division accordingly looks at the effect in all city pair markets served by both of the merging carriers in terms of both nonstop service and connecting service. Once overlapping city pairs have been identified, the Division looks at the number of other carriers serving each of the markets and at the nature of that service (whether it is connecting or non-stop). Using detailed data that carriers are required to report periodically to the DOT, the Division calculates market shares. It then focuses further analysis on those city pairs in which market

shares and concentration levels indicate a post-merger structure conducive to the creation or enhancement of market power.

15. The Division's analysis does not stop with the market shares. The prospect of potential competition through entry or expansion by other airlines can constrain the ability of incumbent airlines to raise price or reduce output below a competitive level. Under the Merger Guidelines, the Division considers whether entry into the affected markets is so easy, in the sense that it would be timely, likely, and sufficient in its magnitude, character and scope, that it will likely deter or counteract the competitive effects of concern.

16. The Division also will consider and take into account airline-specific business practices and characteristics that affect merger analysis. For example, in the Division's review and ultimate determination to challenge the merger of United Airlines and US Airways, it was concerned that the merger would reduce competition with respect to high volume corporate and government business contracts. The Division will consider these and other factors in assessing the likelihood that a transaction will create or enhance the merging carriers' market power or facilitate its exercise, on a unilateral or coordinated basis.

17. The Division also takes into account any efficiencies that may result from the merger. If a merger brings efficiencies that will enhance the combined firms' ability to compete, and the benefits from that enhanced competition will negate any otherwise potential anticompetitive effect, then the merger is procompetitive. A merger may enable the combined airline to offer consumers better service, for example, by offering more frequent flights between some city pairs, fewer connections, shorter layovers, or service to more destinations throughout the country or the world.