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TURKISH AVIATION ACADEMY

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# Antitrust Law and Airline Mergers and Acquisitions

## Module 22

Istanbul Technical University

Air Transportation Management, M.Sc. Program

**Air Law, Regulation and Compliance Management**

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# Outline

- Trends in Airline Mergers
- Antitrust Issues with Airline Mergers
- Merger Control Laws and Enforcement
- The American-US Airways Case Study

# Trends in Airline Competition

# Trends in airline competition

- To key trends since deregulation and liberalization
  - new business models (LCCs, ULCCs)
  - consolidation
- Airlines developed hybrid business models in response to competition
  - legacy carriers seek to improve their costs; low-cost subsidiaries
  - low-cost carriers diversify by offering value-added services

# Trends in airline competition

- Increased and diversified forms of horizontal cooperation between airlines
  - alliances
  - mergers & acquisitions
- Airline cooperation deepens in depth and scope
  - metal-neutral joint ventures

# Trends in airline M&A

Airline Industry: Key M&A Statistics\*, Global, 2007–2012



Source: Frost and Sullivan (2013)

# Definition of a merger

- The acquisition by one airline of the control or ownership of another airline.
- Airline mergers and acquisitions can be
  - Horizontal
  - Vertical
- ASAs distinguish between
  - Domestic mergers (carriers of the same nationality)
  - International mergers (carriers with different nationalities)

# Why do airlines merge?

- Financial distress post-deregulation
  - Internal factors (bad management)
  - External factors (economic downturns, fuel price, demand shocks, increased competition, etc.)
  - Competitive practices (state aid, tax free airports, low labour costs, etc.)
- Consolidation is subject to merger control under competition laws
  - Financial distress is considered by competition authorities in merger control



# Major non-U.S. mergers

- Air Canada / Canadian Airlines (2001)
- Air France/KLM (2004)
- Japan Airlines / JAS (2006)
- Lufthansa / Swiss, Austrian Airlines, Brussels Airlines
- British Airways / Iberia (2011)
- LAN / TAM (2011)

# Merger Control Laws and Enforcement

# Merger control laws

- Countries have merger control laws that apply generally to all industries (not only to airline mergers)
  - US:
    - The *Sherman Act*
    - The *Clayton Act*
    - Other statutes to close loopholes
  - EU:
    - The *Treaty on the Functioning of the European Union*
    - EC Merger Regulation and Implementing Regulation
  - Canada:
    - The *Competition Act*
- Merger control laws are forward-looking and preventive in nature

# Pre-merger notification

- Approximately 100 states have pre-merger notification laws
  - Requirements range from simple notification to intensive investigations
  - Jurisdictional thresholds are determined by the size of the transaction
- Reviews by antitrust agencies may be suspensory, non-suspensory or hybrid
  - The principal objective is to determine if the merged airline will have market power to increase prices

# How do competition authorities review airline mergers?

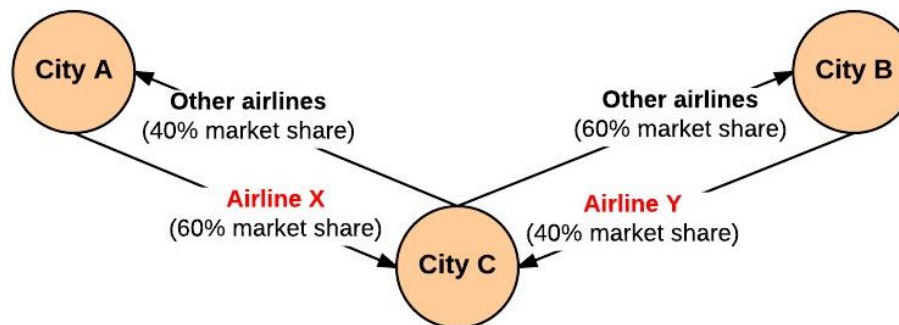
- Competition authorities are concerned with impact on markets where competition is likely to be lowered post-merger
  - Identify overlapping markets
  - Assess the merged airline's ability to exercise market power
  - Assess the anti-competitive effects that are likely to result post-merger

# Network overlap

## Overlapping Networks



## Complimentary Networks



# Bad mergers may get approved

- Competition authorities may still approve a merger, even if it will likely lead to a lessening of competition
  - The efficiency defense
    - The merger will result in efficiencies or cost reductions
  - The failing firm defense
    - one of the merging airlines is likely to fail in the absence of the merger

# But with remedies

- Competition authorities may apply/seek remedies in the case of an anticompetitive airline merger
  - Outright prohibition
  - Structural remedies
    - Airport slot divestitures
    - Route divestitures
    - Gate divestitures
  - Behavioral remedies
    - Access to FFP
    - Obligation to interline
    - Capacity of price constraints
    - Alliance membership withdrawal



# More on remedies

- Remedies in merger control recognize that mergers are the most integrated form of consolidation
  - A merger eliminates competition between carriers as airlines no longer make separate business decisions post-merger

# Airline Merger Control in the United States

# Historical Context

- Prior to 1985, airline mergers required approval by the Civil Aeronautics Board
  - Approval meant antitrust immunity
  - CAB could apply remedies as a condition of approval
- Between 1985 and 1989, airline mergers were regulated by the U.S. DOT
  - All 21 merger applications approved
- After 1989, airline mergers are reviewed by the U.S. DOJ under section 7 of the Clayton Act
  - U.S. DOT retained jurisdiction over international alliances

# The Clayton Act

- The Clayton Act prohibits a person “engaged in commerce or in any activity affecting commerce” from acquiring “the whole or any part” of a business if the acquisition may substantially “lessen competition or tend to create a monopoly.”
  - To prevail, the plaintiff must define the relevant market and prove that the merger will create a danger of anticompetitive consequences.

# The relevant market

- The relevant market is the geographic and product market, using reasonable interchangeability or cross-elasticity of demand analysis.
  - Although market share and concentration levels are relevant, they are not conclusive.
  - Instead, courts examine the market's structure, history and future, the characteristics of the customers, trends toward concentration or concentration, the existence of competitors and barriers to entry.

# The geographic market

- The relevant geographic market is an area where the dominant firm
  - can increase its price without large numbers of consumers turning to alternative supply sources outside the area
- The relevant geographic market in commercial aviation is a **city pair**
  - Airport pairs
  - Hub airports
  - Networks

# The product market

- The relevant product market requires an assessment of the products that are sufficiently close substitutes to compete effectively in each other's markets
  - Courts employ a “reasonable interchangeability” standard gauged by
    - “(1) the product uses, i.e., whether the substitute products or services can perform the same function, and/or
    - (2) consumer response (cross-elasticity); that is, consumer sensitivity to price levels at which they elect substitutes for defendant's product or services.”

# The product market

- Scheduled passenger air transportation in defined city-pairs is probably the relevant product market in commercial aviation (the competitive alternatives of rail, bus and automobile transport, or freight transportation, likely can be ignored for long-haul flights).
  - Non-stop versus connecting flights
  - Premium versus economy class
  - Business (time-sensitive) versus leisure travellers (time-insensitive)
  - Low frills versus full service



# The AA / US Airways Case Study

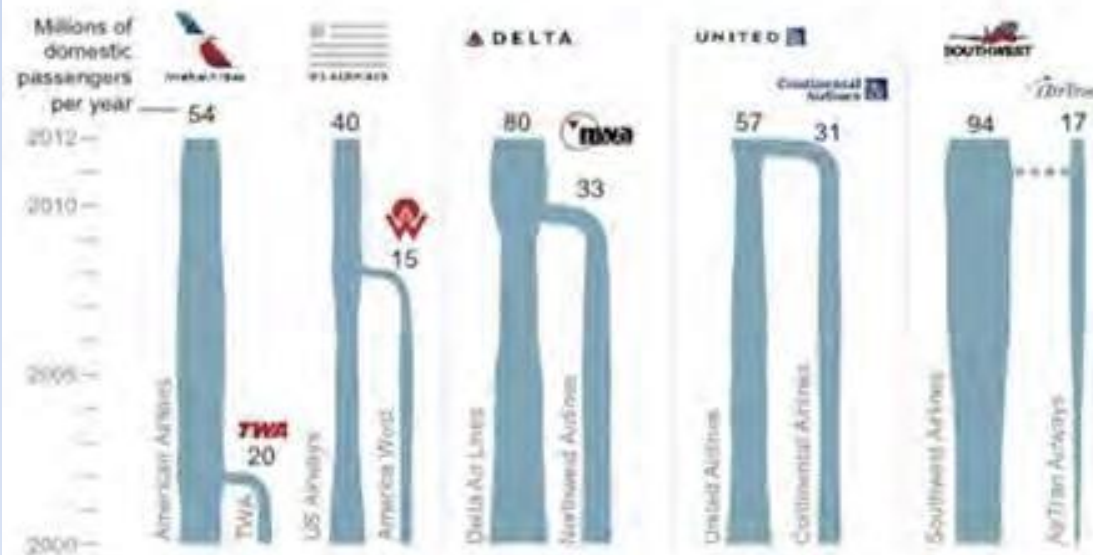
# The world's largest airline

## American Airlines to merge with US Airways

The merger, if approved, would create the world's largest airline, leaving four major carriers in control of 70 percent of U.S. passenger traffic.

### KEY MARKET-SHAPING MERGERS SINCE 2000

Thickness of bands reflect annual domestic air traffic.



**American and US Airways** both made key acquisitions since 2000. A merger of the two would create the world's largest airline.

**Delta** acquired Northwest in 2008, making it the world's largest airline.

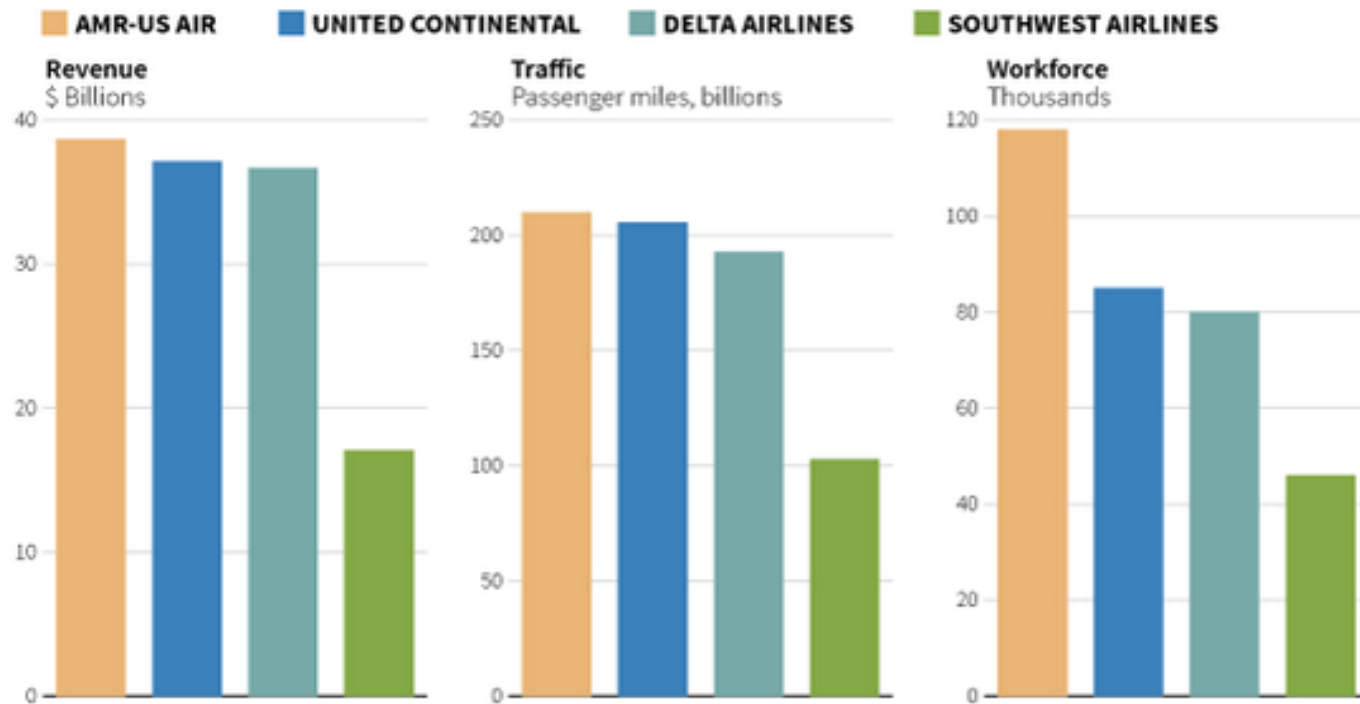
**United** and Continental officially merged in 2012, making United the No. 2 carrier behind Delta.

**Southwest** in 2011 bought AirTran, which continues to operate as a subsidiary.

# The world's largest airline

## A new airline order

A merger of American Airlines and US Airways would create the world's largest airline. Here's how the major U.S. carriers would stack up, based on 2012 figures.



Source: company reports

S. Culp, 14/12/2013

REUTERS

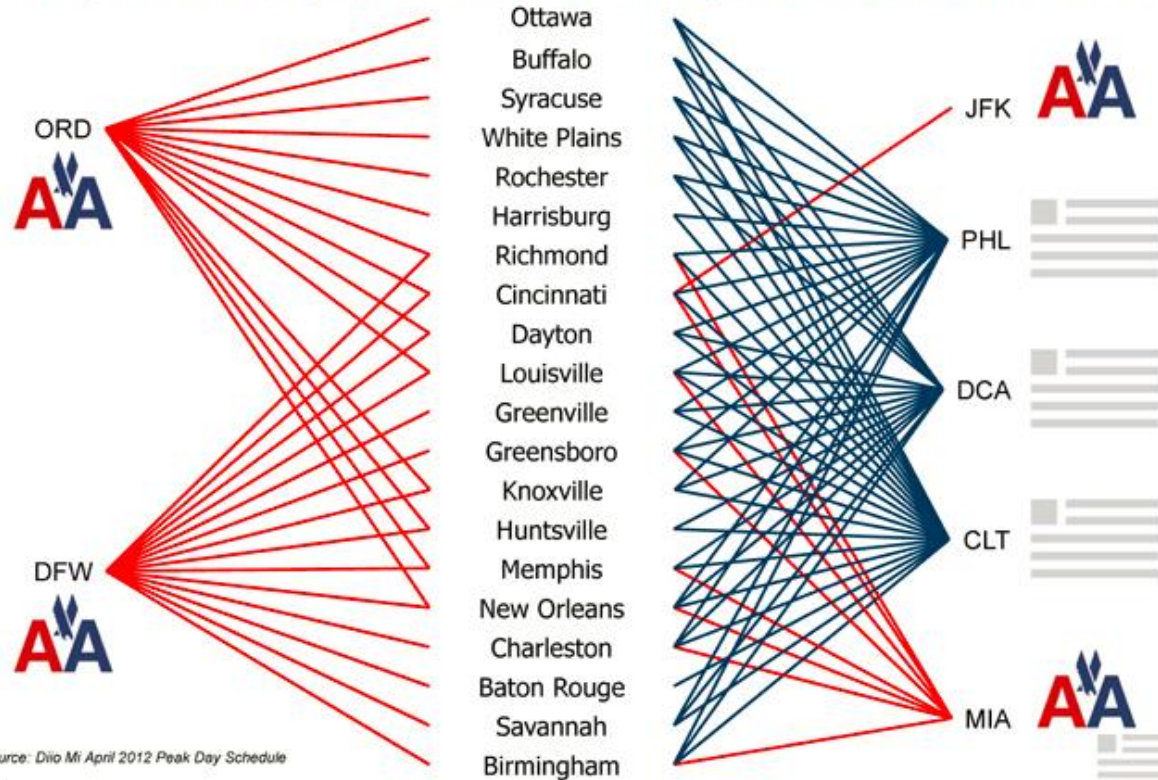
# AA / US Airways international networks



# AA / US Airways domestic networks (East Coast)

## US Adds Valuable Connectivity Along East Coast

- Merger creates a comprehensive network that can compete with United, Delta and others



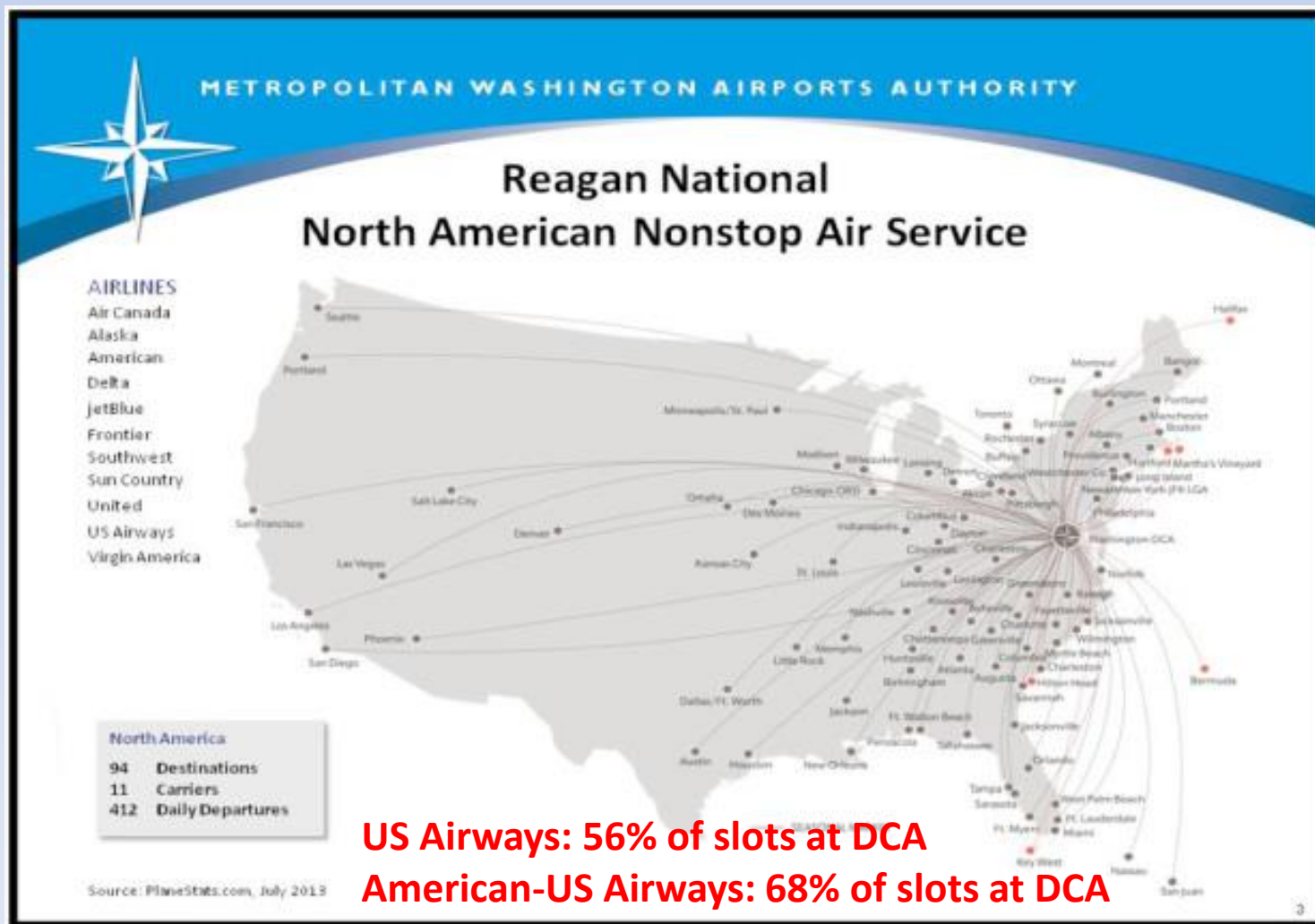
Source: Diio Mi April 2012 Peak Day Schedule

# The U.S. DOJ response to the merger

- The U.S. DOJ challenged the proposed \$11 billion merger on the grounds that
  - “[the merger] would substantially lessen competition for commercial air travel in local markets throughout the United States and result in passengers paying higher airfares and receiving less service.”
- Main concerns
  - US Airways Advantage Fares
  - Higher ancillary fees
  - Facilitated coordination in domestic markets



# Washington Reagan National Airport



# The airlines' response

*“Blocking this procompetitive merger will deny customers access to a broader airline network that gives them more choices.*

*Further, this merger provides the best outcome for AMR's restructuring. The widespread support from the employees and financial stakeholders of both airlines underscores the fact that this is the best path forward for both airlines and the customers and communities we serve.”*



# Settlement resolves concerns

- A settlement was reached to increase presence of low cost carriers in problematic markets and retain service to small communities
  - Slot divestiture
    - 52 slot pairs at Washington's Reagan National airport
    - 17 slot pairs at New York's LaGuardia airport
  - Gate divestiture
    - 2 gates at each of Boston, Chicago, Dallas, LA and Miami
  - American is required to maintain service
    - From its hubs to the states participating in the lawsuit