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US Airways/American Merger Trial Is Set for Takeoff

On Aug. 13, the U.S. Department of Justice and six state attorneys general filed a lawsuit to block the proposed merger of American Airlines and US Airways. Pennsylvania was one of the states to join the suit. The proposed \$11 billion transaction would combine the fourth- and fifth-largest U.S. carriers, making the new American the largest domestic airline, and, by some measures, the largest airline in the world.

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Bill Baer, head of the DOJ's Antitrust Division, said: "We filed the lawsuit today because we determined that the merger—which would create the world's largest airline and leave just three legacy carriers remaining in the U.S.—would substantially lessen competition for commercial air travel throughout the United States." Lawyers for the airlines fired back: "We are litigating this case, period." According to the airlines, "combined, US Airways and American Airlines will offer more and better travel options for passengers through an improved domestic and international network, something that neither carrier could provide on their own." The trial is scheduled to begin in federal court Nov. 25 in Washington, D.C., before U.S. District Judge Colleen Kollar-Kotelly of the District of Columbia. The trial is expected to last 10 to 15 days, and the court has said that a ruling will come in January after the parties have submitted post-trial briefings.

Chamber of Commerce, Nutter Urge DOJ to Drop Suit

The DOJ has run into significant political criticism of its decision to challenge the merger. Just in the last two weeks, Philadelphia Mayor Michael Nutter, along with the mayors of six other cities that serve as hubs for US Airways and American, urged U.S. Attorney General Eric Holder to reconsider the "ill-conceived lawsuit." The mayors' letter claimed that "the failure to clear the combination of American Airlines and US

Airways will put our cities at an unnecessary competitive disadvantage to [cities] that directly benefit from the Delta and United mergers." (When joining the DOJ suit, Pennsylvania asserted that "more than 1 million people traveling to and from Pennsylvania would face higher fares and most of them would begin or end their travels in Philadelphia.") The mayors' letter was followed within days by a letter from 26 city and state chambers of commerce, including Philadelphia, urging the DOJ to settle the suit. A week earlier, 68 House Democrats sent a letter to President Obama urging the DOJ to withdraw the suit and let the merger proceed. Airline employee unions have also been making their case that the merger will save jobs. Texas, which initially joined the suit citing "decreased competition, higher airfares and fees, reduced service and downgraded amenities," recently settled the suit stating that "today's [settlement] agreement ensures that thousands of jobs will remain in Texas."

Lobbying the DOJ to drop the suit is unlikely to succeed; although this is an extraordinary level of political pressure. On Oct. 29, a filing revealed that both sides agreed to use a mediator to possibly resolve the lawsuit. The nature of the complaint makes this a difficult case to settle, but it is not out of the question. If there is a trial, issues such as what areas might see job gains or losses are not relevant. The sole issue at trial will be whether the merger agreement "would likely substantially lessen competition, and tend to create a monopoly in violation of Section 7 of the Clayton Act." A unique feature of a merger trial is that the parties will be trying to convince the court of what will likely happen in the future; most trials are about trying to prove something that happened in the past.

DOJ: Merger leads to Higher Fares, Less Competition

The DOJ believes that the merger will result in U.S. airline passengers paying higher fares, as well as higher fees for items such as bag check, ticket changes and priority boarding. US Airways and American Airlines actually have very little direct competition for nonstop flights compared to prior approved mergers. Nonetheless, the DOJ alleges that the merger will harm competition in three distinct ways: (1) on over 1,000 routes where US Airways and American compete, competition will be reduced to an unacceptable level; (2) competition among the remaining three legacy carriers will be reduced, thereby allowing for increased price coordination; and (3) there will be undue concentration of gates at the Ronald Reagan Washington National Airport where the new American will control 69 percent of the gates.

While American and US Airways have little head-to-head competition on nonstop routes, there is extensive overlap where one airline flies nonstop and the other also services that city pair with one-stop routes. In an appendix, the DOJ lists 1,043 city pairs where the increase in concentration post-merger would be significant enough to be presumptively anticompetitive under the DOJ/FTC merger guidelines due to the high market shares of the remaining competitors. Thirty-six of these "presumptively illegal" routes have Philadelphia as one of the city pairs. The DOJ also alleged that the increase in the concentration of the airline industry would make it easier for the remaining three legacy carriers "to cooperate, rather than compete, on price and service." According to the complaint, the industry is already conducive to coordinated behavior because few large players dominate, and each can readily see the prices charged by competitors. As a result of the previous mergers, the industry is at a point where any further consolidation would harm consumers. The DOJ complaint gives little attention to low-cost carriers such as Southwest Airlines. But, the complaint does state that Southwest cannot restrain the parallel pricing among the legacy carriers by pointing to the fact that Southwest does not charge for the first-checked bag, yet this has not constrained the legacy airlines from instituting and increasing such fees.

US Airways currently holds 55 percent of the slots at Reagan National and the merger would increase this percentage to 69 percent. More worrisome from the DOJ's point of view is that half of JetBlue's slots at Reagan are leased from American; leases that can be terminated by the new American. If the concentration at Reagan National were the primary concern about this merger, however, it would likely be dealt with by something short of blocking the entire merger. The DOJ typically resolves competitive concerns around a merger with a "fix-it-first" policy, e.g., requiring the new American to sell or lease slots to smaller carriers.

The issues in this proposed merger are similar to those in the 2010 merger of United and Continental and the 2008 merger of Delta with Northwest. These were not opposed by the DOJ. What's the difference? There appear to be two major factors that motivated the DOJ to challenge this transaction. First, US Airways appears to be something of a price-cutter among the legacy carriers with its "Advantage Fares," which are

discounts of up to 40 percent for a flier willing to take a one-stop flight instead of nonstop. Delta, United and currently American will charge the same or even higher fare on a connecting flight than a competitor charges for a nonstop. This "respect" by Delta, United and American for each other's pricing on nonstop routes is borne out of a fear of retaliation on their own nonstop routes if they undercut each other. But, US Airways, because of its different route structure, is not as susceptible to this "retaliation." According to the complaint, "US Airways alone among the legacy carriers has a different cost-benefit analysis for pricing connecting routes [versus non-stops]." According to the DOJ, these advantage fares (and competition) would likely stop after the merger because the new American would be vulnerable (in ways that US Airways currently is not) to retaliation by United and Delta.

A second factor that motivated the DOJ is cited in its complaint: "The American public has seen this before." The DOJ approved the Delta/Northwest and United/Continental mergers based in part on predictions that markets would be even more competitive as the carriers strengthened themselves through combinations. In the DOJ's view, however, pre-merger promises of consumer benefit turned out to be illusory. Instead, a more concentrated industry was able to increase fares and fees while reducing capacity and service.

Merger needs to Maintain, Increase Competition

The airlines do not have to prove anything at trial; the burden is on the DOJ to prove the merger is anticompetitive. However, in vowing to fight the suits, American and US Airways put forth two central arguments in defense of the merger. First, they believe the DOJ ignored "the most meaningful competitive development in the airline industry since deregulation: the emergence of low-cost carriers."

US Airways and American place great emphasis on competition from discount carriers and other low-cost carriers. The merger hopefuls believe that the DOJ completely ignored the low-cost and regional carriers in its analysis. From their perspective, vigorous competition with the low-cost and regional airlines will continue after the merger.

Merger proponents also assert that the merger will allow the new larger American to compete against the larger United and Delta airlines. The merging parties believe they have complementary assets and want to combine routes and resources in order to offer more services and options to passengers through an improved domestic and international network, something neither carrier could provide on its own.


The Trial

Airlines keep precise records of every ticket sale, other fees and price movements. Economists for both sides will scrutinize this data, and develop economic models and theories in order to convince the court that the merger will or will not increase prices and will or will not lead to reduced capacity and service. The DOJ will also rely on emails and statements made by the companies about previous mergers and the proposed one, while the airlines no doubt will explain why these statements are taken out of context, were off-the-cuff simplifications, or simply wrong. The airlines will also have emails, documents and testimony of their own.

The Post-Merger world

The case will present two different views of the post-merger world. According to the DOJ, if the merger is blocked, a strong American will emerge from bankruptcy, US Airways will continue to compete with "Advantage Fares" and competition will be preserved. According to US Airways and American, there will be robust competition after the merger, as low-cost carriers, ignored by DOJ, will continue to compete and grow. In addition, with the merger, the new American will be on an even footing and be able to go toe-to-toe, or wing-to-wing, with United and Delta. Although the flying public will not get a vote in this contest, the parties will present their cases to Kollar-Kotelly beginning Nov. 25.

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