AIRLINE MERGERS IN THE EUROPEAN UNION AND THE UNITED STATES

A RETROSPECTIVE ACCOUNT AND THE WAYS FORWARD

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Abstract

The past decade witnessed a substantial wave of airline mergers in the markets of the European Union and the United States. The present thesis will provide a retrospective comparative assessment of the application of antitrust law in each jurisdiction, and will assess its impact on each domestic market under review. It will explore the historical roots of this common tendency towards consolidation, and will analyze how competition regulators in each jurisdiction responded to the antitrust challenges raised by this common trend. It will contend that the European Commission has adopted a more stringent standard in its assessments of the subject mergers than the Department of Justice. It will substantiate this submission by examining three important parameters involved in any competitive assessment, namely the definition of an antitrust market, the substantive test against which a transaction will be reviewed, and the consideration of the efficiencies (allegedly) induced by a merger. It will contrast the European Commission's merger-skepticism to the Department's merger-permissiveness in these three areas. It will subsequently assess the impact of this disparate standard of review on the competitive state of each market. Evidence will be adduced showing that the looser antitrust policy pursued in the United States has produced significant anticompetitive effects in its domestic market. The thesis will conclude by offering a prospective assessment of the ways in which these disparities in antitrust enforcement are liable to affect the future evolution of the industries in the two jurisdictions, and will submit that the European approach is more suited for the preservation of effective competition.

Resumé

Au cours de la décennie écoulée, les marchés européens et américains ont vu se dérouler un nombre important de fusions entre compagnies aériennes. Ce mémoire entamera une analyse rétrospective et comparative de l'application du droit de la concurrence dans chaque juridiction et examinera son impact pour chacun des marchés. Nous examinerons les raisons historiques de la consolidation de chaque marché et analyserons de quelle manière les autorités de la concurrence ont répondu aux défis posés par cette tendance. Notre thèse sera que la Commission Européenne s'est montrée plus stricte dans son analyse que le Département de la Justice américain. Cette opinion sera soutenue par l'examen des trois paramètres utilisés pour une analyse concurrentielle, soit la définition du marché, le critère de fond utilisé pour l'examen d'une transaction et l'évaluation des gains d'efficacité générés par une fusion. Nous contrasterons en particulier l'exigence dont fait preuve la Commission Européenne avec la permissivité affichée par le Département de la Justice sur ces trois aspects, puis étudierons l'impact sur chaque marché produit par ces différentes pratiques. Nous montrerons également que la politique anticoncurrentielle américaine, favorable aux fusions, a produit des effets plus importants dans le cadre de son marché intérieur. Enfin, nous conclurons par une prévision sur l'évolution des deux marchés, telle qu'elle peut être prévue en fonction de l'attitude du régulateur. Nous expliquerons alors en quoi nous considérons l'approche européenne mieux appropriée à la préservation d'une saine concurrence.

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Introduction

Following its liberalization in the last two decades of the preceding century, the aviation industry has recently experienced a wave of mergers between its formerly competing legacy carriers. This trend towards consolidation occurred in the markets of both the United States and the European Union. In the United States, this wave began with the merger of Delta and Northwest, soon followed by United and Continental, and US Airways and American. In the European Union, Air France took over KLM, Lufthansa expanded its group to include Swiss and Austrian, and British Airways paired up with Iberia. In both industries, this trend towards consolidation succeeded their respective deregulation and liberalization.

In the United States, both airfares and capacity were originally determined by the Civil Aeronautics Board. Carrier entry into any given route required the Board's approval, which was contingent on the satisfaction of a "public convenience and necessity" requirement.[1] In 1978, the Airline Deregulation Act was enacted to deregulate the industry. Accordingly, both capacity and pricing were no longer determined by the regulator, but were instead set by the forces of the market. It was wrongly assumed that "there are no major obstacles to entry or exit in a typical aviation market, so there is no "real" public interest rationale for regulation".[2]

This resulted in a huge wave of new entry by smaller carriers with significantly lower cost structures than the legacy incumbents.[3] The effect of this market transformation was twofold. On the one hand, it forced legacy carriers to

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[1] Ivan L Pitt & John R Norsthworthy, *Economics of the U.S. Commercial Airline Industry: Productivity, Technology, and Deregulation* (New York: Springer, 1999) at 67-70.
[2] Eldan Ben-Yosef, *The Evolution of the US Airline Industry: Theory, Strategy and Policy* (New York: Spriner, 2010) at 25.
[3] Paul Stephen Dempsey, "Airline Deregulation and Laissez-Faire Methodology: Economic Theory in Turbulence" (1990) 56 J Air L & Com 306 at 323 [Dempsey, "Deregulation Mythology"].

engage in price-based competition, often below cost, in order to meet the lower fares offered by the new entrants.[4] On the other, it provided the spark for the progressive consolidation of the legacy airlines into fortress hubs, through which passenger traffic would connect to reach its final destination.[5] The dominance of a carrier over its hub airport would be used to yield higher fares from passengers and to deny entry to potential competitors.[6] As a further consequence of this new reality, legacy carriers engaged in predatory conduct, such as fare-wars and capacity flooding, to eradicate and discourage new entry into their routes.[7] The first few years of deregulation saw a wave of bankruptcies and liquidations that indiscriminately struck both the incumbents and the new entrants.[8] Consequently, since deregulation, legacy carriers have been looking for ways to cope with the vigor of free competition with the new low cost carriers, with which they cannot compete.

In the European Union, the intervention of the State took a different form. Unlike the United States, what eventually became the Single European Aviation Market was originally a highly fragmented region of small sovereign nations, each with its own national carrier that was heavily reliant on the funds and support of the State for its survival.[9] It was not until the late 1990s that the European aviation market took its present form, by way of the progressive implementation of the Common Market principles through three aviation liberalization packages.[10]In essence, the barriers of the national aviation markets of each Member State were waived, allowing

[4] *Ibid* at 403.
[5] *Ibid* at 307; Martin Fojt, *The Airline Industry* (Bradford, England: Emerald Group Pub, 2006) at 6-7; Pitt & Norsthworthy, *supra* note 1 at 80-82.
[6] Dempsey, "Deregulation Mythology", *supra* note 3 at 329-335.
[7] See e.g. Paul Stephen Dempsey, "Predation, Competition & Antitrust Law: Turbulence in the Airline Industry" (2002) 67 J Air L & Com 685 [Dempsey, "Predation"].
[8] Dempsey, "Deregulation Mythology", *supra* note 3 at 325-327; Pelline, "Bumpy Ride Under Deregulation", San Fransisco Chron, Oct 28, 1988 at 21.
[9] Alan P Dobson, *Globalization and Regional Integration: The Origins, Development and Impact of the Single European Aviation Market* (London: Routledge, 2007) at 150-151.
[10] Paul Stephen Dempsey, *European Aviation Law* (The Hague: Kluwer Law International, 2007) at 89.

any community carrier to service *any* route within the common market. Further, the restrictions on the foreign ownership of national carriers by community nationals were waived, allowing the formerly national carriers to be owned and controlled by any entity bearing the European nationality.[11] Additionally, the rules on state aid were tightened, and the circumstances in which such aid was acceptable were significantly contained.[12] This transformation completed the antecedent wave of privatization of the formerly state-owned national airlines, and resulted in the emergence of Union-wide low cost carriers operating across the entire Single European Aviation Market.[13]

Therefore, the two markets manifest three similarities. First, they both transitioned from a state of intense regulation or intervention to a free market subjected to the vigor of unrestricted competition.[14] Second, they both encompass two distinct species of carriers, namely the legacy airlines and the newly created low cost carriers with their lower cost structures, as a result of which pricing does not always occur on the basis of cost, but, rather, on the basis of price.[15] Third, and as a result of the previous two factors, the former legacy carriers have a strong incentive to consolidate and shield themselves from the competitive constraints incurred through the interaction with their low cost competitors.[16]

However, despite these similarities, the two markets also manifest one crucial difference, namely the fact that, following the lapse of the recent merger wave, the domestic market of the United States has emerged significantly more concentrated than the Single European Aviation Market. Accordingly, the increases in airfares have

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[11] Dobson, *supra* note 9.
[12] *Ibid* at 129-138.
[13] Dobson, *supra* note 9 at 164.
[14] Rigas Doganis, *The Airline Business* (London: Routledge, 2006) at 17-20; Stephen Holloway, *Straight and Level: Practical Airline Economics* (Burlington: Ashgate, 2008) at 26-27.
[15] Alessandro Sento, *The Airline Industry: Challenges in the 21st Century* (Heidelberg: Physica-Verlag, 2009) at 94.
[16] Rigas Doganis, *Flying off Course: The Economics of International Airlines* (London: Routledge, 2002) at 96-99 (for a discussion of Europe); Costas Iatrou & Mauro Oretti, *Airline Choices for the Future: From Alliances to Mergers* (Burlington: Ashgate, 2007) at 1-2.

been more pronounced in the United States, as has the prejudice to the interests of the travelling public.

The present thesis will provide a retrospective comparison of the regulation of the two industries thus far, in order to explain the present disparity in their concentration levels. It will focus on the regulation of competition, and specifically airline mergers. Since the instinctive responses of legacy-carriers towards competitive threats are the same regardless of their nationality or location, and since both industries were exposed to strong competition through their liberalization, the only *dis*similar variable capable of affecting the concentration levels in each market can only be, by way of elimination, antitrust and merger control.

It could be argued that the more lenient bankruptcy code of the United States is also a parameter worthy of consideration. Its more generous provisions enable unhealthy carriers to remain in the market by restructuring, instead of exiting through liquidation.[17] Yet, the effect of such a barrier to market exit can only militate against high market concentrations, as it ensures the presence, rather than elimination, of an additional market participant with whom the market will be shared.[18] Consequently, it is only antirust that can account for the different levels in market concentration and the reduced competition that has resulted from its rise in the United States.

[17] Mark C Mathiesen, "Bankruptcy of Airlines: Causes, Complaints and Changes" (1996) 61 J Air L & Com 1017 at 1034-1035.

[18] It could be counter-argued that the generous restructuring provisions of Chapter 11 could amount to an effective barrier to market entry in the long run, insofar as they enable the cost-inefficient incumbent legacy carriers to remain in the market and, through their exclusionary practices, to deny entry to newer and more cost-efficient carriers (*c.f. supra*, note 17). Accordingly, in the long-term, the provisions of Chapter 11 could be facilitating the accrual of high market concentrations in favor of the legacy incumbents. This discussion is beyond the scope of the present thesis. However, for the purposes of the present comparison of the two markets under review, the prolonged subsidization of national carriers by governments in Europe can be assumed to have produced a comparable market-distorting effect, as it secured the survival of otherwise financially unfit carriers. Hence, the working assumption of the present thesis to the effect that the disparate concentration levels in the two markets are attributable to the differential vigor of merger control is tenable.

Accordingly, it will be submitted that the European Commission's competitive assessment is more suited for the stricter review of airline mergers than the respective assessment of the Department of Justice. It will be argued that the Department has adopted an unduly lax and permissive standard of review that has failed to capture the anticompetitive dangers arising in the particular context of airline mergers. Hence, it will be suggested that, if competition regulators are willing to protect the interests of airline passengers, they should align their methodology with the respective practices of the European Commission.

This thesis will apply certain general theoretical debates of competition law in the particular context of airline mergers. Because the aviation industries of the European Union and the United States have experienced a similar historical evolution, and because their regulators have adopted the opposite views expressed in the aforementioned debates, the two markets provide a very suitable reference point against which the significance of these general theories of competition law in the aviation context can be tested. The thesis will analyze how these theoretical differences have influenced both the content and application of merger law in the airline industries of the two jurisdictions. Accordingly, it will scrutinize the assumptions, reasoning and methodology of the competitive analyses conducted by the regulators of each market. It will subsequently assess the effects of these substantive and methodological disparities upon the competitive state of the domestic airline industry of the United States and the European Union. It will use these competitive impacts to comment on the effectiveness of the merger policy pursued in each jurisdiction.

Having regard to these underlying themes, the thesis is divided into four chapters, each exposing a different aspect of the theoretical and practical differences in the enforcement of merger control.

The first chapter will briefly introduce the governing airline merger regime of each jurisdiction, namely the Merger Regulation in the European Union and the Clayton Act in the United States.

The second chapter will analyze how airline markets are defined for the purposes of antitrust analysis. It will begin by explaining the basic principles of an antitrust market, and will then explore the main issues associated with the definition of airline markets, as well as the practices of the European Commission in this area. It will continue by assessing the theoretical arguments favoring the jettison of the antitrust market from the competitive analysis, and will dismiss them as inapt for the conduct of a stringent competitive assessment in the context of the airline industry. It will accordingly criticize the less disciplined approach of the Justice Department in this area. It will further reveal that the latter's more general definitions of airline markets have biased the competitive analysis in favor of the mergers under review, and have failed to preserve competition across the entirety of the domestic airline industry of the United States.

The third chapter will analyze the substantive tests governing airline mergers in each jurisdiction, and will reveal their different focal points; whereas the Clayton Act, as recently applied, is directly concerned with the avoidance of abusive changes in price and output, the European Merger Regulation is more concerned with the avoidance of dominant positions giving rise to anticompetitive market structures*, as a result of which* abusive changes in price and output are expected to occur. It will then argue that the European dominance-based test sets a higher standard of review in the particular context of airline mergers, as it results in the presumptive treatment of the latter as inherently anticompetitive transactions. It will illustrate how this test has been applied by the Commission in a fair and balanced, albeit stringent, fashion. This will be contrasted to the Department's flawed application of its more merger-permissive test.

The fourth chapter will consider the impact of merger-induced efficiencies in the review of airline mergers. It will begin by introducing this phenomenon, followed by an explanation of the historical origins and goals of the antitrust jurisprudence of each jurisdiction. It will then evaluate the disparate treatment of efficiencies in the light of these different theoretical backgrounds. It will assert that the Department of Justice has unduly relied on efficiencies to justify otherwise patently anticompetitive mergers, by using the former to legitimize the strong anticompetitive effects of the mergers under review.

The thesis will conclude by assessing the effects of the disparate vigor in the application of merger control on the domestic market of each jurisdiction. It will contend that, because of the divergent merger policies discussed, the market in the United States has been significantly more concentrated, and that the rise in domestic airfares in the United States has been substantial. It will also submit that, although the unconditional approval of airline mergers by the Department of Justice has contributed to the improvement of the erstwhile dire financial performance of the nation's airline industry, this gain has come at the high cost of a substantial market concentration. It will further be contended that, if the Department of Justice truly wishes to protect the interests of passengers, as it has declared, then several lessons can be learnt from the European Union's approach to merger review, especially at a time when a wave of low cost carrier consolidations may be in its incipiency. If, in the wake of this second merger wave, the Department wishes to remedy the anticompetitive impact of the consolidation of the nation's legacy carriers, it must reframe its review of airline mergers, and it must align it with the European practice in this area.

Chapter 1: The Governing Merger Regimes

1.1 The European Merger Regime

Airline mergers are governed by *Council Regulation 139/2004 on the Control of Concentrations Between Undertakings*,[19] henceforth "the Regulation". The Regulation is trans-industrial and applies indiscriminately across all sectors of the European economy. Both the present Regulation and its predecessor were intended to remedy certain deficits in the general competition laws of the European Union after the creation of the European common market.[20] The expansion and integration of the European Union gave rise to several opportunities for trans-national co-operation and consolidation, albeit in the absence of a special regulatory regime governing transactions of this nature. With the integration of the European market having reached completion, the Merger Regulation attempts to guard against impediments to effective competition therein resulting from mergers.[21] It is enforced by the European Commission, which is required to consider the anti-competitive impact of corporate consolidations, or, in the parlance of the Regulation, "concentrations".[22]

The Regulation only applies to concentrations bearing a "Community dimension", essentially transactions involving entities of sufficient size and power capable of affecting competition in the common market. Consequently, the requisite Community dimension is fiscally defined by reference to the "combined aggregate

[19] EC, *Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings*, [2004] OJ, L24/1 [EU Merger Regulation].
[20] *Ibid* at 1.
[21] *Ibid*.
[22] *Ibid* at 10, Article 6.

turnover of all undertakings concerned".[23] Transactions occurring predominantly in the domestic market of a Member State are excluded from its ambit.

Proposed concentrations with the requisite Community dimension must then be deemed compatible with the common market. Such transactions will be deemed incompatible "if they would significantly impede effective competition [therein]…in particular as a result of the creation or strengthening of a dominant position".[24]

When assessing the compatibility of mergers with the common market, the Commission's objective is the protection of consumer rights. According to its most recent policy statement,

> Competition puts businesses under constant pressure to offer the best possible range of goods at the best possible prices, because if they don't, consumers have the choice to buy elsewhere. In a free market, business should be a competitive *game with consumers as the beneficiaries*.[25] [emphasis added]

1.2 The Merger Regime in the United States

Following deregulation, the jurisdiction for the review of airline mergers was originally retained by the Civil Aeronautics Board,[26] and, following its dissolution, the subject jurisdiction was transferred to the Department of Transportation until 1988.[27] The responsibility for the review of airline mergers was then transferred to the Department of Justice, which assesses their legality under Section 7 of Clayton

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[23] *Ibid* at 6, Article 1.
[24] *Ibid* at 7, Article 2(3).
[25] EC, *European Commission, Delivering for Consumers: What Is Competition Policy, online: European Commission, Competition* <http://ec.europa.eu/competition/consumers/what_en.html>. For a detailed discussion of the compatibility of the Commission's objective with the purposes of competition law as recognized by the European Court of Justice, see Anne C Witt, "From Airtours to Ryanair: Is the More Economic Approach to EU Merger Law Really About More Economics?" (2012) 49 CML Rev 217 at 232-233.
[26] US, Government Accountability Office, *Airline Competition: DOT's Implementation of Airline Regulatory Authority* (1989) at 2.
[27] *Ibid*.

Act.[28] A violation of section 7 occurs if a merger results in the "substantial lessening of competition", a "restraint of trade", or a "tendency to create a monopoly in any line of commerce".[29] The Department of Transportation retains an advisory role in merger proceedings through its Office of Aviation Analysis, which submits its analyses to the Department of Justice in confidence.[30] Further, the Department of Transportation retains a residual power of intervention for the prevention of "unfair and deceptive practices" to prevent anticompetitive conduct.[31] In the recent consolidation wave, the Department of Transportation did not oppose any decision of the Department of Justice, and has recently expressed its hesitation to exercise this power on the basis of the high evidential threshold that it can often not meet.[32] Consequently, for all practical purposes, the approval of airline mergers in the United States has remained the prerogative of the Department of Justice and its application of Section 7 of the Clayton Act.

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[28] *Ibid*.
[29] *Clayton Act*, c 323, § 7, 38 Stat 731 (as amended, 15 U.S.C. § 18 (1964)).
[30] US, Department of Transportation, *Airline Mergers: Overview* online: US DoT <http://www.dot.gov/policy/aviation-policy/competition-data-analysis/mergers-acquisitions>.
[31] 49 USC §41712 (2011).
[32] US, Government Accountability Office*, Slot Controlled Airports: FAA's Rules Could be Improved to Enhance Competition and Use of Available Capacity* (Washington DC: US GAO, 2012) at 67.

Chapter 2: The Definition of Airline Antitrust Markets

2.1 Introduction

Under traditional antitrust analysis, the starting point in any competitive assessment is the identification of the relevant antitrust market over which the competitive assessment will be performed. Antitrust markets are useful methodological devices, as they enable regulators to measure an entity's market share, and to thereby draw certain tentative conclusions regarding its market power and its ability to engage in anticompetitive conduct post-merger. The way in which a market is defined can significantly bias the outcome of a competitive assessment. Contrary to the European Commission, which has respected the primacy of market definition as the starting point in its competitive analyses, the Department of Justice has been more willing to leapfrog this exercise and to directly estimate the anticompetitive effects of a merger.

The present chapter will argue that the European Commission's market-faithful competitive analysis has been more successful in guarding against anticompetitive abuses by the merging carriers. It will begin by introducing the general principles of market definition. It will then consider how these principles have been applied in the context of airline markets by the European Commission. It will subsequently explore the theoretical arguments in favor of the abandonment of market definition, and will dismiss them as inapt for a diligent competitive assessment in the specific context of airline mergers. This will be followed by an analysis of the Department's inconsistent and liberal definition of airline markets. It will be concluded that the abandonment of a consistent market definition by the Department of Justice paved the way for its more relaxed application of the substantive test of Clayton Act, which will be the subject matter of the following Chapter.

2.2 Basic Principles of Market Definition

Both jurisdictions have adopted the "Small but Substantial Non-Transitory Increase in Price" (SNNIP) test for the delineation of antitrust markets.[33] The crux of this definitional exercise is whether small unilateral price increases by a concentration post-merger will be profitable.[34] The answer to this question depends on the substitutability of the service provided by the merging entities. If customers are able to find another provider of the same service, they will most likely respond to abusive price increases by switching suppliers. Accordingly, the SNIPP test seeks to identify all similar goods to which the current customers of the merging entities can be potentially diverted in the event of abusive price increases.[35] This exercise seeks to identify a market that is "worth monopolizing".[36]

The breadth or narrowness in the definition of a market is of critical importance to the outcome of a competitive assessment. A definition would be narrow if it sought *all* aspects of a particular service in a substitute. A comprehensive insistence of this sort would hinder the finding of a suitable substitute, since it would be unlikely that the services offered by other suppliers are exactly identical to that provided by the merging entity. A narrow market definition would be liable to

33 EC, *Commission, Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law* [1997] OJ C 372/5 at 7 para 17; US, Department of Justice Antitrust Division & the Federal Trade Commission, *Horizontal Merger Guidelines* (Washington: Department of Justice & Federal Trade Commission, 2010) [US Merger Guidelines] para 4.1.2.
34 Alistair Lindsay & Alison Berridge, *The EU Merger Regulation: Substantive Issues*, 4th ed (London: Sweet & Maxwell, 2012) at 101-102.
35 *Ibid*.
36 *Ibid* at 107.

exclude from consideration certain alternatives that were, in reality, available to consumers.[37] Thus, the inquiry would overestimate the potential anticompetitive effect of a merger, since, in the absence of substitutes to which consumers could be diverted, a small price increase would be deemed profitable for the merging firm. Conversely, if only *some, but not all,* aspects of a product were sought in a substitute, the latter would be easier to find. In such a case, the market would have been defined broadly, as it would encompass too extensive a variety of potential substitutes. Consumers would be presumed able to switch to certain goods that might not be available in reality, as they may be unsuited for the fulfillment of the particular need the former seek to satisfy. In such instances, the anticompetitive impact of a merger would be underestimated, as it would be premised on the assumption of non-existent alternatives.[38]

In the context of airline markets, substitutability of service involves three issues. The *first* concerns the difference between non-stop[39] and connecting[40] service. If the merging carriers were to increase airfares over direct flights between two cities, the relevant substitutability concern would be whether passengers could be diverted to indirect air service for the performance of the same journey. The *second* concerns the difference between time-sensitive and time-*in*sensitive passengers, and the extent to which each class is willing to compromise travel time for cheaper travel alternatives of longer duration. If the answer is in the negative, then the market of time sensitive passengers dependent on short and efficient travel will be worth monopolizing, since for this class of travellers time is worth more than lower fares.[41] The *third* concerns

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[37] Giorgio Monti, *EC Competition Law* (Cambridge: Cambridge University Press, 2007) at 131-132.
[38] *Ibid*.
[39] Also known as “direct” service.
[40] Also known as “indirect” service.
[41] Pietro Crocioni, “Defining Airline Markets: A Comparison of the U.S. and EU Experiences” (2000) 45 Antitrust Bull 1 at 52.

the substitutability of a city's different airports, and the extent to which a fare increase from flights to one airport of that city will result in passenger diversion to an alternative airport serviced by a competitor.

2.3 The Definition of Airline Markets by the European Commission

According to the Commission's Guidelines on Horizontal Mergers,[42] the starting point in a competitive assessment is the definition of the market expected to incur the anticompetitive effects of a merger.[43] Markets are defined on a case-by-case basis, and such case-specific definitions do not constitute binding precedent for subsequent reviews.[44] The precise definition of a market is important, as it will enable the Commission to perform an accurate assessment of the anticompetitive impact of a concentration; "it is the starting point for a competitive assessment and not an end".[45]

In its assessments of airline mergers, the Commission has been defining the relevant markets in terms of individual city pairs.[46] Such markets have been further subdivided based on the price sensitivity of their passengers, or their ability to withstand and/or accept increases in fares. The definition of airline markets involves an assessment of the following elements.

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[42] EC, Commission, *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings* [2004] OJ C 31/5 [EU Merger Guidelines].
[43] *Ibid* at 6.
[44] See e.g. *Coca-Cola v Commission*, T-227/97, [2000] ECR II-1733 at II-1763 (the definition of the market is highly dependent on the circumstances of the particular market at a specific point in time).
[45] Lindsay & Berridge, *supra* note 34 at 100.
[46] See e.g. EC, Commission, *Case No COMP/M.3280 - Air France / KLM* (Luxemburg: EC, 2004) at 3 [*Air France/ KLM*]; EC, Commission, *Case No COMP/M.4439 – Ryanair / Aer Lingus* (Luxemburg: EC, 2007) at 15-16 [*Ryanair/ Aer Lingus*]; EC, Commission, *Case No COMP/M.5335- Lufthansa/ SN Air Holding* (Luxemburg: EC, 2009) at 6-7 [*Lufthansa/SN Air Holding*].

2.3.1 Airline Markets as City Pairs and not as Carrier Networks

Markets can be delineated differently, depending on whether the definitional standard is applied from the perspective of passengers or the airlines. Each perspective leads to a different definition of the market, as was conveniently illustrated by the Commission in its *KLM/Air France*[47] decision. A demand-based definition pays regard to the travel options available to passengers willing to travel between a particular city pair, and the extent to which their choices will be hindered by a proposed merger.[48] It is not in the interest of the assessor how the carrier will be able to service the route in issue. Equally irrelevant under this perspective is the significance of a particular city pair within the overall network of a large carrier. The sole consideration is the variety of options available to passengers wishing to travel between the two points of the subject route. Under a supply-based definition of the market, the assessment would not focus on passengers' needs over individual pairs, but would instead concentrate on a carrier's overall operations and network.[49] Hence, the markets would not be defined so narrowly as particular city pairs, but would only consider competition between the merging carriers' networks.

The latter possibility would amount to a very broad definition of the market, and would fail to capture localized, albeit grossly anticompetitive, outcomes. In the *KLM/ Air France* decision, the two combined entities would enjoy a monopoly position in the route between the cities of Paris and Amsterdam. If the market were narrowly defined as this particular city pair, then strong anticompetitive concerns would patently arise from such a monopoly position. If the same market were defined broadly as *all* travel possibilities between Paris and any other city served by KLM's

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[47] *Air France/ KLM*, *supra* note 46.
[48] *Ibid* at 3-4.
[49] *Ibid*.

network, the overlapping routes giving rise to anticompetitive concerns would not be as many,[50] since, and unlike the Paris-Amsterdam city pair, several competing carriers could be found to service it, thereby providing viable travel substitutes.

In *KLM/Air France*, the Commission expressly rejected the supply-side standard, and opted for a consumer, demand-based definition of the market. Even though it did not object to the assertion that "competition nowadays between carriers occurs on a network [rather than an individual city pair] basis",[51] the Commission upheld its policy objective of protecting passenger rights. Hence, it reasoned that, "the network approach is normally of little relevance to the individual consumer. If confronted with high prices due to a monopoly on a particular [city] pair, a passenger may find little comfort in the fact that airlines compete world-wide in the development of their respective networks."[52] The irrelevance of a carrier's overall network vis-a-vis a particular city-pair market was reiterated by the Commission in *Ryanair/Aer Lingus*,[53] where it noted that connecting travellers "are regarded as "point-to-point" passengers for the purpose of this decision, even if their ultimate destination is different".[54]

The Commission confirmed this demand-based reasoning in the *Ryanair/Aer Lingus* case, which concerned the merger of two low cost carriers operating out of the same base, namely Dublin Airport. It refused to adopt a network-based definition and thereby define the relevant market as all flights out of Ireland offered by the two merging carriers. It insisted that the assessment is focused on the availability of ample travel alternatives to passengers wishing to travel between two cities, and not on the

[50] *Ibid*.
[51] *Ibid* at 4.
[52] *Ibid* at 4.
[53] *Ryanair / Aer Lingus*, *supra* note 46.
[54] *Ibid* at 19.

cities the merging carriers are willing to fly to.[55] It dismissed the argument that the market was defined not by the passengers' travel needs, but by the flights offered by the applicant low cost carriers, allegedly on the basis that passengers of such carriers would either fly for the very low fares wherever the carriers offered to take them, or would not fly at all.[56]

2.3.2 Geographic and Temporal Refinements in the Delineation of a City Pair

The definition of a market in terms of a *city* pair is then subject to further geographic and temporal refinements, in terms of "airport"[57] and "intermodal"[58] substitutability. Again, the Commission has opted for narrower definitions, which restrict the finding of possible carriage substitutes for air travel between two cities.

Airport substitutability refers to the possibility of treating two airports in the vicinity of the same city as part of the same market. A typical manifestation of this problem would be the question of whether flights between Amsterdam and Paris, Charles De Gaulle and Paris, Orly Airports can be treated as interchangeable. The starting point is again the substitutability of service, in other words whether flights originating in and/or arriving at proximate, albeit different, airports can be considered as travel alternatives, and hence substitutes.[59] As a matter of principle, for two airports to be substitutable, both must offer *adequate* service of a particular city pair. As was emphasized by the Commission in the *British Airways/ Iberia*[60] decision, the

[55] *Ibid* at 15.
[56] *Ibid*.
[57] See e.g. *Air France/KLM*, *supra* note 46 at 6.
[58] See e.g. *Lufthansa/ SN Air Holding*, *supra* note 46 at 204.
[59] *Air France/KLM*, *supra* note 46 at 7-8.
[60] EC, *Commission, Case No COMP/M.5747 - Iberia/ British Airways* (Luxemburg: EC, 2010).

adequacy of such service is measured by the number of flights and active operators in the subject route.[61]

The standard used for this assessment is an airport's "catchment area", which refers to the maximum distance of an airport from the center of a city before the former is considered too remote for the service of the latter.[62] Once again, this assessment is conducted from the perspective of passengers, and the key issue is whether the two airports can satisfy the passengers' travel needs as effectively.[63] To answer this question, the Commission specified, in the *Ryanair/Aer Lingus* case, four relevant parameters of equal gravity that need to be balanced against each other.[64] This balancing exercise takes account of the demographics and other travel preferences of the passengers comprising a particular market, as gauged by the Commission in the course of its competitive investigation.[65] First, in markets whose passengers have accorded limited significance to the duration of the journey, longer commuting times to more remote airports will be permitted.[66] Second, in markets composed of price-sensitive passengers seeking access to cheaper, albeit more distant, airports, the relevant catchment area will be expanded.[67] Third, passengers valuing high frequencies and particular departure and arrival times on a given day may be willing to commute to more distant airports in the absence of convenient times of service at more proximate airfields.[68] Fourth, markets comprising passengers sensitive to the quality of service will be not give rise to large catchment areas; traditionally, distant airports are used by low cost, no frills carriers, whose quality of service both

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[61] *Ibid* at 5-7.
[62] *Ryanair / Aer Lingus*, *supra* note 46 at 22.
[63] *Ibid*.
[64] *Ibid* at 21.
[65] *Ibid.*
[66] *Ibid.*
[67] *Ibid.*
[68] *Ibid.*

onboard and on the terminal is humble.[69] In the *Ryanair* decision, the Commission concluded that the catchment area around the city of Dublin was 100 kilometers. However, in *Lufthansa/ SN Brussels*, it insisted that the radius of catchment areas is decided on a case-specific basis, following a careful balancing of the aforementioned factors.[70] The 100 kilometer rule used in *Ryanair* was accordingly treated as such a case-specific application of the general rule.[71]

However, airport substitutability is not defined only in terms of geographic proximity. The flight connectivity offered by an airport is also relevant, since passengers may not treat as interchangeable two airports offering different levels of flight connections for onward travel.[72] In the context of mergers between hub carriers competing on the basis of their respective networks, this requirement results in a narrow market definition, as it excludes from consideration proximate airports that do not comprise a carrier's network. This is despite the fact that such airports could have been considered as interchangeable by non-connecting passengers travelling between a carrier's hub and another city.

Intermodal Substitutability refers to the interchangeability of alternative *modes* of transportation providing carriage between the two ends of a city pair. The Commission has regard to two factors when assessing inter-modal substitutability, namely the time sensitivity of passengers, explored in the next sub-section, and the distance between the two cities defining the city pair in question.[73] Different treatment is accorded to water and land-based modes of transportation. Water-based alternatives have received adverse treatment, especially owing to the substantially longer travel

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[69] *Ibid*.
[70] *Lufthansa/ SN Air Holding*, *supra* note 46 at 17-18.
[71] *Ibid*.
[72] *Air France/KLM*, *supra* note 46 at 7.
[73] *Ibid* at 15.

times required for otherwise short routes,[74] as well as the relatively limited connectivity of sea ports, compared to airports, with the city in question.[75] Land-based alternatives are treated differently, depending on the time sensitivity of passengers. Whilst coach and high-speed rail services are deemed acceptable substitutes for time *in*sensitive passengers for trips not exceeding 1,000 km, such land-based modes are not considered appropriate substitutes for time sensitive travellers.[76]

2.3.3 Time-Sensitive versus Time-Insensitive Passengers

Some travellers are more willing than others to accept higher prices in exchange for greater scheduling flexibility. This includes higher flight frequencies between two points on a given day, as well as the ability to make or cancel bookings on short notice.[77] These travellers are referred to as time-sensitive passengers. Because time-sensitive passengers are assumed to be valuing flexibility more than low fares, they can be charged significantly higher prices than other members of the travelling public, who may refrain from travel on a given date or at given time when confronted with higher fares. Consequently, airlines are able to price their passengers in a discriminatory fashion for the same flight, and thus yield the highest possible revenue from each one, based on the latter's willingness and ability to accept higher prices.[78] This practice is known as price discrimination and has been taken into account by the Commission when defining the relevant markets.

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[74] See e.g. *Ryanair / Aer Lingus*, *supra* note 46 at 68-69; EC, Commission, *Case No COMP/M.5830 – Olympic/ Aegean Airlines* (Luxemburg: EC, 2010) at 27-29 [*Olympic/Aegean*].
[75] *Olympic/Aegean*, *supra* note 74 at 31.
[76] *Lufthansa/ SN Air Holding*, *supra* note 46 at 52.
[77] See e.g. *Air France/KLM*, *supra* note 46 at 5.
[78] For a detailed explanation of the pricing strategies employed by airlines, see Paul Stephen Dempsey & Laurence E. Gesell, *Airline Management Strategies for the 21st Century*, 2d ed (Chandler: Coast Air Publications, 2006) at 423-437 [Dempsey & Gesell, "Airline Management"].

Since markets are defined by reference to substitutability, which in turn depends on the capacity of consumers to accept higher prices, time-sensitive and time-*in*sensitive passengers cannot comprise the same market. It is for this reason that city-pair, or geographic, markets are further subdivided into markets representing each type of passenger. Time-sensitive passengers constitute a narrower market than their time-insensitive peers, as their key substitutability criteria, namely high scheduling flexibility and reduced travel time, are not offered by many operators. Since *Air France/KLM*, the Commission has accepted that the category of time-sensitive passengers is not restricted solely to business class travellers, but also includes passengers paying flexible economy class fares.[79] In *Ryanair/Aer Lingus*, it was further clarified that, because the chief concern of time-sensitive passengers pertains to scheduling flexibility and not quality of service, they could also be treated as customers of low cost carriers. [80] This has ensured that the narrower submarket of time-sensitive passengers, and hence the anticompetitive presumptions stemming from such a narrower market definition, can be used in mergers involving all kinds of carriers, rather than only in mergers between full service airlines.

2.3.4 Direct versus Indirect Service

The rules on the substitutability of direct and indirect service were originally enunciated by the Commission in the *United/ US Airways*[81] decision. A distinction is drawn between short-haul and long-haul flights, the latter commonly defined as trans-continental travel. As regards the former, owing to the "substantial time

[79] *Air France/KLM*, *supra* note 46 at 5.
[80] *Ryanair / Aer Lingus*, *supra* note 46 at 78-79.
[81] EC, Commission, *Case No COMP/M.2041 – United Airlines / US Airways* (Luxemburg: EU, 2001).

disadvantage"[82] of indirect flights compared to direct service, the two are not treated as substitutes. However, in the context of time-sensitive passengers, this general rule has, in principle at least, been qualified by the Commission in *Air France/KLM*, in which it was recognized that the time-bias associated with connecting service may be offset by the availability of more dense service providing higher scheduling flexibility, which is the critical parameter for this class of passengers.[83] Yet, the Commission has yet to accept such substitutability in practice. As regards long-haul travel in excess of six hours, connecting services have been accepted as substitutes for direct travel, provided the layover does not exceed 150 minutes. [84]

2.3.5 Low Cost versus Full Service Carriers

The Commission has expressly pronounced that low cost and full service carriers comprise the same market, with the definition of the subject market not being contingent on the operating model adopted by each airline.[85]

2.3.6 Conclusions on the definition of airline markets by the European Commission

The Commission has adopted a consumer perspective in the assessment of all parameters that are relevant to the definition of an airline antitrust market. This election is consonant with the stated policy objective of consumer protection. A network-based definition would have been unduly broad, and would have failed to capture and rectify anticompetitive excesses arising over particular city-pairs.

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[82] *Ibid* at 4-5.
[83] *Air France/KLM*, *supra* note 46 at 5-6.
[84] *Ibid*.
[85] *Ryanair / Aer Lingus*, *supra* note 46 at 14-15.

Additionally, the Commission's insistence on narrower market definitions, in terms of airport substitutability, price sensitivity and directness of air service, succeeds in highlighting *all* potentially problematic submarkets giving rise to anticompetitive concerns. As the following discussion will reveal, this may be concealed by a broader network-based definition of a market, or even by a market *un*specific competitive assessment.

2.4 The Definition of Airline Markets in the United States

2.4.1 The Diminishing Role of the Antitrust Market In the Competitive Assessment

Contrary to European practice, the Merger Guidelines in the United States ascribe less significance to the antitrust market in the course of the competitive assessment. Traditionally, markets have been used in antitrust analysis to provide the yardstick against which a firm's dominance can be measured, by reference to its share of the market and its consequent ability to exercise market power; the utility of the antitrust market is of a functional nature.[86] In the United States, however, "some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition",[87] thereby limiting the traditional primacy of the antitrust market.[88] As the following discussion will reveal, this methodological flexibility has enabled many airline city-pairs to slide through the cracks of antitrust analysis, even though the market concentrations resulting from the carriers' merger would have given rise to strong anticompetitive presumptions that should have alerted regulators. The

[86] *Infra*, note 60.
[87] US Merger Guidelines, *supra* note 33 Section 4.
[88] Herbert Hovenkamp, "Harm to Competition under the 2010 Merger Guidelines" (2011) 39:3 Review of Industrial Organization 3 at 12.

European Commission's consistent and narrow approach has avoided this blunder.

2.4.2. The Theoretical Justifications for the Abandonment of the Antitrust-Market and their Inaptness in the Airline Context

2.4.2.1 The Legality of Abandoning the Antitrust Market

The requirements concerning the definition of antitrust markets were promulgated by the Supreme Court of the United States in the seminal case *of United States v Brown Shoe*.[89] This was the first, and one of the very few, occasions in which the Supreme Court discussed the application of section 7 of the Clayton Act in the context of horizontal mergers.[90] It has been widely acknowledged that the precedential value of this case in the matter of market definition has subsisted, even though subsequent case law has discredited other pronouncements of the particular case with regard to the substantive requirements of a violation of section 7.[91] In *Brown Shoe,* the Court conditioned the finding of a "violation of the Clayton Act…on the necessary predicate [of the determination of a relevant market]".[92] It reasoned that the assessment of a transaction's anticompetitive effects could not occur in a vacuum, and could "be determined only in the terms of the market affected".[93]

Consequently, the theories in favor of the abandonment of antitrust markets, however defensible on other grounds, may offend the existing case law. Yet, such theories have been argued to be reconcilable with a narrower interpretation of *Brown Shoe* that limits the pronouncements of the case to its special facts. The ultimate

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[89] *Brown Shoe Co, Inc. v United States*, 370 US 294 (1962) [*Brown Shoe*].
[90] Herbert Hovenkamp, "Markets in Merger Analysis" (2012) 57:4 Antitrust Bull 887 at 887 [Hovenkamp, "Markets"].
[91] *Ibid* at 894.
[92] *Brown Shoe*, *supra* note 89 at 320.
[93] *Ibid* at 324.

concern of the Court in *Brown Shoe* was the avoidance of high concentrations in the market under review.[94] The Court feared that the significant merger-induced cost advantages that would vest in the merging entity would preclude effective cost-based competition in the subject market, as the remaining non-merging incumbents would not experience similar cost gains to those accruing in favor of the merging parties. The Court was concerned that this cost disparity would either result in the demise of the merging entities' competitors, or would trigger a tide of industry mergers and consolidations that would culminate in a highly concentrated industry, and which "should be curbed in [its] incipiency".[95] Accordingly, and as Hovenkamp observes, the purpose of the definition of a market in *Brown Shoe* was "fundamentally different" from the purpose of the same exercise in the contemporary assessment of mergers.[96] In *Brown Shoe*, the harm that would be assessed by reference to the defined marked concerned the anticompetitive cost advantage that would vest in the merging entity. Under contemporary antitrust analysis, however, the anticompetitive threat pertains to potential price increases, output reductions and compromises in the quality of the services offered.[97]

Rightly, this argument has not informed the subsequent jurisprudence of the courts, under which the antitrust analysis always commences with the definition of an appropriate antitrust market.[98] Hovenkamp's argument seems to conflate two distinct issues that should be conceptually separated, namely the definition of a market and

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[94] Hovenkamp, "Markets", *supra* note 90 at 897.
[95] *Brown Shoe*, *supra* note 89 at 346.
[96] *Supra* note 94.
[97] *Ibid*.
[98] Although, see Louis Kaplow, "Market Definition: Impossible and Counterproductive" (2013) 79 Antritrust LJ 361 [Kaplow, "Impossible & Counterproductive"] (commenting on *FTC v Staples, Inc*, 970 F. Supp. 1066 (DDC 1997) and noting that "the judge in the Staples merger case began by examining evidence bearing on whether the proposed merger would significantly raise price, and then, concluding that it would, adopted a narrow market definition (making it a three-to-two merger), in which the post-merger HHI and the contribution of the merger to that HHI were both large [thereby suggesting that the analysis did not actually begin with the definition of a relevant antitrust market" at 378).

the objectives of antitrust policy. The antitrust market is a methodological aid facilitating the conduct of the competitive assessment.[99] While policy considerations should and do influence the outcome of the latter, they are of no relevance to the former. Antitrust markets merely provide a policy-neutral conceptual locus within which antitrust policy is pursued through the collection of all pertinent information.[100] The question of whether the direct beneficiary of antitrust policy should be the welfare of consumers, which would focus solely on price, output and quality, *or* the competitive structure of the industry, which would also focus on the welfare of service providers and their ability to compete, certainly constitutes a matter of policy choice. As such, it should not inform the definition of the conceptual device through which such policy will be pursued. Consequently, and absent a more recent pronouncement by the Supreme Court on this matter, the legality of the complete abandonment of antitrust markets should be viewed with suspicion.

Further, it is submitted that the remaining theoretical condemnations of the antirust market are also not justifiable. Most of the contemporary criticism focuses on the limitations of antitrust markets in performing their functional purpose of augmenting the competitive analysis. Yet, the following four subsections will reveal that, at least in a concentrated and anticompetitive industry such as commercial aviation, a properly defined antitrust market is essential to the adequate identification of the anticompetitive challenges arising from carrier mergers. Consequently, the theoretical notion of a market-free competitive analysis will be dismissed.

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[99] See e.g. Malcolm B Coate & Joseph J Simons, "In Defense of Market Definition" (2012) 57:4 Antitrust Bull 667 at 669.

[100] *Ibid*; Franklin M Fisher, "Horizontal Mergers: Triage and Treatment" (1987) 1:2 Economic Perspectives 23 at 27 [Fisher, "Triage"].

2.4.2.2. Structural Presumptions of (il)legality

Prior to the development of econometric science, which can now more accurately predict the likely effects of a merger on competition, the definition of a relevant antitrust market was significant, since the levels of competition in a market were presumptively connected to the levels of concentration therein.[101] The legality of a proposed transaction was contingent on the expected market share that would vest in the merging entity and the resulting market concentration, both of which could only be measured by reference to a particular antitrust market.[102] The Supreme Court expressed this "structural presumption"[103] of illegality in the *Philadelphia National Bank*[104] case, in which it held that "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger [will not be anticompetitive]".[105] The chief argument against a market definition requirement is that recent developments in econometric science have eliminated all reliance on the antitrust market for the prediction of a merger's anticompetitive effects.[106]

However, the ability of econometrics to predict the anticompetitive effects of a transaction independently of market share has been questioned.[107] Further, even if the

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[101] Joseph Farrell & Carl Shapiro, "Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition", online: (2010) 10:1 The B.E. Journal of Theoretical Economics 9 <http://faculty.haas.berkeley.edu/shapiro/alternative.pdf> at 3.

[102] *Ibid*.

[103] *Ibid*.

[104] *United States v Philadelphia National Bank*, 374 U.S. 321 (1963).

[105] *Ibid* at 363.

[106] See e.g. Jonathan B Baker, "Market Definition: An Analytical Overview" (2007) 74:1 Antitrust LJ 129 at 131.

[107] Coate & Simons, *supra* note 99 at 699-700; Duncan Cameron, Mark Glick & David Mangum, "Good Riddance to Market Definition?" (2012) 57:4 Antitrust Bull 789 at 720-721.

accuracy of econometrics *per se* was not doubted, the retention of a market-specific rebuttable presumption relating to market share is meaningful and significant. In the airline industry, the anticompetitive effects of carrier mergers are very pronounced, and the factors capable of alleviating these effects are very weak. Merging carriers enjoy extraordinarily high market shares in the city pairs between their hubs, and often in city pairs with a hub in one of their ends.[108] At the same time, the industry is subject to significant barriers to market entry,[109] and its carriers have manifested a marked proclivity towards anticompetitive and exclusionary conduct.[110]

In such an environment, the *market-based* presumption of illegality can subject airline mergers to a more stringent, albeit fair, standard. On the one hand, it succeeds in capturing the patently anticompetitive high market shares resulting from airline mergers over hub-related city pairs. On the other, because of its presumptive, and hence rebuttable, nature, it is not fatal to the approval of mergers that genuinely do not threaten competition. Provided certain factors capable of alleviating the anticompetitive effects of a merger are proved by the merging parties, their merger will not be opposed. [111] If the goals of antitrust policy are to be given full effect in this inherently anticompetitive industry, this market-based presumption of illegality is justifiable, since it treats with suspicion airline mergers, which ordinarily result in the

[108] These high concentrations were in place even prior to the recent consolidation wave. See e.g. Andrew R Goetz, "Deregulation, Competition and Antitrust Implications in the US Airline Industry" (2002) 10 Journal of Transport Geography 4 ("In this part of the analysis, the largest 250 city-pair markets in 1998 were scrutinized for possible effects from the proposed combinations…[and it was found that] there was only one of the 250 city pairs that had a HHI of less than 1800, [with] all other city pairs…already exceeding the standard for a concentrated market." At 14-15).

[109] See e.g. Michael Levine, "Airline Competition in Deregulated Markets: Theory, Firm Strategy and Public Policy" (1987) 29 Yale J on Reg 393 [Levine, "Competition"]; Goetz, *supra* note 108 at 4; Martin Dresner, Robert Windle & Yuliang Yao, "Airport Barriers to Entry in the US" (2002) 36:3 Journal of Transport Economics and Policy at 402-403.

[110] See e.g. Dempsey, "Predetation", *supra* note 7; Roger D. Blair & Jeffrey L Harrison, "Airline Price Wars: Competition or Predation" (1999) 44:2 Antitrust Bull 489.

[111] See below, section 3.5.

patently anticompetitive dominance of the merged carrier over hub city-pairs.[112] Market *un*specific competitive assessments would fail to capture the unique tendency of airliner mergers to produce anticompetitively high market shares over certain particularly vulnerable city pairs.

2.4.2.3 The Irrelevance of Market Definitions in Instances Involving Differentiated Products and Anticompetitive Harm Resulting from the Operation of Unilateral Effects

When the merging entities are involved in the provision of differentiated rather than homogenous products, the competitive harm resulting from abusive price increases by the merged entity is not necessarily contingent on the latter's possession of a substantial market share.[113] Such competitive harm will instead arise from its ability to successfully raise prices, whilst retaining most of its existing customers.[114] The success of such conduct, also known as unilateral effects, would not be attributable to the absence of an adequate number of competitors, but would result from the unique nature of the differentiated product, whose attributes cannot be found in similar products offered by competing firms.[115] Consequently, the critical parameter vesting the merged entity with the ability to unilaterally raise its prices will not be the company's market share, but the "nature of the demand" of the product in question,[116] even though market structure may be of some evidential value in proving the possible occurrence of unilateral effects.[117]

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[112] *Ibid*.
[113] Joseph Farrell & Carl Shapiro, *supra* note 113 at 1; Malcolm B Coate, "Unilateral Effects Analysis in Merger Review: Limits & Opportunities" (2014) online: < http://ssrn.com/abstract=2383476> at 12-13.
[114] Farrell & Shapiro, *supra* note 113 at 5-6.
[115] *Ibid*.
[116] Coate, *supra* note 113 at 11.
[117] *Ibid* at 11-12.

With the structure of the market being of secondary importance in this scenario, Hovenkamp's argument on the limits of the legal requirement that antitrust markets be part of the competitive analysis could be more meaningfully applied in the present context. This would be supported by the Supreme Court's approach to market definition by reference to the "reasonable interchangeability of use or the cross-elasticity of demand [between the two products]".[118] In a pure "unilateral effects" scenario involving highly differentiated products, the cross-elasticity of demand, and hence its utility, are liable to be limited.[119]

However, it is inevitable that certain consumers who are unable to withstand such price increases will be diverted to competitors offering similar, albeit not identical, products.[120] The more similar, or the less differentiated, the products, the more potent will be the competitive constraints exercised by competitors on the merging entity, even in a unilateral effects case.[121] Consequently, both the definition of an antitrust market and the inquiry on the availability of such imperfect alternatives are useful in improving the prediction of the merger's anticompetitive effects.[122]

Further, the classification of air carriage in terms of the homogenous/differentiated product divide becomes problematic, as air transport more accurately represents a hybrid of a homogenous and differentiated product that is incapable of falling squarely within either classification.[123] Although air carriage *per se* cannot be differentiated, certain aspects thereof, such as the quality of in-flight

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[118] *Brown Shoe*, *supra* note 89 at 325.
[119] Louis Kaplow, "Why (Ever) Define Markets?" (2010) 124:2 Harv L Rev 437 at 481-482 [Kaplow, "Why Ever Define Markets"].
[120] Cameron, Glick & Mangum, *supra* note 107 at 726-727.
[121] ("the market definition analysis is helpful because it focuses the analysis on the critical determining issue – the strength of existing and reasonably anticipated constraints to any attempted exercise of market power" *Ibid*).
[122] *Ibid*.
[123] Dempsey & Gesell, "Airline Management", *supra* note 78 at 45-50.

service or passenger loyalty programs, tend to add certain differentiating elements.[124] Consequently, and regardless of its merit, the present anti-market argument is inapplicable in the context of airline mergers, insofar as the industry involves the provision of a homogenous rather than differentiated product.

2.4.2.4. The Antitrust Market as a Source of Arbitrariness and Bias

It has been noted that the notion of an antitrust market is a legal construct that is not supported by economic theory, which is averse to "binary classifications"[125] of products as falling clearly within or clearly beyond the scope of a given market.[126] Under conventional economic theory, markets can overlap and interact, and, accordingly, their delineation need not be as pristine and absolute in terms of their product composition.[127] Yet, antitrust analysis insists on the definitive association of a particular product with a specific market.[128] The necessity for such associations results in arbitrariness both on a theoretical and practical level.[129]

In the context of airline markets, such arbitrariness would be demonstrated most vividly by the separation of non-stop and connecting airline service, based on the six-hour total travel-time divide, and the refusal to consider any connecting travel alternative for journeys not exceeding that time limit. Such a narrow definition is liable to overestimate the dominance of a merging carrier over a particular city pair.[130]

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[124] *Ibid*.
[125] Fisher, "Triage", *supra* note 100 at 28.
[126] Fisher, "Triage", *supra* note 100at 27; Farrell & Shapiro, *supra* note 101 at 4.
[127] Fisher, "Triage", *supra* note 100 at 27.
[128] *Cf supra* note 125.
[129] Richard S Markovits, "Why One Should Never Define Markets or Use Market-Oriented Approach to Analyze the Legality of Business Conduct under U.S. Antitrust Law: My Arguments and A Critique of Professor Kaplow's" (2012) 57:4 Antitrust Bull 747 at 828-834.
[130] Franklin Fisher, *supra* note 125 at 27.

It is submitted that the definition of airline markets in the conventional way proposed by the European Commission is defensible for two reasons.

First, the delineation of non-stop airline markets by reference to the six-hour rule is not arbitrary. It has been based on empirical research concerning the preferences of the travelling public, and the extent to which they deem connecting service a viable travel alternative.[131]

Second, even if it were conceded that adherence to this temporal divide may not represent the travel preferences of passengers over *all* city-pairs under review, thereby giving rise to arbitrariness over those city-pair markets whose passengers *would* consider connecting travel as an alternative, such arbitrariness would remain defensible. It would represent the price for the universal enforcement of antitrust over all city pairs potentially affected by a merger. A market-insistent approach to competitive assessments serves the noble purpose of emphasizing the anticompetitive effects of a concentration over all city-pairs within a network,[132] which is especially pertinent in the context of mergers between hub carriers. Antitrust markets can and do provide a useful forum for the comprehensive accumulation of data concerning the competitive state of an industry.[133] They thereby ensure that *no* city pair escapes competitive scrutiny. A market *un*specific assessment would fail to achieve this objective; accordingly, the dismissal of the airline antitrust market on the basis that, *in its present and slightly arbitrary form*, may result in *isolated* instances of arbitrariness over a few individual city pairs would jeopardize the far more important objective of

[131] See e.g. *Air France/KLM*, *supra* note 46 at 6.
[132] *C.f.* Daniel L Rubinfeld, "Antitrust Enforcement in Dynamic Network Industries" (1998) 43 Antitrust Bull ("neither the fact that the rate of advancement of technology is rapid [in the context of technology network industries], nor the fact that the price of many products is falling, should be a barrier to the "surgical" [ie market specific] application of antitrust principles to restrict anticompetitive behavior" at 882 [emphasis added]).
[133] Coate & Simons, *supra* note 99 ("markets are defined to aid in the evaluation of competitive concerns" at 681-682); Franklin Fisher, *supra* note 125 at 27.

the effective and far-reaching enforcement of antitrust across all city-pairs potentially affected by a merger.

Airline city pairs are exceptionally vulnerable antitrust markets. Abusive carrier pricing over them is as likely to occur post-merger, as it is frequent before it, especially in those city pairs between the merging carriers' hubs.[134] Accordingly, the identification of a merger's anticompetitive effects over *all* potentially affected city-pairs remains important. If the protection of passengers is to be given meaningful effect, and with both jurisdictions having purportedly embraced this policy objective,[135] the retention of the city-pair antitrust market is necessary, despite its occasional and localized arbitrariness.

2.4.2.5 The Relationship Between Market Definition and Market Power: a Self-Defeating Circular Logic

The abandonment of antitrust markets has also been advanced on the basis of the following conceptual circularity. The sole purpose of an antitrust market is to facilitate a prediction of the expected market power that will accrue in favor of the merging entity post-merger. However, the definition of the antitrust market is itself influenced by considerations of market power. Accordingly, it has been contended that the utility of the market concept is defeated, since the latter's delineation is premised on the object it seeks to achieve.[136]

However, the present argument misses the mark by presuming that the antitrust market is the end rather than the means of the competitive analysis. Indeed, the delineation of the relevant market is not always free from assumptions regarding

[134] See e.g. Darin Lee & María José Luengo "The Impact of Passenger Mix on Reported "Hub Premiums" in the U.S. Airline Industry" (2005) 72:2 Southern Economic Journal 372 at 393.
[135] See *supra* note 25; *infra*, note 336.
[136] Lee & Luengo, *supra* note 134.

the competitive state of the industry post-merger. The point of the antitrust market is to help reveal the geographic or product loci in which the potential for anticompetitive abuse may arise, even if certain assumptions are made about market power. It is only once these vulnerable markets have been defined that appropriate remedies or other factors capable of alleviating the transaction's anticompetitive effects can be identified and implemented.[137]

2.4.3 The Definition of Airline Markets in the United States: Airline Markets Independently of City Pairs as the Entire Network of the Carriers?

The previous section revealed that the theoretical arguments in favor of the abandonment of the antitrust market are incompatible with the conduct of a stringent assessment of airline mergers. The present section will reveal how these considerations have not fully informed the reasoning of competition regulators in the United States.

The approaches of the Department of Justice and the judiciary over this question have diverged.

The courts have been consistently faithful to the market definition requirement. The relevant case law is scarce. Of the three major cases that have undergone judicial scrutiny, two concerned allegations of predatory conduct.[138] The third case[139] concerned the merger of Continental and United Airlines, and the analysis of the court was consistent with the reasoning of the European Commission. Unduly expansive delineations of airline markets were rejected for two reasons.

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[137] *c.f.* Cameron, Glick & Mangum, *supra* note 107 ("even if a direct relationship between market share and market power were available at a point in time, more is needed to evaluate real antitrust issues" at 732).

[138] *Spirit Airlines v Northwest Airlines*, 431 F (3d) 917 (6th Cir 2005); *United States v AMR Corp*, 335 F (3d) 1109 (10th Cir 2003).

[139] *Malaney v UAL Corp*, No 3:10-CV-02858-RS (ND Cal).

First, broad definitions would be liable to provide misleading signs on the competitive state of the market(s) in issue, and the anticompetitive impact of a proposed merger upon them.[140] The court accordingly rejected the domestic airline industry of the United States *in its entirety* as a "non-viable" antitrust market.[141] It noted that the widespread emergence of low cost carriers as a potent competitive constraint would reduce the *industry-wide* market concentration levels of the merging carriers below the levels evoking anticompetitive concerns according to the Horizontal Merger Guidelines.[142] This restrictive interpretation is preferable. A macroscopic market definition of this nature would conceal the strong competitive concerns over individual city pair markets dominated by large hub carriers, and in which the infiltration of low cost carriers has been limited, if existent at all.[143]

Second, the Court noted that the competitive assessment of mergers is conducted through the perspective of passengers, and the availability of alternate service for their travel needs between individual city pairs.[144] For this assessment, the competitive state of the overlapping *networks* of merging carriers is irrelevant,[145] for the same reasons discussed in the European Commission's analysis. However, this particular challenge to the merger was dismissed by the court on other grounds.

The Department's practices, on the other hand, have differed,[146] and have ranged from a complete renunciation of airline antitrust markets to meaninglessly

[140] *Ibid* at 21.
[141] *Ibid*.
[142] *Ibid*.
[143] *Ibid*.
[144] *Ibid*.
[145] *Ibid*.
[146] This discrepancy between the definitional practices of the judiciary and the Department of Justice is indicative of a structural friction between the two regulatory bodies in the United States, in which mergers can be challenged before the courts by private litigants alongside the Department's review. This can result in the development of two parallel jurisprudential threads in the consideration of the same merger application. However, such initiatives of private "merger law enforcement" are commonly unsuccessful, as the restricted investigatory powers of private plaintiffs often prevent them from discharging the evidential burden needed for the success of their claim (see e.g. Bill Baer, "Public

broad definitions on a network, rather than city-pair, basis.[147] The adoption of a broader market definition on a network level is not necessarily objectionable, if supplemented by the microscopic identification of the individual city pairs likely to incur the anticompetitive effects of a merger and the increased market power it entails. After all, hub carriers do compete on a network basis, and, often, their anticompetitive interactions affect different parts of their networks, which may not necessarily overlap.[148] However, as the next chapter will reveal, whenever the Department has used this broad market definition to approve a merger, it has done so imprudently. It has used it to justify a merger on the basis of its network-wide benefits to passengers, while at the same time failing to apply the city-pair market definition to rectify the dramatic loss of competition over individual hub-related city pairs, as was the case in the *Delta/Northwest*[149] merger. In fact, in that case, the generality of the references to the network-wide benefits of the transaction could even be construed as a definition of no market at all. Similarly, in *United/Continental*,[150] the Department referred to Continental's network out of Newark in a general sense when it required the slot divestures in favor of Southwest, again failing to direct the required slot

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and Private Antitrust Enforcement in the United States" (Remarks Prepared for Delivery to the European Competition Forum, Brussels, 11 February 2014)). Accordingly, the Department's reasoning in the approval of mergers usually prevails. The judicial dismissal of the lawsuit against the merger of United and Continental was such an instance. In the European Union, the Commission is the sole instrument entrusted with the enforcement of the Merger Regulation. The conferral of this regulatory power on such an exclusive basis has ensured the development of a unitary line of analysis.

[147] American Bar Association Section of Antitrust Law, *Market Definition in Antitrust: Theory and Case Studies* (Chicago: ABA, 2012) at 223.

[148] *United States of America v US Airways Group Inc*., Civil Action No. 2013-1236 (D.C. 2014) (Trial Brief of the United States) para 54-58 [DOJ, *American/US Trial Brief*]; *United States v. Northwest Airlines Corp*, Civil Action No. 98-74611 (E. D. Mich.) (October 24, 2000) (Trial Brief of the United States) para B.2 and III.C [DOJ, *Northwest Trial Brief*].

[149] US, Department of Justice Antitrust Division, Press Release, *Statement of the Department of Justice's Antitrust Division on its decision to close its investigation of the Merger of Delta Airlines Inc. and Northwest Airlines Corporation* (29 October 2008) online: US DoJ Briefing Room< http://www.justice.gov/opa/pr/2008/October/08-at-963.html> [DOJ, *Delta/Northwest*].

[150] US, Department of Justice Antitrust Division, Press Release, *United Airlines and Continental Airlines Transfer Assets to Southwest Airlines in Response to Department of Antitrust Concerns* (27 August 2010) online: US DoJ Briefing Room <http://www.justice.gov/opa/pr/2010/August/10-at-974.html> [DOJ, *United/Continental*].

divestures to the particularly vulnerable city pairs that would be disadvantaged by the merger, and which were several.[151]

2.5 Conclusions

The European Commission has been consistently faithful to the definition of airline antitrust markets on a narrow city-pair basis. This has ensured that the anticompetitive effects of airline mergers over no affected city-pair will escape scrutiny. The Department of Justice has pursued a line of broader, and hence merger-permissive, market definitions, which have failed to reveal the repercussions of hub carrier mergers over particularly vulnerable city pairs, such as those between hubs. Occasionally, the generality of the Department's network-wide references reveals a renunciation of the antitrust market concept in its entirety. This is despite the strong theoretical objections to the abandonment of the airline antitrust market, on the basis of its incompatibility with a thorough competitive review. The effect of this merger-permissive choice on the part of the Department is compounded to its adoption of a less stringent substantive test, to which this discussion will now turn.

[151] See below, section 3.5.2.1.

Chapter 3: The Substantive Tests: Theoretical Challenges and their Application in Airline Mergers

3.1 Introduction

This chapter will examine the differences in the substantive tests of the Merger Regulation in the European Union and section 7 of the Clayton Act in the United States. It will be argued that the European Commission has adopted the more rigorous test of market dominance, which places significant emphasis on the structure of the antitrust market under review. It will be submitted that, because airline mergers do give rise to dominant carriers over city-pairs associated with a hub in the post-merger environment, the European insistence on this standard is more apt for a strict review of a proposed concentration. This will be contrasted to the approach of the Department of Justice, whose analysis is much less concerned with the structure of the market, and which, instead, seeks to directly predict a firm's ability to raise prices and decrease output post-merger. It will further be contended that, in addition to opting for a more merger-permissive test, the Department erred in two demonstrable ways when conducting its competitive analyses. *First*, it over-relied on non-price advantages that were alleged to result from the consolidation of the merging carriers, such as improvements in the quality of service offered to passengers. This will be contrasted to the European aversion to similar fare-*un*related considerations. *Second*, and unlike the European Commission, the Department acted on the basis of naïve and misinformed assumptions concerning the competitive state of the airline industry, and the anticompetitive proclivities of its agents.

3.2 The Substantive Test in the European Union: The Primacy of Market Dominance

3.2.1 Background to the Substantive Test: Market Dominance under the Old and Current Merger Regulations

The substantive test governing the competitive assessment is provided by Article 2(2) of the amended Merger Regulation, which reads:

> A concentration which would not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared compatible with the common market.[152]

Under an isolated reading of the foregoing text, a merger between two entities can be disapproved only if the resulting concentration will result in *either* the creation of a significant impediment to effective competition, *or* the creation or strengthening of a dominant position in favor of a concentration. *Prima facie,* the relationship between these two conditions is of an alternative rather than cumulative nature. The policy objective transpiring from the present formulation of the substantive test would seem to be the preservation of effective competition *per se*, as opposed to the avoidance of market dominance; the latter merely constitutes an instance of the former.

The linking of the two concepts with such an alternative relationship would appear to reflect, nominally at least, a marked change in the substantive test originally enunciated by the preceding Merger Regulation 4064/89.[153] According to the old test, incompatibility with the common market would arise should a merger "create or

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[152] EU Merger Regulation, *supra* note 19 at 7.
[153] EC, *Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings* [1990] OJ, L 257/14 [EC, Old Regulation].

strengthen a dominant position *as a result of which* effective competition would be significantly impeded”[154] [emphasis added]. The event that was outlawed was the creation or strengthening of a dominant position *per se*. Contrary to the text of the current Merger Regulation, the concepts of “dominant position” and “effective competition” were causally and cumulatively connected. The satisfaction of the dominant position requirement was a necessary predicate for a finding of incompatibility with the common market. The following discussion will reveal that, notwithstanding the new wording of the Regulation, dominance does remain the central test for the assessment of mergers in Europe. The new wording of the Regulation does *not* represent a repudiation of the primacy of dominance, but merely seeks to rectify a difficulty that had arisen under the old test, and which will be discussed in the next section.

3.2.2 The Weakness of Dominance as an Assessment Standard

3.2.2.1 The Nature of the Limitation

The natural meaning of the term “dominance” would suggest that a merger should only be disapproved if it would result in a position of market leadership. After all, only a leading firm can dominate its market. The jurisprudence of the European Court of Justice reflects this view. The Court has pronounced that, “very large [market] shares are in themselves…evidence of the existence of a dominant position”.[155]

Yet, *prima facie*, the concept of dominance cannot be applied in all mergers

[154] *Ibid* at 17.
[155] *Irish Sugar plc v Commission of the European Communities*, T-228/97, [1999] ECR II-2969 at II-3008.

giving rise to anticompetitive effects. The intrinsic limitations of the dominance test become appreciable in the light of the following three different ways in which competition can be impeded by a merger.[156]

First, a merger can result in the creation of a monopoly. The post-merger concentration will be the sole provider of a service, will control supply and prices, and will be setting both without any regard for the needs of the market. Instead, the service provider will produce and price at such levels as are required for the maximization of his profits.[157] This scenario would arise in markets originally hosting only two suppliers, who then decide to merge.

Second, a merger can result in or exacerbate an oligopoly, whereby the post-merger market will be dominated and controlled by only a few suppliers. If the market share accruing to the merged entity were high, then the present scenario would be very akin to the preceding one. Conversely, if the market share accruing to each supplier were not substantial, then there could be no finding of individual market dominance. Provided the antitrust market comprises homogenous, substitutable products, no individual agent would be able to unilaterally increase prices and/or reduce output without adversely affecting his profitability. Any such unilateral pursuit would most likely be punishable by consumer recourse to competing suppliers, and hence a diminished market share.[158] However, in a market dominated by only a few producers, there is a strong incentive for, and only a few practical obstacles to, coordination among competitors.[159] In essence, it would become more profitable for all suppliers to agree to a common price in excess of that set by the market. A

[156] Lindsay & Berridge, *supra* note 34 at 43-46.
[157] Robert J Carbaugh, *Contemporary Economics: An Applications Approach*, 7th ed (New York: M.E. Sharpe Inc, 2014) at 113-115.
[158] Robert C Marshall & Leslie M Marx, *The Economics of Collusion: Cartels and Bidding Rings* (Cambridge, MA: MIT Press, 2012) at 1-21.
[159] *Ibid*.

multilateral and coordinated price increase of this sort would ensure that no individual supplier would lose his consumers to a competitor, since his individually higher price would be matched by everyone else.[160] In this situation, known as the *"coordinated effects"*[161] scenario, although no supplier is individually dominant, *collectively*, all colluding suppliers are, as they can act independently of the market. [162]

Third, a concentration can result in the merger of two entities selling similar services that, as far as consumers are concerned, are highly interchangeable. If one firm unilaterally increases the price of the service it sells, some consumers will accept that higher price, while others will opt for the similar, albeit cheaper, interchangeable alternative. If two firms offering such interchangeable services merge, and either increases its price in the described fashion, those customers who do not accept the higher price will be lost to the alternate supplier. Yet, since the latter will be part of the same entity post-merger, the customers lost by one firm will be regained by the other.[163] Consequently, the merged entity will be able to unilaterally raise prices without compromising its total share of a given market. Alternatively, if the merging firms sell differentiated goods, such that the certain attributes of one product cannot be replicated in another, substitutability will be limited. Consequently, producers will still be able to raise their prices, since their consumers will have limited recourse to competing products to satisfy their needs.[164]

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[160] *Ibid*.
[161] EU Merger Guidelines, *supra* note 42 at 9.
[162] Simon Baxter & Frances Dethmers, "Collective Dominance Under EC Merger Control - After Airtours and the Introduction of Unilateral Effects, Is There Still a Future for Collective Dominance?" (2006) 27 CML Rev 148 at 148-149.
[163] Randal C Picker, "An Introduction to Game Theory and the Law" (Paper Delivered at the Coase Lecture Series hosted by the Coase-Sandor Institute for Law and Economics, University of Chicago, 6 December 1994) at 2-6; Roscoe B Starek III & Stephen Stockum, "What Makes Mergers Anticompetitive?: "Unilateral Effects" Analysis Under the 1992 Merger Guidelines" (1995) 63 Antitrust LJ 801 at 802-809.
[164] *Ibid*.

This situation, also known as the *"uncoordinated or unilateral effects"*[165] scenario, is distinguishable, as it can occur even if each individual company enjoys a limited share of the market. As such, there can be no creation or strengthening of a dominant position in the normal sense of the term. Further, as unilateral effects can occur in the absence of coordination, there can also be no collective dominance.

Thus, it appears that the dominance-based test prescribed by the original Merger Regulation is unable to capture anticompetitive situations not involving a position of market leadership. The test merely refers to dominance, not to *collective* dominance, and is patently silent about instances giving rise to no dominance of any sort.

3.2.2.2 The Legal Creation of the Dominance Gap and its Implicit Rectification

The European Court of Justice filled this apparent gap, albeit only in part, by drawing a distinction in its jurisprudence between concentrations giving rise to coordinated and uncoordinated anticompetitive effects. In the seminal case of *Gencor*,[166] which concerned the merger of the two largest suppliers in the pertinent market, the Court was confronted with evidence suggesting a substantial risk of post-merger collusion. It reasoned that the word "dominance" was not sufficiently precise to permit an accurate delineation of its ambit.[167] Since the plain meaning of the word in issue could not be used to ascertain its exact scope, the Court employed a purposive interpretation in the light of the Regulation's "overall objective and its position in the legal hierarchy of the system created by the Treaty of Rome."[168] It reasoned that the

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[165] EU Merger Guidelines, *supra* note 42 at 7.
[166] *Gencor Ltd v Commission of the European Communities*, T-102/96, [1999] ECR II-753 [*Gencor*].
[167] *Ibid* at II-799.
[168] *Ibid* at II-800.

Regulation was intended "[to establish] a system ensuring that competition in the common market [would not be] distorted".[169] Consequently, the Court opined that the word "dominance" could be construed broadly enough to cover instances of tacit collusion. It reasoned that companies acting in a coordinated way could achieve a state of *collective* dominance, even if each were *individually* unable to dominate the market. By identifying a very broad policy objective, the Court was able to stretch the concept of dominance to instances that would otherwise offend its plain meaning. Interestingly, it ascribed no relevance to the non-inclusion of the adjective "collective" in the text of the Regulation, and similarly dismissed the importance of its express mention in the national laws and regulations of other Member States, such as the United Kingdom and Germany.[170]

The *ratio* of *Gencor* was subsequently reaffirmed in the decision of the European Court of First Instance in the *Airtours* case[171]. Unlike *Gencor*, in *Airtours* the proposed merger involved the second and third largest companies operating in the subject market. One of the grounds for the Commission's objection to the transaction was the alleged risk of post-merger collusion between the formerly largest service provider in the subject market and the merged entity. The Court overruled the Commission's disapproval of the transaction on the basis of its inadequate evidential substantiation of the alleged collusion. However, it did reiterate[172] the *ratio* of the decision in *Gencor*, thereby confirming that, for the dominance test to be satisfied, it was necessary to prove the collusive, or otherwise coordinated, nature of the anticipated anticompetitive effects. It has been argued that, by not expressly denying that dominance cannot cover instances of *un*coordinated effects, the Court's decision

[169] *Ibid* at II-816.
[170] *Ibid* at II-791.
[171] *Airtours v Commission of the European Communities*, T-432/99, [2002] ECR II-2585.
[172] *Ibid* at II-2613.

in *Airtours* did not necessarily place anticompetitive effects of such a nature beyond the ambit of the dominance test.[173] However, this assertion cannot be accepted; the Court did emphasize the need for the joint pursuit of common and collective conduct, which is the essential ingredient of coordinated effects.[174]

It has been contended that, as a matter of principle, instances of *un*coordinated anticompetitive effects should not be treated as manifesting a gap[175] in the reach of the dominance test.[176] At the heart of such an argument is that uncoordinated effects are in reality nothing more than alternative manifestations of the two anticompetitive species already covered by market dominance, namely concentrations resulting in very high market shares and concentrations giving rise to a likelihood of post-merger collusion. This contention is premised on two assumptions. The first is that it is wrong to equate "dominance" with "leadership" in a given market. Even though the English language might ascribe such a connotation to the term "dominance", proponents of this view insist that this is not the case in other languages.[177] If the conceptual divorce of dominance from leadership is accepted, the second assertion is that the objectionable post-merger market dominance need not vest in the merged entity; instead, the test will be satisfied even if it is the dominant position of a third party not privy to the transaction that is strengthened.[178] According to this view, what is required is merely a causal connection between the proposed merger and the creation or strengthening of the dominant position of *any* market participant.

[173] Ioannis Kokkorris, "The Reform of the European Merger Regulation in the Aftermath of the Airtours Case – The Eagerly Expected debate: SLC v. Dominance Test" (2005) 26 Euro Comp L Rev 35 at 37.
[174] Neil Horner, "Unilateral Effects and the EC Merger Regulation – How the Commission Had its Cake and Ate it Too" (2006) 23 Hanse Law Review 23 at 31.
[175] Edith Müller & Ulf Boge, "From Market Dominance to the SLC Test: Are There Any Reasons for a Change?" (2002) 23 Euro Comp L Rev 495 at 497-498.
[176] Frank Montag & Andreas von Bonin, "Collective Dominance in Merger Cases After Airtours" in Götz Drauz & Michael Reynolds, eds, *EC Merger Control: A Major Reform in Progress* (Richmond, UK: International Bar Association, 2002) 323 at 329.
[177] *Ibid* at 333.
[178] *Ibid* at 333-334.

However, this hypothesis can only be applied in jurisdictions whose substantive competition laws are not restricted by the concept of market dominance, as it features in the European test. It cannot be reconciled with either the plain meaning of the word "dominance", as understood in the English language, or the limits set thereto by the European Court of First Instance in *Gencor* and *Airtours*.

In response to the limitation of the dominance test, the European Commission progressively began to incorporate a unilateral effects analysis in its assessment, even though it phrased its decisions in terms of dominance.[179] By the time the Regulation was amended, certain scholars presumed that the dominance test had been substantively expanded to cover instances of unilateral effects that did not necessarily arise from dominant positions.[180]

<u>3.2.3 Is Dominance *Still* the Governing Standard? The Lingering Prevalence of Dominance under Regulation 139/2004: Dominance as a Starting point, Subject to the Residual Test of Impediments to Effective Competition</u>

Although the wording of the new Merger Regulation appears to place market dominance on the same standing as the general "impediments to effective competition" requirement, which would capture unilateral effects not related to dominance, the dominance-centered analysis has survived into the new regime. It could be suggested that the amendment of the Merger Regulation renders the conceptual differentiation of the two tests irrelevant, since, under the new regime,

[179] For a detailed discussion of the creep of unilateral effects into the dominance-based analysis, see Simon Baxter & Frances Dethmers, "Unilateral Effects under the European Merger Regulation: How Big Is the Gap?" (2005) 26 Eur Comp L Rev 380 at 381-382.
[180] See e.g. Giorgio Monti, "The New Substantive Test in the EC Merger Regulation – Bridging the Gap between Economics and Law?" 2008 (10) Cambridge YB Eur Legal Stud 263 at 271-274.

"dominance" and "impediments to effective competition" are equivalent grounds for a finding of incompatibility with the common market.

However, such a view would accord insufficient regard to the fact that, in principle, the two notions are distinct, and that, consequently, the finding of either in the course of a competitive review is subject to different conditions. This conceptual distinctness was reiterated in Recital 25 to the Regulation, according to which,

> The notion of "significant impediment to effective completion" should be interpreted as extending, *beyond the concept of dominance*, only to the anti-competitive effects of a concentration resulting from the non-coordinated behavior of undertakings which would not have a dominant position on the market concerned[181] [emphasis added]

The concept of a "significant impediment to effective competition" was envisaged to cover situations beyond the ambit of "dominant position". It would therefore be unwarranted to substantively equate the two, since each was intended to govern a different situation. The assertion that the substantive difference between the two terms should be disregarded merely because the two concepts can ultimately have the same effect, namely a declaration of incompatibility with the common market, would be placing the cart before the horse. Besides, the Commission did insist that,

> By keeping the concept of dominance unaltered, the new test will preserve the acquis and, thus, the guidance that can be drawn from past decisional practice and case law. As a result, previous decisions and judgments could still be relied upon as precedents when considering whether a merger is likely or not to create or

[181] EU Merger Regulation, *supra* note 19 at 4.

strengthen a dominant position.[182]

As required by the new Merger Regulation, the European Commission has issued Guidelines outlining the factors that will govern its consideration of future mergers and their compatibility with the common market. These Guidelines do not reflect parity between the dominance and the general "impediments to effective competition" tests; rather they manifest the continuing primacy of the former.

The Guidelines start with an appraisal of the expected market share of the merged entity and continue with a general competitive assessment of the market. In defining market dominance, the Guidelines merely reiterate the case law[183] preceding the latest version of the Merger Regulation. Thus, they read, "very large market shares - 50% or more - may in themselves be evidence of the existence of a *dominant* market position".[184] On the other hand, market shares below 50% are only deemed relevant if they are obtained in markets with a few strong competitors, substantial barriers to entry or involving products that are close substitutes.[185] For such lower market shares, the key issue is whether the merger "will raise competition concerns",[186] thereby placing the assessment within the realm of the general "impediments to effective competition" test. So far, the Guidelines appear to reflect the equivalent, as opposed to hierarchical, relationship between dominance and impediments to effective competition alluded to by the wording of the new Regulation. However, unilateral effects are subsequently treated as one of "the two main ways in which horizontal mergers may significantly impede effective

[182] P. Lowe, "Implications of the recent reforms in the antitrust enforcement in Europe for National Competition Authorities", Speech at Italian Competition/Consumers day, Rome, December 9, 2003 cited in Baxter & Dethmers, *supra* note 179 at 381.
[183] EU Merger Guidelines, *supra* note 42 at 7.
[184] *Ibid*.
[185] *Ibid*.
[186] *Ibid*.

competition, "*in particular by creating or strengthening a dominant position*".[187] Specifically, it is asserted that certain unilateral effects "would significantly impede effective competition *by creating or strengthening the dominant position of a single firm*" [188] [emphasis added].

This approach would seem to understate the independent nature of uncoordinated effects, which can, and often do, arise *regardless* of an entity's market share and, hence, possible dominance. Uncoordinated effects could have been divorced from the concept of dominance. These Guidelines, however, fail to reflect the conceptual distinction between the two tests, and only perpetuate the primacy of dominance into the regime of the new Merger Regulation by presumptively treating unilateral effects as a subspecies of dominance. The "impediments to effective competition" novelty is merely a residual "catch all" safety net. Under the old merger regime, the starting point in the analysis was dominance; if the latter could not be established in the normal meaning of the term, unilateral effects analysis would be used to find dominance. Under the new merger regime, dominance remains the starting point in the analysis; it is assumed that unilateral effects will occur in a dominated market. If such dominance cannot be established, then recourse will be had to the redundant "impediments to effective competition" test, which in essence rectifies the distortions of the dominance term to which the Commission had to resort in order to catch the pure unilateral effects cases under the old wording of the substantive test.[189]

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[187] *Ibid*.
[188] *Ibid* at 8.
[189] *C.f.* Monti, *supra* note 180.

3.3 The Substantive Test in the United States: Unilateral Effects over Dominance

Under the latest editions of the Merger Guidelines of both jurisdictions, the competitive analysis commences with the consideration of the expected impact of a proposed merger on market power.[190] Both jurisdictions have defined the concept of market power similarly, by reference to an entity's ability to, *inter alia*, raise prices above or restrict output below the clearing level of the market.[191] Additionally, both Guidelines acknowledge non-monetary considerations in their definitions of market power, such as the quality of service available to consumers.[192] The respective analyses under both Merger Guidelines further coincide insofar as they recognize that competition can be impeded or reduced through the operation of both uncoordinated and coordinated effects.[193]

Yet, this conceptual convergence is defeated by the varying significance of dominance in the jurisprudence of each jurisdiction. European legal analysis insists on conducting the competitive assessment in terms of market dominance and, consequently, by reference to the structure of the market under review, and the competitive importance of any changes thereupon.[194] Conversely, the competitive assessment in the United States centers on the ability of the merging entity to unilaterally elevate its prices post-merger,[195] and restricts the significance of market structure and market concentration to merely "one [among several other] useful

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[190] EU Merger Guidelines, *supra* note 42 at 5 para 8; US Merger Guidelines, *supra* note 33 para 0.1.
[191] EU Merger Guidelines, *supra* note 42 at 5 para 8; US Merger Guidelines, *supra* note 33 para 0.1.
[192] EU Merger Guidelines, *supra* note 42 at 5 para 8; US Merger Guidelines, *supra* note 33 para 0.1.
[193] EU Merger Guidelines, *supra* note 42 at 7 para 22; US Merger Guidelines, *supra* note 33 para 0.1.
[194] Lorenzo Coppi & Mike Walker, "Substantial Convergence or Parallel Paths? Similarities and Differences in the Economic Analysis of Horizontal Mergers in U.S. and E.U. Competition Law" (2004) 49 Antitrust Bull 101 at 135.
[195] *Ibid* at 136; Carl Shapiro, "The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years" (2010) 77:1 Antitrust LJ 49 ("the biggest shift in merger enforcement between 1992 and 2010 has been the ascendency of unilateral effects as the theory of adverse competitive effects most often pursued by the Agencies" at 60).

indicator[s of the] likely competitive effects of a merger."[196] Since section 7 of Clayton Act is not phrased in terms of dominance, there are no obstacles to the performance of a unilateral effects-centered analysis.[197]

Accordingly, the competitive analyses in each jurisdiction proceed in opposite directions. The competitive assessment under the Merger Guidelines in the United States begins by identifying the nature of the product, after which determination the unilateral effects analysis will be conducted.[198] For differentiated products, the abuse of the increased market power is expected to take the form of unilateral increases in price.[199] The analysis will continue to be product-centered and will seek to identify similar products in order to estimate the diversion ratio of existing customers to competing producers in response to post-merger price increases.[200] If the product is homogenous, the analysis will seek to predict how the market could harbor abusive decreases in output, in addition to increases in price, by the merging entity.[201] The structure of the antitrust market and, accordingly, market shares will acquire relevance in this context, since the inquiry will focus on the ability, availability and adequacy of the non-merging incumbents, and potentially rapid entrants, to remedy the output gap that would result from the unilateral anticompetitive reduction of output by the merged entity.[202]

Contrary to the European approach, the Merger Guidelines in the United States have achieved the conceptual divorce[203] of unilateral effects from market

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196 US Merger Guidelines, *supra* note 33 para 5.3; Shapiro, *supra* note 195 at 66.
197 Coppi & Walker, *supra* note 194 at 119-120.
198 US Merger Guidelines, *supra* note 33 para 2.2.
199 US Merger Guidelines, *supra* note 33 para 2.21.
200 US Merger Guidelines, *supra* note 33 para 2.211; Shapiro, *supra* note 195 ("[the] DoJ puts far more weight on diversion ratios and margins than on [market concentration] when diagnosing unilateral price effects" at 68).
201 US Merger Guidelines, *supra* note 33 para 2.22.
202 *Ibid*.
203 See e.g. Daniel J Gifford & Robert T Kudrle, "European Union Competition Law and Policy: How Much Latitude for Convergence with the United States?" (2003) 48 Antitrust Bull 727 ("it appears that

structure, and hence dominance, at least in cases involving differentiated products. Under the European approach, unilateral effects are presumptively associated with market dominance, subject to the recognition of a *residual* possibility that such effects can occur independently of the former.[204] The approach of the Guidelines in the United States gives effect to the argument which the European Guidelines have refused to embrace, namely that the cause of certain unilateral effects chiefly pertains to the unique attributes of the product or service in issue, rather than the structure of the market in which that service is provided, even if the latter can be one of the factors amplifying the magnitude of these anticompetitive effects.[205]

There are no signs that this divergence between the two jurisdictions will cease. In the United States, the recognition of unilateral effects in its present state is the result of the progressive development of economic theory from as early as 1968, when unilateral effects were first introduced in the Merger Guidelines and were closely related to market structure.[206] In the European Union, their recognition as a residual species of anticompetitive conduct not covered by dominance was the result of an extensive effort to close the enforcement gap of the dominance-centered test. It did not represent an integration of the developing economic theory into the competitive analysis.[207] In fact, European jurisprudence has been averse to the exclusive deference to unilateral effects as the appropriate review threshold. Discussions with European competition officials reveal concerns that the unilateral effects yardstick may fail to catch anticompetitive abuses resulting from a changed market structure, the effect of which may be more severe than that caused by

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all firms in a European market are either “dominant” or “non-dominant” and that a very different set of constraints applies to dominant firms than to others”at 739).

204 EU Merger Guidelines, *supra* note 42 at 8 para 25.

205 Copi & Walker, *supra* note 194 at 135.

206 Shapiro, *supra* note 195.

207 Coppi & Walker, *supra* note 194 at 133-136.

unilateral effects.[208] In other words, while regulators in the United States are primarily concerned with price increases post merger, their European counterparts also wish to guard against market structures involving market dominance, which could exacerbate the price impact of the unilateral effects.[209]

<u>3.4 Is Dominance the Appropriate Standard for the Assessment of Airline Mergers?</u>

Because, under the Commission's assessments, airline markets are narrowly defined on a city-pair basis, it is very common for the merged entity to enjoy a substantial market share, and hence a strong position of dominance, in routes involving one of its hubs.[210] Accordingly, by only requiring the creation or strengthening of a dominant position, the European dominance-centered test is highly appropriate for the stringent regulation of a dominance-inclined industry, as it will often give rise to a merger-averse presumption. Yet, as the next section will reveal, the Commission's analysis has ensured that this presumption is neither imbalanced nor irreversible. Even though the commonly high market shares arising from airline mergers could have resulted in a summary disapproval of the proposed concentrations, the Commission has refrained from conducting such transient analyses. It has instead performed a general competitive assessment of the market, in a quest for circumstances alleviating or exacerbating the resultant market dominance and its incompatibility with the common market.

Conversely, a test that focuses on unilateral effects without according due regard to the resulting dominance risks acting like a red herring. It can distract

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[208] *Ibid*.
[209] *Ibid*.
[210] Goetz, *supra* note 108.

regulators by enabling them to use other factors to justify the approval of a merger, and to thereby ignore the patently anticompetitive dominant positions arising over particular city pairs. As the following discussion will reveal, this exact error was committed by the Department in its analyses. Further, given the difficulty associated with the unequivocal classification of air carriage as either a differentiated or homogenous product, the Department's analysis, which is premised on unilateral effects by presuming that such clear classifications are in fact possible, becomes problematic in the context of airline mergers. Accordingly, a test that focuses on the structure of the market, rather than the nature of the product, is more practical.

3.5 The Application of the Substantive Tests in Airline Cases & the Competitive Assessment

3.5.1 The Analysis of the European Commission

The Commission's inquiry begins with the estimation of the market share expected to accrue in favor of the merging carriers post-merger over each city-pair currently serviced by the merging parties. This is followed by the assessment of other factors capable of refining the first impression stemming from the isolated consideration of market share.

In that endeavor, the Commission has followed rather mechanically the factors enumerated in the Merger Guidelines.[211] It first considers the levels of actual competition in the pre-merger market through a *retro*spective analysis, as well as the expected levels of potential competition in the post-merger market through a *pro*spective analysis. The latter inquiry pays regard to the power of consumers to

[211] Monti, *supra* note 180 at 275.

resist possible post-merger price abuses, as well as the barriers to market entry that may discourage future potential competitors from servicing the subject market.[212] This comprehensive analysis improves the accuracy of the competitive assessment, and hence contributes to the more effective exercise of the Commission's discretion. However, because the Commission has made very conservative assumptions with regard to the competitive contribution of each of these factors, it has preserved the anti-merger bias of its dominance-based test.

The Commission's conservative consideration of the factors enumerated in the foregoing discussion will now be expanded upon.

3.5.1.1 The Existence and Proximity of Competition Between the Merging Entities in the Pre-Merger Market

This element of the assessment concerns the pre-merger levels of competition between the merging airlines. The inquiry focuses on the *actual* competition between the carriers servicing a city-pair.[213] It is relevant because it helps estimate the anticompetitive impact of the proposed transaction on that market. It is to be recalled that the test prescribed by the Merger Regulation is concerned with the *overall* anti-competitive effects of a concentration, including the loss of competitive constraints formerly exercised by the merging carriers vis-à-vis each other. In the context of duopolies, or other restricted oligopolies, the competitive constraints between the merging carriers are quite commonly the most potent competitive forces in the subject market. Thus, when assessing the anticompetitive effects of a merger upon a duopoly,

[212] See e.g. the Commission's summary of its competitive assessment in *Ryanair / Aer Lingus*, *supra* note 46 at 80-81.
[213] *Ryanair / Aer Lingus*, *supra* note 46 at 86.

the Commission presumes the existence of such competitive constraints between the two carriers.[214]

There are no express opinions with regard to whether full service, high frills carriers can be in actual competition with low cost, no frills airlines. In the *Ryanair/Aer Lingus* decision, the Commission refused to treat flight options offered by a hybrid carrier, Aer Lingus, and a low cost carrier, Ryanair, as *not* being in competition, reasoning that there are no substantial differences between a carrier offering medium to low frills service and a carrier offering exclusively low frills service.[215] This was because the two carriers already were, in terms of market shares and traffic volumes, the closest competitors. It would appear that the same conclusion would be reached as regards the competitive relationship between purely full service and purely low cost carriers. This is supported by the Commission's inclusion of full service carriers, such as British Airways and Cityjet, in its competitive analysis when considering the barriers to market entry likely to be confronted by potential competitors in the post-merger environment.[216] Such a broad view of substitutability would also be consonant with the Commission's policy objective of protecting the interests of passengers. If the services offered by the two airlines are deemed substitutable, then the two carriers will be considered to be in competition pre-merger, thereby exercising competitive constraints upon each other. Post-merger, such competitive constraints will be lost and, consequently, the *overall* impact of the concentration will be anti-competitive.

In addition to the duopoly-based presumption and the substitutability considerations, the Commission will also find the existence of actual competition between two carriers if there is evidence of previous price-based interaction between

[214] *Ibid*.
[215] *Ibid* at 89.
[216] *Ibid* at 87.

them.[217] This interaction can take the form of *ad hoc* price adjustments to match a competitor's fares in individual markers, but can also occur on a systematic basis by way of automated price-matching technologies.[218]

3.5.1.2 Elimination of Potential Competition to the Detriment of Consumers

In addition to the loss of a competitive constraint, as explored in the preceding section, this factor also includes the loss of the incentive to explore and service new routes, and hence the motivation to compete, post-merger. In *Ryanair/Aer Lingus*, the Commission reasoned that new, unexplored markets provide higher yields to the first carrier that starts serving them, because of the monopoly position such a carrier will enjoy as the first market entrant.[219] Consequently, carriers are deemed incentivized to explore new routes and capitalize on the opportunities associated with first entry.[220] Once a strong competitive constraint is lost from the market, carriers will have no incentive to pursue such opportunities, which will result in fewer travel alternatives for passengers in the future.[221]

3.5.1.3 Limited Service Alternatives Available to Consumers

This concern is most commonly evoked when the merging entity is expected to hold a substantial market share post-merger. The assessment is comprehensive and is thereby conducted from both a demand and a supply perspective. The demand-based test will consider the travel alternatives available to passengers and, as such,

[217] *Ryanair / Aer Lingus*, *supra* note 46 at 86; *Olympic/Aegean*, *supra* note 74 at 55-56.
[218] *Ibid*.
[219] *Ibid* at 121-126.
[220] *Ibid*.
[221] *Ibid*.

involves a rudimentary assessment of substitutability as discussed previously.[222] From the supply-side perspective, the Commission will consider the operating capabilities of potential competitors and their capacity to service the routes in issue, thereby providing a viable competitive constraint in the market. [223]

3.5.1.4 Barriers to Entry

Barriers to entry represent difficulties that potential competitors may incur in order to establish themselves in and profitably service a given market.[224] The Commission's competitive assessments place significant weight on the analysis of such barriers,[225] and consider both demand and supply-related impediments.

Demand-based barriers to entry are commonly associated with the strength of the incumbent carriers' brands[226] in a given market, and the difficulty for potential entrants to acquire equivalent brand recognition. Such an endeavor entails high marketing and advertising costs, which increase the cost of entry. The Commission has assumed that the financial cost of preserving an already recognized brand is substantially lower than that associated with the establishment of an equally acclaimed brand.[227] This assumption biases the competitive assessment by creating a general presumption of market inaccessibility.

Demand-based barriers to entry also include the demographics of a particular route. If the majority of passengers travelling between a city pair are connecting travellers destined for onward travel beyond the particular city pair in question, then

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[222] See Section 2.1, above, for more information.
[223] *Ryanair / Aer Lingus*, *supra* note 46 at 91-101.
[224] *Ibid* at 150-151.
[225] See e.g. *Lufthansa/ SN Air Holding*, *supra* note 46 at 53; *Olympic/Aegean*, *supra* note 74 at 152.
[226] *Olympic/Aegean*, *supra* note 74 at 135-137.
[227] *Ryanair / Aer Lingus*, *supra* note 46 at 150-151.

carriers not offering flight connections at either end of the pair are deemed to be at a competitive disadvantage.[228] This disadvantage is treated as a barrier deterring the entry of a potential competitor. This is especially the case in routes between the hubs of two network carriers.[229] In addition to the primary travel purposes of a market's demographic, the brand-consciousness of passengers will also be relevant. If the majority of travellers are loyal to the incumbent brands, then new entry will be considered especially difficult.[230]

In line with the Merger Guidelines[231], the Commission will also consider the likelihood of aggressive competition being pursued by incumbents as a deterrent to the entry of future competitors. Evidence of past predatory conduct will be highly prejudicial to the merger application.[232]

Supply-related barriers are relevant from an operational and financial perspective. From an operational view, the absence of a base or hub in one end of the subject city pair will be considered a barrier to entry because of the comparatively higher operating costs and reduced operational flexibility associated with the service of the route in question.[233] From a financial perspective, the barriers to entry that evoke concern include the relatively weaker negotiating positions of new entrants vis-à-vis airport operators over such issues as landing charges and "the distribution of airport resources."[234]

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[228] See e.g. *Lufthansa/ SN Air Holding*, *supra* note 46 at 55; EC, Commission, *Case No COMP/M.3770 Lufthansa/Swiss* (Luxemburg: EC, 2005) at 18.
[229] *Ibid*.
[230] *Ryanair / Aer Lingus*, *supra* note 46 at 148-149; *Olympic/Aegean*, *supra* note 74 at 111.
[231] EU Merger Guidelines, *supra* note 42 at 12.
[232] *Ryanair / Aer Lingus*, *supra* note 46 at 154-160.
[233] See e.g. *Lufthansa/ SN Air Holding*, *supra* note 46 at 54-55 (for carriers operating out of a hub); *Ryanair / Aer Lingus*, *supra* note 46 at 93-99 &102 (for carriers operating out of bases).
[234] *Ryanair / Aer Lingus*, *supra* note 46 at 95.

3.5.1.5 Conclusions on the Application of the Dominance Test in Airline Mergers

The dominance-based analysis has resulted in a stringent review of airline mergers. The adverse presumptions resulting from the inevitably high market shares and concentrations have succeeded in identifying the strong anticompetitive impact of a merger over vulnerable city pairs. However, the Commission has not been unfairly dismissive of other considerations capable of alleviating the anticompetitive presumptions resulting from such high market shares, and has gone a long way in conducting a comprehensive assessment of the aforementioned potentially mitigating factors. Yet, in doing so, it has restrained itself from indulging in pro-competitive assumptions, which could facilitate the proof of these mitigating circumstances. Instead, it has made the most conservative estimations of the competitive contribution of each parameter considered. This practice will now be contrasted to the treatment of airline mergers by the Department of Justice in the United States.

3.5.2 The Competitive Assessment of Airline Mergers in the United States: Points of Divergence

3.5.2.1 The Department's Limited Consideration of Market Share and Market Power

The Department of Justice has generally accorded insufficient regard to the probative value of high market shares as a precursor to the lessening of competition. In the *Delta/Northwest* merger, the Department did not consider the substantial combined market concentrations of the merging carriers, either before or after the proposed transaction. This was despite the fact that the market concentrations in all "hub to hub" markets exceeded the levels that would have given rise to anticompetitive concerns under the Guidelines.[235] Similarly, in *United/Continental*, the Department's concerns were only evoked by the competitive state of routes out of Newark airport. However, high market concentrations, which would be presumptively anticompetitive under the Guidelines, had again accrued in favor of the merging carriers in several other routes between their hubs.[236] This mirrored the market situation in *Delta/Northwest*, which, once again, the Department failed to diagnose and rectify. It was only in the *American/US Air* merger that the Department truly appreciated the alarmingly high concentrations in several hub-specific markets, including flights to Washington Reagan Airport, which would occasion higher airfares and frequency reductions.[237]

This conduct could be deemed consistent with the overall thrust of the latest Merger Guidelines, as well as their preceding edition, and their diminishing ascription of substantial importance on market concentration as a predictor of anticompetitive effects. However, a closer reading of the Guidelines would suggest complacency rather than compliance on the Department's part. Under the Guidelines, market concentration has been renounced as the primary means for the estimation of a transaction's anticompetitive effects, insofar as that estimation can be conducted by alternative means of comparable probative and predictive value. The abandonment of the primacy of market concentration was a methodological novelty that was not envisaged to loosen the already lax enforcement standards of antitrust, which had been further compromised by the effective renunciation of the airline antitrust market. This is to be contrasted to the European practice, which, through the faithful

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[235] See e.g. The American Antitrust Institute, White Paper, "The Merger of Delta Air Lines and Northwest Airlines: An Antitrust White Paper" (10 July 2008) online: AAI <http://www.antitrustinstitute.org/files/AAIWhite%20Paper_Delta_NW_071020081922.pdf> [AAI, "Delta/Northwest"] at 5-7.

[236] US, Government Accountability Office, *Issues Raised by the Proposed Merger of United and Continental Airlines* (2010) at 19 [GAO, "United/Continental"].

[237] US DOJ, *American/US Trial Brief*, *supra* note 148 para10.

application of the dominance-based test over all potentially affected city pairs, would have sought, identified and been alerted by the finding of high market shares, thereby presuming the merger to be illegal. Even if the Department was willing to free its analysis from the high market shares over individual city pairs, there was still ample evidence[238] of the anticompetitive effects of the two transactions, which, as the subsequent subsections will reveal, it failed to take into account by *not* pursuing the Commission's conservative and "merger-skeptic" assessment.

3.5.2.2 Loss of Competitive Constraints – the Unsatisfactory Application of a Powerful Network-Wide Market Definition

Following the merger of two previously competing carriers, the mutual competitive constraints exercised upon each other prior to the merger will cease to exist, as the two airlines will no longer be in competition with each other. Consequently, the effect of a merger that eliminates previous head-on competition will be inherently anticompetitive.[239] In the context of the consolidation of two network carriers, the more significant the overlap of their networks, the more anticompetitive will be the effect of their merger. This is because the aggregate loss of the competitive constraints exercised over the individual city pairs of their overlapping networks will be higher. Yet, it was not until the *American/US Air* merger that the Department properly estimated the extent of the two carriers' network overlap. In both the *Delta/Northwest* and the *United/Continental* mergers, the networks in issue were described as "complementary",[240] or non-overlapping, despite warnings of significant such overlaps, at least in the domestic market of the United

[238] See e.g. AAI, "Delta/Northwest", *supra* note 235.
[239] US Merger Guidelines, *supra* note 33 para 2.1.4.
[240] DOJ, Delta/Northwest, *supra* note 149; DOJ, United/Continental, *supra* note 150.

States[241]. Thus, the assessment considerably underestimated the true anticompetitive impact of the transaction.

This underestimation also amounts to an unsatisfactory application of the broader, network-wide market definition that the Department has more willingly embraced than the European Commission. Had the Department properly estimated the extent of the overlap of the two carriers' networks, it would have benefited from a much stronger premise for the condemnation of the merger, or at least for the imposition of significantly more effective remedies, whose inadequacy will be explored in the next section.

3.5.2.3 The Department's Treatment of Low Cost Carriers, Remedies and Service to Small Communities

The Department has been relying increasingly on the competitive constraints exercised by Low Cost Carriers across the networks of the merging legacy carriers. There is strong evidence to the effect that exposure to Low Cost Carrier competition produces significant fare disciplining effects.[242] Low Cost Carriers have been regarded as a competitive counterweight that will remedy the anticompetitive effects of the recent large-scale consolidation of the network carriers. Accordingly, their

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[241] AAI, "Delta/Northwest", *supra* note 235 ("It is clear that the Delta and Northwest systems substantially overlap in both the Midwest and Southeast." at 10); GAO, "United Continental", *supra* note 236 (characterizing the overlap as "considerable" at 15).

[242] See e.g. William P Anderson, Gang Gong & T R Lakshmanan, "Competition in a Deregulated Market for Air Travel: The U.S. Domestic Experience and Lessons for Global Markets" (2005) 13 Research in Transport Economics 3 ("fares in a particular market are lower by $66 if Southwest offers service in that market [and the] the threat of competition [alone] from Southwest reduces fares by $27" at 17); Steven M Wu, "The "Southwest Effect" Revisited: An Empirical Analysis of the Effects of Southwest Airlines and JetBlue Airways on Incumbent Airlines from 1993 to 2009" (2012) 5:2 The Michigan Journal of Business 11 ("fares on leisure routes, legacy-dominated routes and routes connecting endpoints with high traffic volume all witnessed severe drops in fares from Southwest threat and entry […whereas routes to] airports that were slot-controlled surprisingly were not all that much affected from Southwest threat" at 30); Jan K Brueckner, Darin Lee & Ethan S Singer, "Airline Competition and Domestic US Airfares; A Comprehensive Reappraisal" (2013) 2 Economics of Transportation 1 ("LCC competition has dramatic fare impacts, whether it occurs in-market, at adjacent airports, or as potential competition" at 15).

competitive contribution has been envisaged to spread across the entire airline industry of the United States.[243] Thus, in both *United/Continental* and *American/US Air*, the Department conditioned the withdrawal of its condemnation of the two mergers on the merging carriers' divestiture of slots at their slot-controlled airports, and the transfer of the latter to Low Cost Carriers.[244]

However, from a competitive perspective, this assumption can be challenged. It erroneously assumes that Low Cost Carriers will be willing to service all city pairs that have incurred the anticompetitive effects of the recent consolidations. This assumption can be inferred from the Department's reference to the entry of Low Cost Carriers into "key constrained airports across the country".[245] Yet, the commercial interests of Low Cost Carriers are restricted to dense point-to-point routes,[246] which only represent a fraction[247] of the city-pairs in which competition has diminished after the recent mergers of the legacy carriers. Several thinner routes will still not benefit from this plan. Additionally, there is evidence that the number of slots allocated to

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243 US, Department of Justice Antitrust Division, Press Release, *Department of Justice Requires US Airways and American Airlines to Divest Facilities at Seven Key Airports to Enhance System-wide Competition and Settle Merger Challenge* (12 November 2013) online: US DoJ Briefing Room <http://www.justice.gov/opa/pr/2013/November/13-at-1202.html> [DOJ, *American/US Settlement*] ("this agreement has the potential to shift the landscape of the airline industry. By guaranteeing a bigger foothold for low-cost carriers at key U.S. airports, this settlement ensures airline passengers will see more competition on nonstop and connecting routes throughout the country").

244 DoJ, *United/Continental*, *supra* note 150; DoJ, *American/US Settlement*, *supra* note 243.

245 DoJ, *American/US Settlement*, *supra* note 243.

246 See e.g. Xavier Fageda & Ricardo Flores-Fillol, "Air Services on Thin Routes; Regional versus Low-Cost Airlines" (2012) 42 Regional Science and Urban Economics 702 ("our empirical analysis indicates that low-cost airlines operate similarly to network airlines in the US, at least in terms of route choices…[thereby serving] high-density routes, while thin routes are served mainly by regional carriers using regional jet aircraft" at 712); Harumi Ito & Darin Lee. "Low cost carrier growth in the US airline industry: past, present, and future", online: (2003) Brown University Department of Economics < http://www.brown.edu/Departments/Economics/Papers/2003/2003-12_paper.pdf> ("LCCs typically enter city-pairs with high passenger density, since these markets allow them to exploit their comparative advantage in providing quick-turn, point- to-point service" at 4).

247 See e.g. US, Government Accountability Office, *Issues Raised by the Proposed Merger of American Airlines and US Airways* (2013) ("by October 2012, network airlines share of domestic seats had fallen to 52 percent and low cost airline's share had risen to 33 percent [with a forecast of reduced Low Cost Carrier growth and market penetration due to increasing costs]" at 6); US, *The Proposed United-Continental Merger: Possible Effects for Consumers and Industry: Before the U.S. House of Representatives Committee on Transportation and Infrastructure*, Subcommittee on Aviation, 111th Cong (2010) (Albert E Foer) [Foer, "United/Continental Testimony"] ("Because low cost carriers compete only on certain non-stop routes, they provide at best only a limited discipline on a system-wide basis").

Low Cost Carriers is not sufficient to realize the stated objective of the slot divestitures and the effective integration of low cost service into the nation's market.[248]

Further, from an implementation perspective, and by approving the merger of the two Low Cost Carriers Southwest and Air Tran, the Department has also subverted its own efforts to facilitate the competitive ascent of Low Cost Carriers in the domestic market of the United States.[249] Although it premised its approval on the complementarity of the carriers' networks, and hence on the absence of competitive constraints exercised upon each other, research has revealed that, "the Southwest–AirTran merger eliminated one of the competitive barriers to [Southwest's] raising [its] own fares when faced with reduced competition from other carriers."[250]On the one hand, the Department has relied on the competitive constraints exercised upon the merging network carriers by Low Cost Carriers, and on the other, it has approved mergers that have undermined the potency of these constraints. This is to be contrasted to the European Commission, which has been highly averse to the merger of two large Low Cost Carriers.[251]

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[248] See e.g. The American Antitrust Institute, *Comments of the American Antitrust Institute, AirlinePassengers.org, Association for Airline Passenger Rights, Business Travel Coalition, Consumer Travel Alliance, and FlyersRights.org. (7 Feb 2014) in Re: United States v. US Airways Group, Inc. and AMR Corp.*, No. 1:13-cv-01236 (CKK) ("The divestitures maintain competition in the relevant market for slots at Reagan National Airport, and potentially increase competition in some local markets the acquiring carriers choose to serve, but they fail to ameliorate the harms in the hundreds of city-pair markets identified in the complaint, and will cause additional harms in still other markets").

[249] US, Department of Justice Antitrust Division, Press Release*, Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of Southwest's Acquisition of Airtran* (26 April 2011) online: US DoJ Briefing Room <http://www.justice.gov/opa/pr/2011/April/11-at-523.html>.

[250] Sakib bin Salam & B Starr McMullen, "Is there still a Southwest Effect?", online: (2013) 2325 Journal of Transportation Research Board 1 at 7 < http://trb.metapress.com/content/772310h1u38x71m5/>. (In fact, "The results show that, after including the necessary controls, AirTran and Spirit appear to have had the strongest impact on Southwest's fares, which are on average 6.57% lower if the airline faced competition from AirTran and about 16% lower if Spirit Airlines was present" *Ibid*).

[251] *Ryanair/ Aer Lingus*, *supra* note 46 ("the fact that Ryanair and Aer Lingus…operate according to a similar model of point-to-point / low-frills services [has] a significant effect on the nature of competition that they exert on each other and that would be lost following the proposed merger" at 80 – the merger was disallowed).

As regards service to smaller communities, and contrary to the European Commission's requirements, the remedies proposed by the Department have failed to protect the integrity of such service. The European Commission's remedies for the alleviation of a merger's anticompetitive effects have included positive steps towards the *integration* of smaller airlines into the networks of the merging legacy carriers, by requiring the combination of their respective frequent flier programs or the code sharing of flights with smaller carriers servicing a merging carrier's fortress hub.[252] The Department of Justice has requested no similar measures. Of course, the different composition of the two markets would preclude the imposition of similarly far-reaching remedies by the Department. Contrary to the European market, in which independent regional airlines still operate alongside low cost carriers, the former species has not survived in the deregulated industry of the United States, in which the bulk of the nation's regional service for onward network connections is provided by companies controlled by the merging legacy carriers.[253] At the same time, by virtue of their unique business model, low cost carriers are averse to code sharing, frequent flier reward programs or inter-lining, at least with full service network carriers,[254] not least because they focus on thick point to point service, which often excludes small communities.[255] However, this structural difference still fails to justify the complacency of the Department in the protection of regional service, which has been adversely affected.[256]

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[252] See e.g. *Air France/ KLM*, *supra* note 46 at 33-34.
[253] See e.g. Silke Januszewski Forbes & Mara Lederman, "The Role of Regional Airlines in the U.S. Airline Industry" (2007) 2 Advances in Airline Economics 193 ("A regional may be wholly-owned by the major with which it partners. Or, a regional may be independently owned and contract with one or more major carriers" at 201). For the anticompetitive exercise of this control in the form of exclusion of competing regional carrier, see also Dempsey, "European Aviation Law", *supra* note 10 at 161.
[254] See, *supra* note 246; Dempsey & Gesell, "Airline Management", *supra* note 78 at 187-194.
[255] *Supra* note 254.
[256] US, Government Accountability Office, *Status of Air Service to Small Communities and the Federal Programs Involved* (2014) ("mainline airlines have been reducing the total amount of capacity for which they contract by eliminating previous point-to-point service between nearby smaller airports,

3.5.2.4 The Department's Consideration of Coordinated Effects

Contrary to the European Commission, the Department's analysis has ascribed substantial significance to the possibility of network-wide collusion among hub carriers. The triumph of the coordinated effects analysis appeared in the *American/ US Air* merger, in which the Department adduced evidence of such past practice, as well as managerial statements admitting to and praising its pursuit.[257] Yet, the possibility of carrier coordination was ignored in the two preceding mergers of *Delta/Northwest* and *United/Continental,* despite strong external warnings of this danger.[258] These collusive effects have been construed broadly by the Department to include deteriorations in the quality of service and reductions in the complementary amenities, in addition to price coordination.[259]

The Department's allegations of network-wide collusion also reveal the structural difference between the merger analyses in the United States and the European Union, and the significance of a clearly defined antitrust market in the competitive assessment. Under the European review, such market *un*specific allegations would not be acceptable considerations, since they would fail to respect the analytical methodology by which the Commission abides, and under which the starting point of the assessment is the definition of a market on a city-pair basis. Under the Department's review, in which the antitrust market can be conceptually leapfrogged if there is strong independent evidence to raise anticompetitive concerns, such generalizations do not only become possible, but could have also been used to condemn, or at least qualify, the mergers. However, the Department failed to utilize

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thus, reducing the level and frequency of service provided" at 9).

[257] DOJ, *American/US Trial Brief*, *supra* note 148 para 41-47.

[258] See e.g. AAI, "Delta/Northwest", *supra* note 235 at 12; Foer, "United/Continental Testimony", *supra* note 247.

[259] *Supra*, note 257.

the full potential of such a broader antitrust market, and instead assumed that the limited entry of Low Cost Carriers will suffice to cure the alleged network-wide collusion.

3.5.2.5 The Department's Consideration of Barriers to Entry

The Department's consideration of barriers to market entry confronted by potentially competing carriers has been inconsistent and arguably lax.

In line with the analysis of the European Commission, the Department has identified sunk costs as a strong entry barrier. However, their discussion and analysis has been less comprehensive and detailed than the Commission's, which has classified them into two categories, namely; (i) commercial expenses relating to brand awareness and the prolonged incurrence of significant advertising costs for the successful penetration of a carrier's brand into the market, and; (ii) operational capabilities and costs pertaining to the fleet capacity of potential entrants and the opportunity costs associated with the diversion of their operations into new markets.[260] The Department's analysis has instead presumed the incurrence of significant market entry costs and has focused on their amplification by the predatory conduct expected to be pursued by incumbent legacy carriers to deter entry in inter-hub markets.[261] It has accordingly centered on the high risk associated with the assumption of such high costs, rather than their precise identification.[262] Interestingly, this consideration comes after decades of regulatory acquiescence to the subject predatory practices.[263]

[260] See above, section 3.5.1.4.
[261] DOJ, *United/Continental*, *supra* note 150.
[262] DOJ, *Northwest Trial Brief*, *supra* note 148 para III.C.
[263] Dempsey, "Predation", *supra* note 7.

In the past, and prior to the *Delta/Northwest* merger, which opened the door to the industry's large-scale consolidation, the Department had also recognized the carriers' closed networks as a barrier to the service of inter-hub routes.[264] Yet, in the *Delta/Northwest* merger, it opted to assume that the foregoing entry barriers were not existent, or at least not anticompetitively potent. This was despite extensive literature discussing how these barriers had deterred competitive entry in hub-dominated markets, and which long preceded the particular transaction.[265] The same mistaken assumption was made in the context of the *United/Continental* merger.[266] This treatment of hub-related barriers to market entry is to be contrasted to the European Commission's imposition of network accessibility conditions in its approval of similar mergers, as discussed earlier.

More recently, in its condemnation of the *American/US Air* merger, the Department offered a summary recognition of commercial barriers to entry, such as frequent flyer programs impeding the migration of passengers to competing carriers and the lack of brand recognition. [267]In the settlement agreement, however, this extensive list of barriers that had been populated in the Department's complaint was disregarded in the wake of the slot divestitures in favor of the Low Cost Carriers.[268] Yet, as the previous section revealed, the precompetitive impact of Low Cost Carriers may not be as strong as envisaged by the Department, and, as such, it may not be sufficient for the full eradication of the anticompetitive effects of the aforementioned barriers, which may still effectively impede competitive entry.[269]

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[264] DOJ, *Northwest Trial Brief*, *supra* note 148.
[265]AAI, "Delta/Northwest", *supra* note 235 at 16-19; Levine, *supra* note 109.
[266] Foer, "United/Continental Testimony", *supra* note 247.
[267] DOJ, *American/US Trial Brief*, *supra* note 148 para 91.
[268] DOJ, *American/US Settlement*, *supra* note 243.
[269] See *supra* note 248.

In line with the European Commission, the Department has recognized the unavailability of slots in certain slot-controlled airports as a barrier to entry.[270] Yet, as the *United/Continental* and *American/US Air* cases illustrate, slot-induced restrictions on airport accessibility have been the only operative barrier considered in the Department's analysis, despite the nominal mention of the other commercial and operational barriers. This can be concluded from the fact that the non-condemnation of these two mergers was contingent *solely* on the slot-divestures by the legacy carriers in issue. Unlike the European Commission, the Department failed to request additional remedies seeking to address the other barriers identified in its complaint.

3.5.2.6 The Department's Overreliance on Non-price Considerations for the Competitive Assessment of Airline Mergers

The Department of Justice has placed undue weight on certain merger-induced, non-price considerations pertaining to perceived improvements in the quality of travel, and has thereby ignored the danger of abusive pricing or output restrictions post-merger.[271] This approach is consonant with the definition of anticompetitive effects in the Horizontal Merger Guidelines, which make explicit reference to the variety and quality of service available to consumers as a relevant factor in the competitive assessment.[272] Such non-price considerations have taken the form of seamless inter-connectivity among the merging carriers' complementary networks, which has been treated as a pro-competitive service improvement.[273] Yet, as one commentator has remarked, this argument is oblivious to the ticket reservation

[270] See e.g. DoJ, *United/Continental*, *supra* note 150; DOJ, *American/US Trial Brief*, *supra* note 148 para 84.
[271] AAI, "Delta/Northwest", *supra* note 235 at 15-16.
[272] EU Merger Guidelines, *supra* note 42 at 5 para 8; US Merger Guidelines, *supra* note 33 para 0.1.
[273] DoJ, *Delta/Northwest*, *supra* note 149.

practices of the airline industry, which has for long facilitated the exchange of passengers between the networks of *competing* carriers.[274] The present criticism is further supported by the Department's partial and selective application of this qualitative, connectivity-centered consideration. The Department has still failed to preserve the quality and variety of service to small communities, by letting regional service slide through the cracks of the antitrust assessment.[275] Consequently, the accessibility of the legacy carriers' networks to small communities has deteriorated markedly in the wake of the consolidation wave.

This approach is to be contrasted to the competitive assessments of airline mergers by the European Commission, which has never resorted to purported quality improvements as a basis for the approval of a merger. This is despite a similar recognition of the quality of service offered as a possible pro-competitive effect in the European Horizontal Merger Guidelines.[276]

3.5.2.7 The Gatekeeping Function of the Department of Justice

The language of section 7 is notably broad when setting the threshold for the impermissibility of certain acquisitions. It prohibits any transaction that "*may* substantially lessen competition, or [that] *tend[s]* to create a monopoly".[277] Section 7 has accordingly been ascribed a "prophylactic function"[278] arming regulators with a legal basis for the early intervention and prevention of certain transactions that

[274] Paul Stephen Dempsey & Laurence E. Gesell, *Public Policy and the Regulation of Commercial Aviation* (Chandler: Coast Air Publications, 2013) at 336 [Dempsey & Gesell, "Airline Regulation"].
[275] See, *supra* note 256.
[276] EU Merger Guidelines, *supra* note 42 at 5 para 8.
[277] *Clayton Act*, *supra* note 29.
[278] See e.g. Roger D Blair & Jessica S Haynes, "The Efficiencies Defense in the 2010 Horizontal Merger Guidelines" (2011) 39 Review of Industrial Organization 57 at 58.

"would result in a monopoly or a substantial increase in market concentration".[279] A broad construction of the subject provision would even permit the successful opposition of a particular merger not solely on the strength of its *own* anticompetitive effects, but also for triggering a general trend towards the consolidation of a particular industry.[280] This effect could very much apply in the airline industry, whose dismal financial performance in the early 21st century sparked this sequence of mergers between its struggling legacy carriers. However, in the context of airline mergers, the Department of Justice only used this argument once in the legal action against the merger of Continental and Northwest Airlines.[281] This argument was soon abandoned in the *Delta/Northwest* merger, which marked the beginning of the recent consolidation of the airline industry of the United States. The Department's choice ran contrary to vocal contemporary objections and successful predictions that the trend of airline consolidations would continue unless stopped at its incipiency.[282]

3.6 Conclusions

Accordingly, it can be concluded that the substantive competitive review of the European Commission has been more stringent than the respective analysis of the Department of Justice. The Commission's dominance-centered test, which is very commonly satisfied in the context of airline mergers, has given rise to a merger-averse presumption that is enforced over *all* potentially affected city pairs, since the Commission has remained faithful to the universal application of the antitrust market. This is to be contrasted to the Department's analysis, under which the dominance

[279] *Ibid* at 59.
[280] AAI, "Delta/Northwest", *supra* note 235 at 2.
[281] DoJ, *Northwest Trial Brief*, *supra* note 148 para II, citing *Cargill, Inc. v Monfort of Colorado Inc,* 479 U.S. 104 at 124.
[282] AAI, "Delta/Northwest", *supra* note 235 at 2.

presumption has been abandoned. Compounded by the implicit renunciation of the antitrust market, the abandonment of the dominance test has ensured that instances of carrier dominance over vulnerable city pairs are not adequately revealed. The absence of the city-pair specific dominance presumption could have been rectified by a more diligent competitive assessment. Yet, the Department failed to manifest the requisite diligence for two reasons. First, it over-estimated the competitive constraints exercised by low cost carriers. Second, it did not accord sufficient recognition to the potency of the barriers to market entry, and it over-relied on certain illusory, non-price considerations and other precompetitive assumptions that concealed the true anticompetitive effects of the mergers. The foregoing was despite its broad mandate for intervention under the "prophylactic nature" of section 7 of Clayton Act.

The compounded effect of the looser market definition and the choice of a less stringent substantive test could have been ameliorated through the stricter consideration of efficiencies, which, as the next chapter will reveal, was not opted for by the Department.

Chapter 4: The Treatment of Efficiencies

4.1 Introduction

Consolidations of large entities can result in the rationalization of their respective production processes, thereby reducing the costs of production.[283] Such augmentations of productivity are referred to as efficiencies,[284] and can be achieved through a merger. However, it becomes apparent that the immediate beneficiaries of such efficiencies are the providers of a service, rather than its consumers. It is also common ground that the transfer of those gains from the former to the latter is neither automatic nor immediate; rather, it falls upon service providers, and their respective motives, to take the necessary steps for the transposition of these production-related advantages into the realm of consumers.[285]

Indeed, such cost gains can be used in an anticompetitive fashion to usurp the market share of less efficient producers not endowed with the productive efficiencies vested in the merged entity. According to conventional economic theory,[286] producers facing competition could employ such efficiencies to increase their market share by temporarily reducing prices and increasing output. Once the market share has been substantially increased to the exclusion of competitors, the accrued market power could be abused to increase prices above the levels set by the market. Because of the lower production costs, profitability would not be jeopardized by the temporary

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[283] For a more comprehensive assessment of the supply and demand-side effects of merger induced efficiencies, see e.g. Alison Oldale & Jorge Padilla, "For Welfare's Sake? Balancing the Rivalry of Efficiencies in Horizontal Mergers" (2010) 55:4 Antitrust Bull 953 at 959-969.
[284] Nick Wilson, *Managerial Economics: A Problem Solving Approach* (Cambridge: Cambridge University Press, 2005) at 226-235.
[285] Oldale & Padilla, *supra* note 283.
[286] Wilson, *supra* note 284at 389-394.

lowering of prices.[287] Consequently, the discussion of the legal treatment of efficiencies needs to be conducted with an appreciation of their anticompetitive potential.

As the foregoing discussion has revealed, the concerns of antitrust have centered on the adverse exercise of market power by a merged entity. The anticompetitive harm resulting from increased market power has traditionally been perceived as increases in price and reductions in output in the post-merger market. The occurrence of either has been associated with the diminution of consumers' welfare, and has provided the justification for the opposition to transactions perceived as anticompetitive.

An alternative model, however, has been proposed by Williamson,[288] which seeks to balance the effect of a merger upon the welfare of consumers and the total welfare of society. According to that model, the competitive analysis does not end on the finding of an adverse impact on consumer welfare. Rather, it also considers the producers' gains resulting from the cost-improvements directly flowing from the rationalization of production. Such gains represent the producers' welfare and are commonly referred to as merger-induced efficiencies. Williamson's model recognizes the "tradeoff"[289] between the competing welfares of the two groups in the wake of a consolidation. However, it also recognizes that the net effect of such transactions on the total welfare of society, which amounts to the aggregation of the respective welfares of its producers and consumers, may still be positive, and, hence, desirable,

[287] *Ibid*.
[288] Oliver E Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs" (1968) 58:1 The American Economic Review 18.
[289] *Ibid* at 21.

even if the latter category is adversely affected by the resultant "substantial market power and…relatively large price increases".[290]

The ultimate policy objective of competition law in both jurisdictions under review has purportedly been the protection of consumers' welfare. This goal has been pursued indiscriminately in all industries, including civil aviation, and would hence appear dismissive of Williamson's tradeoff model. However, as this chapter will reveal, the consideration of efficiencies as a defense to otherwise anticompetitive mergers that would *prima facie* restrict the welfare of consumers has been entertained with disparate vigor by regulators in each jurisdiction. Contrary to the European Union, regulators in the United States have systematically resorted to efficiencies to justify, at least in the airline context, anticompetitive mergers that significantly augmented the market power of the merging parties.

This chapter will begin by assessing the theoretical backgrounds of antitrust policy in the European Union and the United States respectively. It will subsequently illustrate how these different backgrounds have affected the consideration of efficiencies in each jurisdiction, and will use the seminal case of the *Honeywell/General Electric* merger to expose how the different theoretical underpinnings of antitrust policy can produce conflicting results through the disparate consideration of efficiencies. It will continue by contrasting the European Union's stricter treatment of efficiencies to the more liberal embracement of the latter by regulators in the United States for the justification of patently anticompetitive mergers. It will conclude by asserting that the more generous treatment of efficiencies in the United States has contributed significantly to its lighter and more sympathetic treatment of mergers in the airline industry.

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[290] *Ibid* at 23.

4.2 The Objectives of Competition Law in the European Union

European competition law has been significantly influenced by and molded after German jurisprudence. As several commentators have observed, the incorporation of the competition law provisions into the Treaty of Rome occurred upon the insistence of Germany, and the Competition Directorate of the European Commission has traditionally been headed by German jurors.[291] Accordingly, the justifications and incentives for the aversion to market dominance under European competition law are traceable to German jurisprudence, and particularly the Freiburg school of thought.

This school attributed the "economic and political disintegration"[292] of the Weimar Republic and the rise of Nazism in Germany to the poor regulation of the nation's industry, which began to consolidate in order to weather the economic difficulties of the inter-war era.[293] The Freiburg school regarded the preservation of healthy competition as a prerequisite for economic prosperity; it further assumed that economic freedom was necessary for the achievement of political freedom.[294] Although the concept of the free market was respected, and the centralization of the economy was accordingly rejected as an impossible alternative,[295] it was also assumed that "the laissez-faire approach of classical liberalism 'ignored the power of private citizens and the fact that the state can be 'captured' by those who wield private

[291] See e.g. David J Gerber, "Constitutionalizing the Economy: German Neo-liberalism, Competition Law and the "New" Europe" (1994) 42 Am J Comp L 25 at 71-73; Stefan Schmitz, "The European Commission's Decision in GE/Honeywell and the Question of the Goals of Antitrust Laws" (2002) 23:3 U Pa J Int'l Econ L 539 at 542-543 (see fn17).
[292] Gerber, *supra* note 291 at 29.
[293] *Ibid*.
[294] Gerber, *supra* note 291 at 36.
[295] Barry J Rodger, "Competition Policy, Liberalism and Globalization: A European Perspective" (2000) 6 Colum J Eur L 289 at 293.

power'"[296]. Such unchecked instances of private power, resulting from industrial consolidations and the creation and strengthening of a few dominant firms, were liable to jeopardize the economic and, accordingly, political freedoms that were at the heart of the Freiburg jurisprudence.

Consequently, the Freiburg perception of competition constitutes a middle ground alleviating the excesses of the two extremes that are economic centralization and an unfettered laissez-faire approach. In the words of a commentator, it represents "a third way [which] would…neither arrest the [economic] developments nor leave them unregulated, but [would instead] steer them into orderly paths".[297] This competition objective, whose ultimate practical goal was the creation of "a level economic playfield",[298] was highly apt for the Treaty of Rome, which sought to realize the same aspiration at an international level through the creation of a Common Market between Member States, with equal opportunity for entry for all firms bearing the European nationality.[299]

4.3 The Objectives of Antitrust Law in the United States

Despite the present state of divergence between the antitrust goals in the United States and the European Union, it has been observed that, in their incipiency, the policy objectives of the two jurisdictions coincided.[300] The debates regarding the enactment of the Sherman and Clayton Acts, as well the amendment of the latter in the aftermath of the Second World War, reveal a strong aversion to large

[296] *Ibid*.
[297] Heinz G Grosskettler, "On Designing an Economic Order: The Contribution of the Freiburg School" in David Walker & D E Moggridge (eds), *Perspectives on the History of Economic Though*t, vol 2 (Cheltenham, UK: Edward Elgar Publishing, 1990) at 58.
[298] Rodger, *supra* note 295 at 306.
[299] *Ibid*.
[300] Schmitz, *supra* note 291 at 544; Hovenkamp, "Markets", *supra* note 90 at 889.

concentrations and to the demise of the small enterprise.[301] They further reveal a strong trepidation of the possible denial of equal economic opportunity to smaller firms that was anticipated to result from the emergence of dominant enterprises in highly concentrated industries.[302] Ironically, and echoing the accounts of the Freiburg school, many Congressmen advocated for socio-economic policies that would guard against the rise of totalitarianism in the United States in a fashion similar to the recent, at that time, European experience.[303] The early jurisprudence of the Supreme Court in the 1950s and 60s echoed this concern. So strong was its aversion to concentration, that the Court went so far as to treat merger-induced efficiencies as a reason militating *for* the prohibition of a merger, as they would prevent competitors with higher cost structures from effectively competing in the post-merger market.[304]

However, progressively, and by the late 1970s, the ideas of another school of thought, known as the Chicago School, began to creep into the jurisprudence of antitrust law.[305] Under the Chicago theory, and contrary to the Freiburg scholarship, the sole objective of competition law should be the attainment of economic efficiency, with the price mechanism being the most apt vehicle for the attainment of this goal.[306] The economic efficiency in issue is the aggregate of the allocative and productive efficiencies, the former benefiting consumers and the latter benefiting producers. It was presumed that consumer welfare would also be served through the pursuit of

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[301] Derek C Bok, "Section 7 of the Clayton Act and the Merging of Law and Economics" (1960-1961) 74 Harv L Rev 226 at 234-237.
[302] *Ibid*.
[303] *Ibid*.
[304] For a detailed discussion of the early case law and the progressive departure of from the adverse treatment of efficiencies, see e.g. Alan A Fisher and Robert H Lande, "Efficiency Considerations in Merger Enforcement" (1983) 71:6 Cal L Rev 1580 at 1593-1596; Robert Pitofsky, "Efficiencies in Defense of Mergers: Two Years After" (1998-1999) 7 Geo Mason L Rev 485 at 487-491.
[305] Herbert Hovenkamp, "Antitrust Policy After Chicago" (1985) 84:2 Mich L Rev 213 at 218; Eleanor M Fox, "We Protect Competition, You Protect Competitors" (2003) 26:2 World Competition 149 at 152 [Fox, "Competitors, not Competition"].
[306] Hovenkamp, *supra* note 305 at 226.

economic efficiency.[307] Accordingly, since efficiency would not compromise consumer welfare, it was justified[308] in becoming the chief concern of antitrust policy in the United States, and to a significantly higher extent than in the European Union.

The assumptions and starting points of the respective jurisprudences of the United States and Europe are different.[309] By focusing exclusively on economic efficiency, the Chicago school excludes all the "non-political considerations"[310] that have underpinned European theory, and most notably the need to preserve economic freedom through the avoidance of high concentrations.[311] These non-economic considerations had also provided the original starting point from which US antitrust policy eventually deviated. The Chicago school further makes certain optimistic assumptions about the competitive tendencies of markets, of which the Freiburg school is more skeptical. First, it presumes that markets are competitively predisposed, and that, accordingly, their profit-maximizing agents are unlikely to pursue anticompetitive conduct.[312] Second, monopoly is deemed "self-correcting, [such that] the monopolist's higher profits generally attract new entry into the monopolist's market, with the result that the [monopoly] position is quickly

[307] For the differing strength of the presumption that consumer welfare would be served through the pursuit of efficiencies, see: William E Kovacic, "Antitrust Paradox Revisited: Robert Bork and the Transformation of Modern Antitrust Policy" (1989-1990) 36 Wayne L Rev 1413 ("consumer welfare means nothing more than efficiency" at 1448); and contrast to: Fox, "Competitors not Competition", *supra* note 305 ("'Consumer welfare' was the label given for the raison d'être of the new regime, but it obscured the fact that the real first principle was non-intervention." at 153); Hovenkamp, *supra* note 305 ("a properly defined antitrust policy will attempt to maximize net efficiency gains [as opposed to solely consumer gains]" at 226); Schmitz, *supra* note 291 ("the exact relationship between efficiency and consumer welfare is not clear…only efficiencies that enhance consumer welfare become part of this ultimate goal" at 549); Robert Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York: Basic Books, 1978) ("[the purpose] of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare" at 91).

[308] Fox, *supra* note 305.

[309] Schmitz, *supra* note 291 at 550 and 587.

[310] Hovenkamp, *supra* note 305 at 231-232.

[311] Grosskettler, *supra* note 297 at 59; Rodger, *supra* note 295 at 294.

[312] Hovenkamp, *supra* note 305 at 226-228.

eroded".[313] This introduces the third key assumption, under which the existence and intensity of barriers to market entry are underestimated.[314]

In light of its declared objectives and heavily pro-competitive assumptions, the Chicago School inevitably envisaged a very restricted role for antitrust in the economy.[315] Since the goals of antitrust policy were deemed solely economic, in terms of ensuring low prices in the market and encouraging lower production costs, and since the price mechanism of the *free* market was the best vehicle for the realization of efficiencies, government regulation was perceived as a largely redundant, if not erosive, intervention.[316] Yet, as Sunstein has noted, "approaches that begin from laissez-faire are bound to misinterpret the modern regulatory state, relying as they do on criteria that cannot capture the diverse legitimate reasons for regulatory controls".[317] This observation best accounts for the more tolerant and transient inclination of regulators in the United States towards merger review, which tends to treat "competition as a process [to the attainment of efficiencies] rather than a goal".[318]

4.4 Efficiencies as a Shield or a Sword? The Honeywell/ General Electrics Case

4.4.1 Background to the Case

The discussion thus far has addressed the different assumptions of the antitrust jurisprudence in each jurisdiction. This section will illustrate how these disparities can

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[313] *Ibid*.
[314] *Ibid*; Richard A. Posner, "The Chicago School of Antitrust Analysis" (1979) 127:4 U Pa L Rev 925 at 926-931.
[315] Hovenkamp, *supra* note 305 at 226 and ("under the Chicago School theory the market itself, not antitrust laws, punishes productive inefficiency" at 238).
[316] Eleanor M Fox, "The Battle for the Soul of Antitrust" (1987) 75:3 Cal L Rev 917 at 917.
[317] Cass R Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (Cambridge, MA: Harvard University Press, 1993) at 229.
[318] Deborah Platt Majoras, "GE-Honeywell: The U.S. Decision", Case Comment online <http://www.justice.gov/atr/public/speeches/9893.htm>.

produce conflicting results through their respective focus on "competition as an end" and "competition as a means to an end".[319] The merger of Honeywell with General Electric[320] will be used for this exercise.

The Department of Justice did not oppose the merger, subject to commitments by the merging parties to enable the access of competitors into two markets in which the Department feared abusive price increases, resulting in an inefficient outcome under Chicago theory. These markets were the "production of U.S. military helicopter engines and the provision of heavy maintenance, repair and overhaul (MRO) services for certain Honeywell aircraft engines and auxiliary power units (APUs)."[321] The parties were accordingly required to "divest Honeywell's helicopter engine business and to authorize a new third-party MRO service provider for certain models of Honeywell aircraft engines and APUs."[322]

On the other hand, the European Commission blocked the transaction, on the basis that the cost advantages in the production and distribution processes resulting from the merger would enable the merged entity to sell its products at anticompetitively low prices.[323] This effect was anticipated to occur through a sales practice known as bundling, whereby several complementary products, such as

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[319] *Ibid*.

[320] "The General Electric Company is a diversified industrial corporation active in fields including aircraft engines, appliances, information services, power systems, lighting, industrial systems, medical systems, plastics, broadcasting (through the NBC media channel), financial services and transportation systems. Honeywell is an advanced technology and manufacturing company serving customers worldwide with aerospace products and services, automotive products, electronic materials, speciality chemicals, performance polymers, transportation and power systems as well as home, building and industrial controls": Dimitri Giotakos et al, "General Electrics/Honeywell – An Insight into the Commission's Investigation and Decision" (2001) 3 Competition Policy Newsletter 5 at 5.

[321] US, Department of Justice Antitrust Division, Press Release, *Justice Department Required Divestitures in Merger Between General Electric and Honeywell: Parties Required to Divest Helicopter Engine Business and to Authorize New Service Provider for Engines and Auxiliary Power Units* (2 May 2001) online: US DoJ Briefing Room <http://www.justice.gov/atr/public/press_releases/2001/8140.htm >.

[322] *Ibid*.

[323] EC, European Commission, Press Release, *The Commission prohibits GE's acquisition of Honeywell* (3 July 2001) online: EUROPA, Press Releases Database < http://europa.eu/rapid/press-release_IP-01-939_en.htm >; Giotakos et al, *supra* note 320 at 6-7; Schmitz, *supra* note 291 at 584.

different spare parts for a particular piece of equipment, are sold as a collective bundle rather than individually. In such cases, the unit price of each item sold as part of the bundle is lower than the price at which the same product would have been sold individually, "due to discounts applied across the product range".[324] The Commission speculated, on a weak evidential basis,[325] that the merged entity might engage in predatory bundle sales, thereby eliminating competition. It used this speculative reasoning to substantiate a finding of dominance over markets in which the merging entity's combined market share would not have necessarily sufficed to establish such a finding.[326]

It must hereby be emphasized that the Commission's decision was *not* phrased in terms of efficiencies, but, rather, in terms of market dominance.[327] Although the possibility of bundle sales *could* have been considered as a merger-induced efficiency, it was not classified as such for the purposes of the competitive analysis. This point is significant, because it reveals the potentially different treatment that can be accorded to such efficiencies under each jurisdiction. Regardless of the label that is attached to the cost gains resulting from a merger-induced rationalization of the production process, efficiencies can be conceptually treated as a shield, thereby alleviating the potential anticompetitive effects of a merger, or as a sword, thereby exacerbating these effects if deployed in an anticompetitive way. In the former case, efficiencies would constitute a "pro-competitive *defense*", whereas, in the latter, they would amount to an "anticompetitive *offense*" and would provide the reason for the disapproval of a merger.[328]

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[324] Schmitz, *supra* note 291 at 578-9.
[325] *Ibid* at 580.
[326] *Ibid* at 586.
[327] *Ibid* at 585-586.
[328] Donna E Patterson & Carl Shapiro, "Transatlantic Divergence in GE/Honeywell: Causes and Lessons" (2001-2002) 16 Antitrust 18 at 20-21.

The European Commission opted to presume the latter,[329] thereby revealing how the different goals of antitrust can result in the disparate treatment of efficiencies. The potential emergence of a dominant position, and the threat it would pose to the competitive state and accessibility of the market, sufficed to justify the negative treatment of efficiencies, even though the latter would have resulted in short term price reductions in favor of the "bundle-buyers".[330] Conversely, under the Chicago jurisprudence, the beneficiary of antitrust laws is not competition itself; rather, it is the efficiency of the market, along with the presumptively resulting augmentations of consumer welfare through lower prices. The law in the United States does

> not protect competitors from mergers that will make the merged firm more efficient, even if they fear they may as a result be forced out of the market. This is because, as former Treasury Secretary Larry Summers reminded us at this year's ABA Antitrust Section Spring Meeting, competition is a means to an end, and not an end in itself: "*The goal is efficiency, not competition*. The ultimate goal is that there be efficiency."[331] [emphasis added]

This case represents an extreme illustration of the conflict between the two antitrust philosophies. However, it is interesting to note that the purported ultimate beneficiary of antitrust in both jurisdictions is the consumer and his welfare. For the European Union, short-term price reductions were worthy of sacrifice if they would result in the prevention of dominance *and* the preservation of competition, and, hence, consumer welfare in the long term.[332] Conversely, as the Department of Justice

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[329] *Ibid*.
[330] Patterson & Shapiro, *supra* note 328.
[331] Majoras, *supra* note 318.
[332] Schmitz, *supra* note 291 at 587-588.

pointed out, the antitrust laws in the United States would only intervene to guard against abusive price *increases* and output reductions, which, under Chicago theory, would not be an efficient outcome.[333] Accordingly, if the efficiencies are known to result in lower prices for consumers, as was the case under the European Commission's speculative "bundle-selling" scenario, they will be accorded positive consideration.[334] Since competition was the means rather the end of the Department's antitrust policy, the creation of a market structure in which competition would be preserved could not justify the temporary sacrifice of lower prices, which would be the efficient outcome under Chicago theory.

4.4.2 The Progressive Decline of Efficiencies, or an Efficiencies Gap?

The previous section revealed how undue deference to the concept of efficiencies, and the latter's primacy over competition, can result in the approval of transactions that would otherwise be liable to give rise to a firm's dominance. This disparity originated in the different theoretical considerations that have informed antitrust analysis in each jurisdiction. Recently, however, this acute divergence between the two ideological trajectories has been moderated. Some commentators have optimistically suggested that the two tracks have, in fact, begun to converge.[335] This section will argue that certain fundamental differences in the treatment of efficiencies persist, even though the jurisprudential gap has stopped expanding in certain respects.

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[333] Hovenkamp, *supra* note 305; Posner, *supra* note 314.
[334] Majoras, *supra* note 318.
[335] Shilei Zhu, "Convergence? Divergence? A Comparison of Horizontal Merger Laws in the United States and European Union" (2006) 29:4 World Competition 635 ("With the explicit recognition of efficiencies especially contained in the Guidelines, the European Community thus shared the same approach as that of the United States" at 643).

Prima facie, the latest version of the Merger Guidelines in the United States seems to contain the supremacy of efficiencies over competition, at least as a declaratory matter of principle. They provide that regulators are "mindful that the antitrust laws give competition [in the form of lower prices], not internal operational efficiency, primacy in protecting customers."[336] This would appear to reverse the earlier statements of the Department of Justice with regard to the hierarchical relationship between efficiencies and competition. Indeed, the preceding version of the Guidelines asserted that "the primary benefit of mergers to the economy is their potential to generate such efficiencies,"[337] without referring to the latter's teleological relationship to competition. This liberal perception of efficiencies was also consonant with the Department's earlier declaration that had demoted competition to the means rather than the end of antitrust policy.

It could accordingly be asserted that the jurisprudential gap in the treatment of efficiencies has been closed. This would also be supported by the coincidence of the evidential rules concerning the pleading and proof of merger-induced efficiencies adopted by the two jurisdictions. Just like in the European Union, the Merger Guidelines in the United States require that the claimed efficiencies be "merger-specific", "timely", "verifiable" and "practical in the business situation faced by the firm…[rather than a mere] theoretical [possibility]".[338] Additionally, efficiencies are required to be of the sort that will be transferrable to consumers.[339] Consequently, efficiency gains resulting in fixed-cost reductions that cannot be transposed into lower prices for consumers will not be accorded significant weight.[340] Further, and from a

[336] US Merger Guidelines, *supra* note 33 at 33.
[337] US, Department of Justice Antitrust Division & the Federal Trade Commission, *Horizontal Merger Guidelines* (Washington: Department of Justice & Federal Trade Commission, 1997) para 4.1.2.
[338] US Merger Guidelines, *supra* note 33 at 33.
[339] *Ibid* at 34.
[340] See below, section 4.5.1.

substantive perspective, both Guidelines provide that the more severe the anticipated anticompetitive effects of a merger, the more pronounced must be the efficiencies pleaded in order to justify such a transaction.[341] Accordingly, both Guidelines assume that mergers giving rise to monopolies will seldom remain unchallenged on the basis of the resulting efficiencies.[342] In the United States, this concession does mark a significant departure from the Chicago theory, which had dismissed the longevity of monopolies and had cherished efficiency as the sole goal of antitrust.

However, it is submitted that the survival of the presumptive treatment of efficiencies as an exclusively competition-enhancing phenomenon in the United States prevents the complete eradication of this jurisprudential gap. The latest Guidelines of the United States recognize that efficiencies may result in lower prices and higher output, thereby producing pro-competitive effects. Yet, the possibility of an aggressive and exclusionary deployment of these efficiencies in an anticompetitive fashion is not entertained. This is in contrast to the European Guidelines, which expressly recognize the potential anticompetitive effects of efficiencies, and which further condition their consideration in a positive manner on their pro-competitive pedigree.[343] Thus, the European Commission may still treat efficiencies as an anti-competitive parameter, if it foresees a possibility of their deployment in an exclusionary fashion post-merger.

This surviving disparity perpetuates the unfilled "efficiencies gap." At best, the latest Guidelines in the United States provide that efficiencies cannot be the *sole* justification of a merger that would otherwise result in anticompetitively high market concentrations. Yet, as the *GE/Honeywell* merger illustrated, the essence of the

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[341] US Merger Guidelines, *supra* note 33 at 34.
[342] *Ibid*.
[343] EU Merger Guidelines, *supra* note 42 ("the Commission takes into account the factors mentioned in Article 2(1)…provided that it is to the consumers' advantage and does not form an obstacle to competition" [emphasis added] at 13).

efficiencies gap is not one of degree, in the sense of the relative significance of efficiencies as a counterweight to other *anti*competitive effects, but one of principle, namely whether the anticompetitive effects of efficiencies can be used for the condemnation of a merger, even if they entail temporary price reductions. Before the restatement, the European response would be in the affirmative, and the response of the United States would be in the negative. Under the new Merger Guidelines of the Department, anticompetitive efficiencies are still capable of positive consideration if they result in temporary price reductions. The Department's Chicago School-informed jurisprudence doctrinally associates lower prices with the incidence of precompetitive effects.[344] Further, by significantly underestimating the potency of restrictions to market accessibility, no efficiencies will be anticompetitive in the long term, since competitive market access will quickly remedy any abusive conduct pursued on the strength of such efficiencies. As such, anticompetitive efficiencies temporarily "promoting competition," through short-lived price reductions, are still favorably admissible, simply because the anticompetitive potential of such efficiencies has not been acknowledged by the Department. Accordingly, the efficiencies gap has survived into the most recent versions of both Merger Guidelines, and was manifested in the superlative in the recent waive of airline mergers, as the next section will reveal.[345]

4.5 Efficiencies in the Context of Airline Mergers

The reconciliation of the economic realities of the airline industry with the economic theory of the Chicago School constitutes a problematic exercise. Although the latter has underestimated the potency of barriers to market entry, the airline

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[344] *Supra* note 307.
[345] See below, section 4.5.2.2.

industry is characterized by a plethora of such barriers, ranging from restrictions on airport and gate accessibility and the operation of large, albeit closed, carrier networks to the exclusionary predatory conduct pursued by several dominant legacy carriers.[346]

If correct, a competitively optimistic hypothesis underestimating the magnitude of the barriers to market entry would justify the positive consideration of anticompetitive efficiencies; the anticompetitive effects of such efficiencies, if existent in the first place, would be rectified by the entry of new competitors. The anticompetitive potential of efficiencies would be short-lived, as it would be fatally defeated by the easy entry of competitors into a highly accessible market.

However, in an *in*accessible industry such as aviation, efficiencies are very capable of producing strong anticompetitive and exclusionary effects. As this section will reveal, a merger policy informed by the precompetitive assumptions of the Chicago School was bound to forgive anticompetitive efficiencies, and was also prone to the adoption of a substantially lower evidential standard for their admissibility. The European Commission's skeptical analysis succeeded in avoiding both blunders.

4.5.1 The Consideration of Efficiencies in the European Union

The Merger Regulation accords post-merger efficiencies an ambivalent status. The operative text of the Regulation contains no express provisions pertaining to their treatment. Efficiencies are briefly addressed in the Preamble as something "appropriate to take into account"[347] towards the overall competitive assessment of a proposed concentration; the language of the text also renders this consideration discretionary rather than mandatory. In this context, it has been noted correctly that

[346] Levine, "Competition", *supra* note 109; Dempsey, "Predation", *supra* note 7.
[347] EU Merger Regulation, *supra* note 19at 4.

the legal significance of efficiencies is premised on an "implicit understanding"[348] of their relevance by the Commission. As such, the most authoritative guidance about their application is found in the Commission's Guidelines, which outline the following cardinal principles.[349]

First, notwithstanding their supply-side pedigree, post-merger efficiencies are to be assessed from the perspective of consumers. As a matter of principle, efficiencies should be beneficial to the latter; any "cost reductions, which merely result from anti-competitive [changes] in output, cannot be considered as efficiencies benefiting consumers".[350] Unless consumers are the immediate beneficiaries of the cost gains, any merger-induced efficiencies will not be given consideration in the competitive assessment. This insistence on consumer welfare essentially means that efficiencies generally beneficial to the industry will not be accorded any attention, unless they *also* have a substantial positive effect upon consumer welfare.[351] This requirement has been strictly upheld by the Commission, and its significance is twofold.

From a legal perspective, this approach is consonant with Article 2(1)(b) of the Merger Regulation, which obligates the Commission to consider the interests of consumers when conducting its competitive assessment.[352]

From an industrial perspective, the efficiencies defense is not available to sectors such as aviation, characterized by high fixed costs that are inherently non-transferable, at least directly, to passengers. Fixed costs are constant and unresponsive to the actual levels of the services produced. In the airline industry, the highest costs

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[348] Alexandr Svetlicinii, "Assessment of the non-horizontal mergers: is there a chance for the efficiency defense in EC merger control?" (2007) 28 Euro Comp L Rev 529 at 530.
[349] EU Merger Guidelines, *supra* note 42 at 13-14.
[350] *Ibid* at 13.
[351] Hanne Iversen, "The Efficiency Defense in EC Merger Control" (2010) 31 Euro Comp L Rev 370 at 370-371.
[352] *Ibid* at 375-376.

associated with the provision of air services are fixed,[353] since they account for the fueling, staffing and maintenance of the aircraft used in a particular flight. Such costs are not influenced by load factors, or the number of passengers, of a given flight. The marginal, or extra, cost associated with the sale of an additional aircraft seat is negligible.[354] Airline mergers entail significant *fixed* cost reductions.[355] Yet, in *UPS/TNT Express*, the Commission dismissed the relevance of fixed cost gains, holding that there was insufficient evidence that they will ultimately be transferred to consumers;[356] only variable cost gains can be used to substantiate the efficiencies defense.

Second, the precise significance of efficiencies in the assessment process is not entirely clear. According to the Guidelines, efficiencies are one of the several factors to which the Commission must have regard when conducting its holistic competitive assessment.[357] However, the Guidelines also use the term "counteract" when referring to their positive, pro-competitive effects.[358] This suggests that efficiencies may be considered separately as an *offsetting* criterion vis-à-vis the other anticompetitive effects associated with a concentration.[359] However, both the wording and context of the Guidelines do not support this assertion, and appear to be fusing efficiencies in the single, holistic competitive assessment performed for each market, rather than treat them separately.[360]

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[353] Dempsey & Gesell, "Airline Management", *supra* note 78 at 74-79.
[354] *Ibid*.
[355] *Ibid*.
[356] EC, Commission, *Case No COMP/M.6570 UPS/TNT Express* (Luxemburg: EC, 2013) cited in Andrea Lofaro, "Do Efficiencies Deliver? Lessons from the UPS/TNT case" (2013) 34 Euro Comp L Rev 373 at 374.
[357] EU Merger Guidelines, *supra* note 42 at 13.
[358] *Ibid*.
[359] Svetlicinii, *supra* note 348 at 533-534.
[360] Iversen, *supra* note 351.

Third, both the Guidelines and the Commission's decisions indicate that the efficiency gains must benefit the particular market affected by the merger.[361] It is not sufficient that such gains are deflected to the benefit of another market. The significance of this requirement becomes appreciable in the light of the *Ryanair/Aer Lingus III* decision. In that case, it was contended that the resulting efficiencies would enable the merged entity to enter and start serving new markets; however, the Commission summarily dismissed this plea on the basis that the efficiency gains would not accrue to the benefit of the existing city-pairs that would incur the anticompetitive effects of the proposed merger.[362] Consequently, efficiencies alleged to occur on a general, network-wide basis would not be admissible.

Fourth, according to the Merger Guidelines, the stronger the anticompetitive impact of a proposed merger, the more pronounced the resulting efficiencies evoked by the merging parties as a defense will need to be. Additionally, in such cases, it will also need to be shown that there is a high likelihood that the benefits will eventually be felt by consumers to a *sufficient* degree.[363] Exactly what level of "consumer pass-on" is deemed sufficient for the purposes of the Guidelines remains unclear. The decisions of the Commission shed little light to the issue. It has been suggested[364] that this question can be resolved by reference to Article 101 of the Treaty on the Functioning of the European Union (TFEU) concerning "agreements between undertakings…which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market".[365] This provision of the Treaty expressly permits the making of such

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[361] EU Merger Guidelines, *supra* note 42 at 13.
[362] EC, Commission*, Case No COMP/M.6663 – Ryanair/ Aer Lingus III* (Luxemburg: EC, 2013) at 349 [*Ryanair/Aer Lingus III*].
[363] EU Merger Guidelines, *supra* note 42 at 14.
[364] Iversen, *supra* note 351 at 371.
[365] EC, *Treaty on the Functioning of the European Union*, 13 December 2007, [2012] OJ C 326/47 at

agreements, provided they give rise to efficiencies that accord "consumers a fair share of the resulting benefit".[366] The required "fair share" is defined in the Guidelines on the Application of Article 101 as any "pass-on of benefits…[which] *at least compensates* consumers for any actual or likely negative impact caused to them by the restriction of competition".[367] Yet, the inadmissibility of the non-trasnferrable fixed-cost gains resulting from merger-induced efficiencies will ensure that, whatever its measure, the requisite "sufficiency" will never be met in the context of airline mergers.

Fifth, efficiencies expected to be realized in the distant future are treated less favorably by the Commission.[368] Compounded to the previous requirement, such a treatment of efficiencies has effectively given rise to a "sliding scale"[369] in their assessment, whereby their significance is contingent upon not only their intrinsic importance, but also their overall place within the grand scheme of the transaction. In airline cases, the realization of merger-induced efficiencies can be a cumbersome and lengthy process,[370] which further compromises their admissibility under this temporal requirement.

Sixth, the admissibility of efficiencies as a defense to the potential anticompetitive effects of a merger is conditioned on them being unique to the transaction in issue. As such, the purported efficiencies must be causally connected to the merger under review, and must result from the specific circumstances of that particular merger. Efficiency gains that could have been similarly attained even if the

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[366] *Ibid* at 89.

[367] EC, Commission, Communication from the Commission, *Notice Guidelines on the application of Article 81(3) of the Treaty* (2004/C 101/08) [2004] OJ C 101/97 at 106.

[368] EU Merger Guidelines, *supra* note 42 at 14.

[369] Svetlicinii, *supra* note 348 at 531.

[370] See e.g. Jad Mouawad, "For United, Big Problems at Biggest Airline", The New York Times (28 November 2012) online: *The New York Times* < http://www.nytimes.com/2012/11/29/business/united-is-struggling-two-years-after-its-merger-with-continental.html?_r=0>.

entities did not merge will not be acceptable. This requirement is illustrated in the *Ryanair/ Aer Lingus III* decision, in which the operational cost gains associated with the joint operation of the two carriers' fleets were dismissed as not being specifically attributable to the particular transaction under review.[371]

From the foregoing transpires a very conservative predisposition towards efficiencies by the Commission, which has never relied on the latter to approve a merger. Rather, and consistently with its Guidelines, it has imposed a series of onerous conditions for their positive consideration. This has ensured that only efficiencies with substantial and genuinely competitive effects will be admissible justifications for the approval of otherwise anticompetitive mergers. Because the fulfillment of these conditions is unlikely in the airline industry, the influence of efficiencies has been very limited. This will now be contrasted to the approach of the Department of Justice.

4.5.2 Efficiencies in the Context of Airline Mergers & the Department of Justice: "Efficiencies Analysis is King, to the Detriment of Consumers"[372]

Efficiencies have not been used consistently by the Department for the non-condemnation of airline mergers. They have featured most prominently in the announcement concerning the merger between Delta and Northwest, in which it was noted, *inter alia* that,

> the merger likely will result in efficiencies such as cost savings in airport operations, information technology, supply chain economics, and fleet optimization that will benefit consumers. Consumers are also likely to benefit

[371] *Ryanair/Aer Lingus III*, *supra* note 362 at 348-349.

[372] US, *The Proposed United-Continental Merger: Possible Effects for Consumers and Industry: Before the U.S. House of Representatives Committee on Transportation and Infrastructure, Subcommittee on Aviation, 111th Cong* (2010) (Darren Bush) [Bush, "United/Continental Hearings"].

> from improved service made possible by combining under single ownership the complementary aspects of the airlines' networks.[373]

The efficiencies argument was slightly attenuated in the subsequent approval of the merger between United and Continental, in which it was predicted that the consolidation would be "likely [to] significantly benefit consumers on overlap routes as well as on many other routes."[374] When the merger between American and US Air was opposed, efficiencies were not only not mentioned by the Department as a justification for the merger, but their existence was denied in its entirety.[375]

This section will contend that, in contrast to the European Commission, the Department has not respected the evidential thresholds for the admissibility of efficiencies prescribed by the Merger Guidelines. It will further show that the "efficiencies gap" has been manifested in the Department's analysis and has produced many of the anticompetitive effects against which the European Commission's skeptical treatment of efficiencies has guarded.

4.5.2.1 The Evidential Threshold and the Pass-On Requirement

Contrary to the Merger Guidelines, which require proof of *verifiable* efficiencies, the Department appears to have accepted a lower threshold for their admissibility as a defense in both the *Delta/Northwest* and the *United/Continental* mergers.[376] This is revealed by the language of its press releases, according to which, efficiencies, the primary justification for the approval of the mergers, were considered

[373] DoJ, *Delta/Northwest*, *supra* note 149.
[374] DoJ, *United/Continental*, *supra* note 150.
[375] DoJ, *American/US Trial Brief*, *supra* note 148 para 93.
[376] Bush, "United/Continental Hearings", *supra* note 372.

as *likely* to occur.[377] Further, there is evidence suggesting that many of the efficiencies claimed by the merging network carriers, and especially economies of scale and scope, were defeated by their hub structure.[378] As the American Antitrust Institute has noted,

> Past a certain point…"hubbing" can neutralize or even negate economies of density. For example, bigger networks create peak-load problems because network effects encourage a hub carrier to bunch its flights at peak times. This increases the disparity during the day in the number of arrivals and departures and creates problems for efficient staffing of gate, ticket, and maintenance personnel. Bunching of flights at hubs occurs even at the cost of additional delays to a carrier's own flights and is the largest contributor to air traffic congestion.[379]

In addition to the adverse effects of a hub structure, there was strong evidence challenging the veracity of the efficiencies allegations, on multiple grounds.[380] Accordingly, the "congizability" requirement prescribed by the Guidelines should not

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[377] *Ibid*.
[378] AAI, "Delta/Northwest", *supra* note 235 at 14, subsequently cited again in the United/Continental merger in Bush, "United/Continental Hearings", *supra* note 372.
[379] AAI, "Delta/Northwest", *supra* note 235 at 14.
[380] Tae Hoon Oum, Xiaowen Fu & Chunyan Yu, "New Evidence on Airline Efficiency and Yields: a Comparative Analysis of Major North American Air Carriers and its Implications" (2005) 12 Transport Policy 153 (counterargument to proposition that optimization of fleets post-merger will result in efficiencies: "over-aggressive fleet adjustment to short-term market fluctuations has had negative effects on gross [productivity]" at 157); Rico Merkert & Peter S. Morrell, "Mergers and Acquisitions in Aviation – Management and Economic Perspectives on the Size of Airlines" (2012) 48:5 Transportation Research 853 (directly supporting a positive correlation between merger-induced growth and diseconomies of scale: "airlines operating above [of over a certain size]…face not economies of scale (where any growth is beneficial in terms of efficiency) but diseconomies of scale…[such that] if their objective is to improve their efficiency, these airlines should aim to shrink instead of growing further" at 861); *cf* Michael Creel & Montserrat Farell, "Economies of Scale in the US Airline Industry After Deregulation: a Fourier Series Approximation" (2001) 37:5 Transportation Research 321 ("The estimation results also indicate economies of scale for US airlines for moderate levels of output but these economies decline at high levels of output" at 332); Carlos P Barros, Qi Bin Liang & Nicolas Peypoch, "The Technical Efficiency of US Airlines" (2013) 50:1 Transport Research 139 ("airline size does not seem to constitute a driver of efficiency" at 146).

have been met as easily as the Department assumed.[381] Equally, research suggests that the "pass-on" of the efficiency gains to consumers through reduced airfares or improved quality of service has not been substantially realized in the case of airline mergers, notwithstanding the strong requirement to that effect under the Guidelines.[382]

4.5.2.2 The Efficiencies Gap Revisited

The efficiencies so liberally accepted by the Department in *Delta/Northwest* are comparable to the efficiencies in issue in *GE/Honeywell* that the European Commission rejected as potentially harmful to competition. The integration of airline networks through a merger can amount to a significant impediment to competition, since it allows network carriers and their regional subsidiaries to deny entry to regional carriers that provide interlining passengers with cheaper and better service from smaller communities to the major hubs.[383] Some commentators have even suggested that the networks in issue could amount to an essential facility, access to which could be guaranteed under section 1 of Sherman Act.[384] The unification of such networks under single ownership can only raise further barriers to entry in city pairs

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[381] AAI, "Delta/Northwest", *supra* note 235 at 13; Bush, "United/Continental Hearings", *supra* note 372.

[382] AAI, "Delta/Northwest", *supra* note 235 at 16; E Han Kim & Vijay Singal, "Mergers and Market Power: Evidence from the Airline Industry" (1993) 83:3 The American Economic Review 549 ("efficiency gains start to kick in after merger completion, mainly for routes with potential sources of direct operating synergies, such as routes on which the merging firms have common hubs or provide overlapping service...[such that] efficiency gains offset much of the impact of increased market power…[unlike other routes, for which] no such offsetting effect of efficiency gains [is observed]" at 567. It is interesting to note that in both Delta/Northwest and United/Continental the networks were considered to be "largely complementary", or non-overlapping, thereby minimizing the "consumer pass-on" rate according to this study).

[383] Dempsey & Gesell, "Airline Regulation", *supra* note 274 at 505-512.

[384] *Ibid*.

between hubs, as well as city pairs between a hub and a smaller community.[385] Further, and unlike the *GE/Honeywell* case that would actually result in lower prices for the entity's customers, at least in the short run, there is evidence suggesting that the efficiencies usually pleaded by carriers do *not* translate into lower prices for passengers, with the contrary being the case, especially in the short run.[386] The unification of such networks under singe ownership cannot be pro-competitive in any meaningful way.

Consequently, the Department still admitted inherently anti-competitive efficiencies, namely the unification of networks, to justify the otherwise anticompetitive mergers between the carriers. Such anticompetitive efficiencies would not only have been inadmissible by the European Commission, but would have been accorded unfavorable treatment. This reveals that the efficiencies gap was an operative factor for a substantial part of the major airline consolidation wave. Some commentators have suggested that it is the augmentation of market power, rather than the desire to benefit from merger-induced efficiencies, that provides the true incentive for the mergers between air carriers, even if the former is usually pleaded in the terms of the latter.[387] There is ample evidence suggesting that network carriers will realize

[385] AAI, "Delta/Northwest", *supra* note 235 at 16-18.
[386] In the context of Delta/Northwest, see eg Kathrin Müller & Kai Hüschelrath, "Market Power, Efficiencies and Entry: Evidence from an Airline Merger" (2012) ZEW Discussion Papers, No 12-070 online <papers.ssrn.com/sol3/papers.cfm?abstract_id=2179034> ("the merger led to short term real price increases of about 11 percent on overlapping routes and about 10 percent on routes which experienced a merger-induced switch of the operating carrier…[while over a longer time period]consumers on affected routes are left with an increase of only about 3 percent in real prices" at 22).
[387] Bush, "United/Continental Hearings", *supra* note 372; US, Government Accountability Office, *Airline Industry: Potential Mergers and Acquisitions Driven by Financial and Competitive Pressures* (2010) at 19 ("in an empirical study of airline mergers and acquisitions up to 1992, Winston and Morrison suggest that being able to raise prices or stifle competition does not play a large role in airlines' merger and acquisition decisions, [although] numerous studies have shown that increased airline dominance at an airport results in increased fare premiums, in part because of competitive barriers to entry" at 30 [emphasis added]).

their increased market power to levy higher fares over city pairs with a hub in either or both ends.[388]

Yet, the Department still yielded to the efficiencies claims. This is to be contrasted to the approach of the European Commission, which has refrained from using efficiencies as the primary justification of airline mergers and has actually treated unfavorably efficiencies with possible anticompetitive effects. Its skeptical approach has accordingly been more successful in preventing efficiencies from being used as an anticompetitive sword.

4.6 Conclusions

The European Commission has been more averse to the consideration of efficiencies as a justification for otherwise anticompetitive mergers, and this general aversion has been adhered to in the context of airline mergers. It has only accepted efficiencies as a mitigating factor of, rather than as a *per se* justification for, anticompetitive mergers, and provided the former cannot be employed in an anticompetitive fashion. It has further insisted, at least in the context of airline mergers, that the claimed efficiencies benefit consumers on the narrower ground of airfare reductions or increased service. It has accordingly refrained from accepting non-price considerations, such as allegedly improved network connectivity, as an admissible manifestation of efficiencies, and has preserved the high evidential standard nominally required by the Guidelines of both jurisdictions. Efficiencies were the final frontier that could have checked the excesses of the Department's laxer

[388] See, *supra* note 134.

merger review, as manifested in its market definition practices and its application of the substantive test; however, they were not treated as such.

Unsurprisingly, a compounded consideration of the preceding three chapters would reveal that European antitrust policy has maintained its merger-skepticism, and has accordingly been more successful in preserving competition and protecting the interests of the travelling public, as the next chapter will illustrate.

Conclusion

The foregoing discussion has provided a comprehensive exposition of the disparate standard of review of airline mergers in each jurisdiction, ranging from the definition of the relevant antitrust market, to the substantive test of the competitive assessment and the consideration of efficiencies. In the course of this exercise, it has been argued that the regulation of airline mergers will only attain the stringency that is necessary for the successful and far-reaching preservation of competition in all airline markets affected by a consolidation if the analysis pays regard to four essential elements, which should be applied cumulatively.

First, regulators must respect and uphold the primacy of the antitrust market in their competitive analyses. In the airline context, such markets must be defined on the basis of individual city-pairs. The preservation of effective competition across the entire operating networks of two merging carriers can only be accomplished if the competitive analysis is conducted on the basis of each individual route affected by the transaction. Partial or otherwise qualified applications of this principle will dilute the rigor of the competitive analysis, and will under-estimate the anticompetitive impact of a merger. This comprehensive adherence to the market-centered analysis should not be restricted to the assessment of the *anti*-competitive effects of a merger that provide the basis for its condemnation, but should also encompass the allegedly *pro*-competitive consequences that are raised in its defense. As the decisions of the Department of Justice illustrate, an analysis that only upholds either, rather than both, of these conditions is likely to fail, since market-*un*specific justifications for a merger, such as efficiencies pleaded in the abstract, will fail to remedy the market-specific losses of competition experienced by individual city pairs. This is in contrast to the reasoning of the European Commission, which has defined airline markets as narrowly as possible, and which has always considered every element of the competitive analysis, including efficiencies, in the light of the individual city-pairs expected to incur the anticompetitive effects of a consolidation.

Second, a dominance-centered substantive test is more suited for the stringent competitive assessment of airline mergers and their distinct tendency to produce monopolies or duopolies over individual city-pairs in the post-merger environment. This is because the dominance-based test creates a strong, albeit rebuttable, and hence just, presumption that an airline merger will be anticompetitive. For an industry with significant barriers to competitive market entry and with a distinct predisposition to exclusionary conduct, such a presumptive test ensures that a merger will not be deemed permissible in the absence of substantial precompetitive remedies offered by the merging carriers.

Third, the rigor of a competitive analysis will be diluted if the substantive test is not applied over narrowly defined city-pair markets, and if unduly optimistic assumptions are made about the competitive state of the industry. As the decisions of the Department of Justice illustrate, even the most potent anticompetitive effects of an airline merger can be obscured by an optimistic and abstract vision of a precompetitive tide of low cost carrier emergence. This is especially the case when this vision is premised on an inadequate recognition of the barriers to market entry, as well as a market *un*specific analysis that ignores the limited likelihood of new low cost carrier entry over certain thin routes adversely affected by the mergers.

Fourth, the treatment of merger-induced efficiencies should never lose sight of their anticompetitive potential. As the decisions of the Department of Justice illustrate, the contrary would run the risk of according precompetitive recognition to the inherently anticompetitive consequences of a merger. The maintenance of a high evidential threshold for the admissibility of any pleaded merger-induced efficiencies would also facilitate the attainment of that objective. Further, the consideration of efficiencies should be market-centered; efficiencies pleaded in the abstract, such as general network-wide advantages, and not pertaining to individual city-pairs should not be afforded favorable recognition; otherwise, they will result in the effective circumvention of the market-centered analysis, which ensures that competition is protected across all affected city pairs.

The validity of the foregoing prescriptions, which largely reflect the reasoning of the European Commission, is supported by a rich evidential basis, which suggests that the adverse impact of the subject mergers on domestic airfares, frequency and quality of service has been more pronounced in the United States than in Europe. This outcome strongly suggests that the legal analysis of the European Commission has been more successful in protecting the welfare of passengers in the Single European Aviation Market.

The market concentration of the largest post-merger European airline is significantly lower than the respective share of the largest US carrier.[389] Further, the post-merger concentration levels of the merged legacy carriers in the domestic market of the United States have exceeded the respective figure of European carriers by at least 30 per cent,[390] and, since the first consolidation of Delta and Northwest in 2008, these concentrations have risen in the United States by 17 per cent.[391] Accordingly,

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389 See Appendix I.

390 Andrew Parker, "EU Airline Consolidation Slow to Take-off", The Financial Times (21 April 2013) online: *The Financial Times* <http://www.ft.com/cms/s/0/79458f9a-9d4a-11e2-a8db-00144feabdc0.html#axzz34TA6uh6M>; Appendix I.

391 *Ibid*.

the substantial airfare increases that occurred in the United States have not been followed by the European market to the same degree.[392]

In the United States, the unopposed merger wave has succeeded in improving[393] the financial state of its carriers, thereby reversing their formerly dismal[394] financial performance. Recently, the profitability of airlines in the United States surpassed significantly the respective figure for European carriers,[395] which are currently confronted with the economic slowdown in the Eurozone, and which have, in the past, regularly outperformed the United States industry.[396] Yet, it is questionable whether the acquiescence to consolidation through loose antitrust is either an appropriate or sustainable remedy for the industry's chronic profitability issues,[397] especially if it entails the sacrifice of competition and the substantial prejudice of passengers' welfare.

To a certain extent, the anticompetitive effects of these large-scale consolidations between legacy carriers have been mitigated through the emergence and growth of the precompetitive species known as the low cost carrier. However, recently, the low cost markets in both jurisdictions have matured and may be nearing

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[392] See e.g. Michael D Wittman & William S Swelbar, "Evolving Trends of U.S. Domestic Airfares: the Impacts of Competition, Consolidation and Low-Cost Carriers" (2013) MIT Small Community Air Service White Paper 3 at 13 <http://dspace.mit.edu/bitstream/handle/1721.1/79878/ICAT-2013-07.pdf> (for US fare increases between 2008 and 2013); EC, Commission, *Annual Analysis of the EU Air Transport Market* (September 2011) online: Air Market Observatory <http://ec.europa.eu/transport/modes/air/observatory_market/doc/annual-2010.pdf>(See Appendix II for charts).

[393] CAPA Center for Aviation, Analysis, "Airline consolidation: could Europe follow North America's path to improved margins?" (4 June 2014) online: CAPA<http://centreforaviation.com/analysis/airline-consolidation-could-europe-follow-north-americas-path-to-improved-margins-170975>.

[394] International Air Transport Association, Economics Briefing, "Airline Profitability: US vs. Rest of World" (7 December 2005) online: IATA<www.iata.org/whatwedo/Documents/.../airline_profitability_us_rest.pdf>.

[395] *Ibid*.

[396] *Ibid*.

[397] Dempsey, "Deregulation Mythology", *supra* note 3.

saturation.[398] As such, the precompetitive impact of Low Cost Carriers that has offset many of the anticompetitive effects of the legacy-carriers' consolidation thus far has begun to wither.[399] In fact, in both jurisdictions, a consolidation wave among low cost carriers is at its genesis.[400] In the United States, Southwest recently merged with Air Tran, yet, in the European Union, the merger between RyanAir and Aer Lingus was recently prohibited. Thus, if a tide of mergers between low cost carriers is in fact in its incipiency, it seems that the disparate antitrust standard discussed in this thesis has already crept into this section of the airline industry and may be liable to repetition, thereby exacerbating the anticompetitive outcomes that have resulted so far in the United States.

If the Department of Justice is to honor its purported policy objective of protecting the interests of passengers, then there is substantial room for improvement in its competitive analysis and methodology, both of which should be aligned with the more effective European practices. The Department's aviation-unsuitable substantive tests, coupled with the flawed application of the latter, have failed where European jurisprudence has succeeded. The latter has not only subjected airline mergers to a higher standard of review through the conservative application of its dominance-centered test and the skeptical treatment of efficiencies, but it has also achieved the universal application of antitrust law across all city pairs of its domestic airline industry.

Further, this industrial consolidation wave occurred in tandem with the grant of antitrust immunity to all three airline-alliances servicing the transatlantic market. These grants were conditioned on the attainment of "metal-neutrality", connoting a

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[398] M Lenartowicz, M Mason & A Foster, "Mergers and Acquisitions in the EU Low Cost Carrier Market. A Product and Organization (POA) Approach to Identify Potential Merger Partners" (2013) 33 Journal of Air Transport Management 3 at 3-5.
[399] *Ibid*.
[400] *Ibid*.

very close level of operational integration between the carriers that is not too far away from the level of integration usually associated with a merger.[401] The only barrier to the *legal* merger of carriers on each side of the Atlantic are the restrictions on foreign ownership, which have for all practical purposes been circumvented through airline alliances and their code-sharing practices.[402] With American and European carriers having already reached a high level of integration of their respective operations in the trans-Atlantic market,[403] the interaction of the latter with the domestic markets under review has intensified significantly; after all, a substantial part of the trans-Atlantic traffic is fed by the domestic markets of the two jurisdictions though the hubs of the merging carriers, that also happen to service both markets. Given this strengthened interaction, and given the existing coordination of the antitrust policies of the two jurisdictions in the area of antitrust immunity, the harmonization of merger control in the domestic markets on each side of the Atlantic would appear to be the next logical goal for antitrust policy.

The present thesis has highlighted the differences in the control of airline mergers in each jurisdiction, and has argued that the practices of the European Commission are more suitable for the preservation of competition in the airline industry. Future research should explore the ways in which the harmonization of merger control in the two jurisdictions can be realized.

[401] See e.g. Angela Cheng-Jui Lu, *International Airline Alliances: EC Competition Law / US Antitrust Law and International Air Transport* (The Hague: Kluwer Law International, 2003); Brian F Havel & Gabriel S Sanchez, *The Principles & Practice of International Aviation Law* (Cambridge: Cambridge University Press, 2014) at 151-163.
[402] Steven Truxal, *Competition and Regulation in the Airline Industry: Puppets in Chaos* (New York: Routledge 2012) at 119-120; Havel & Sanchez, *supra* note 401at 148-151.
[403] Ruwantissa Abeyratne, *Regulation of Air Transport: The Slumbering Sentinels* (New York: Springer International Publishing, 2014) at 37.

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Chart 1: Relative Market Concentrations (HHI Basis)

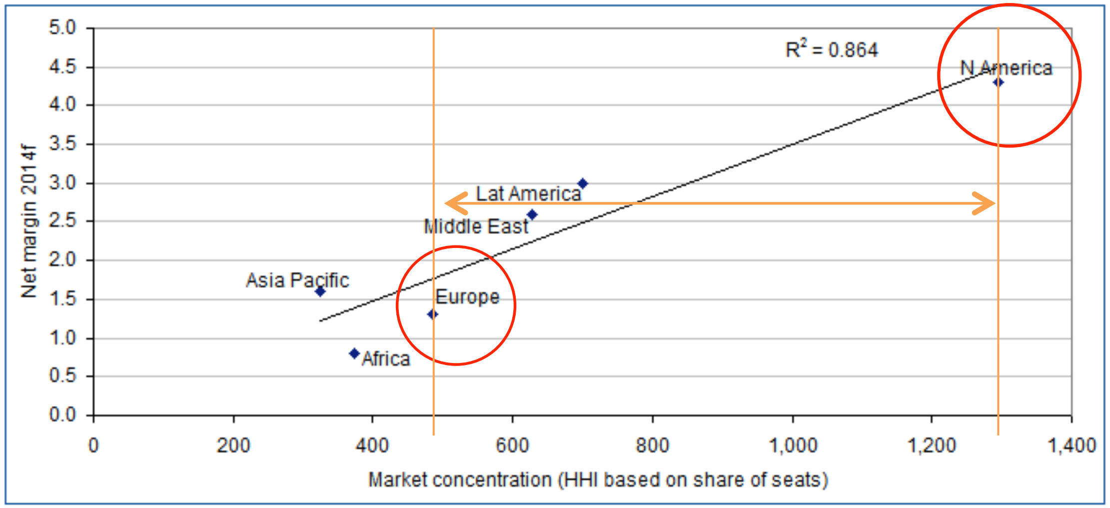
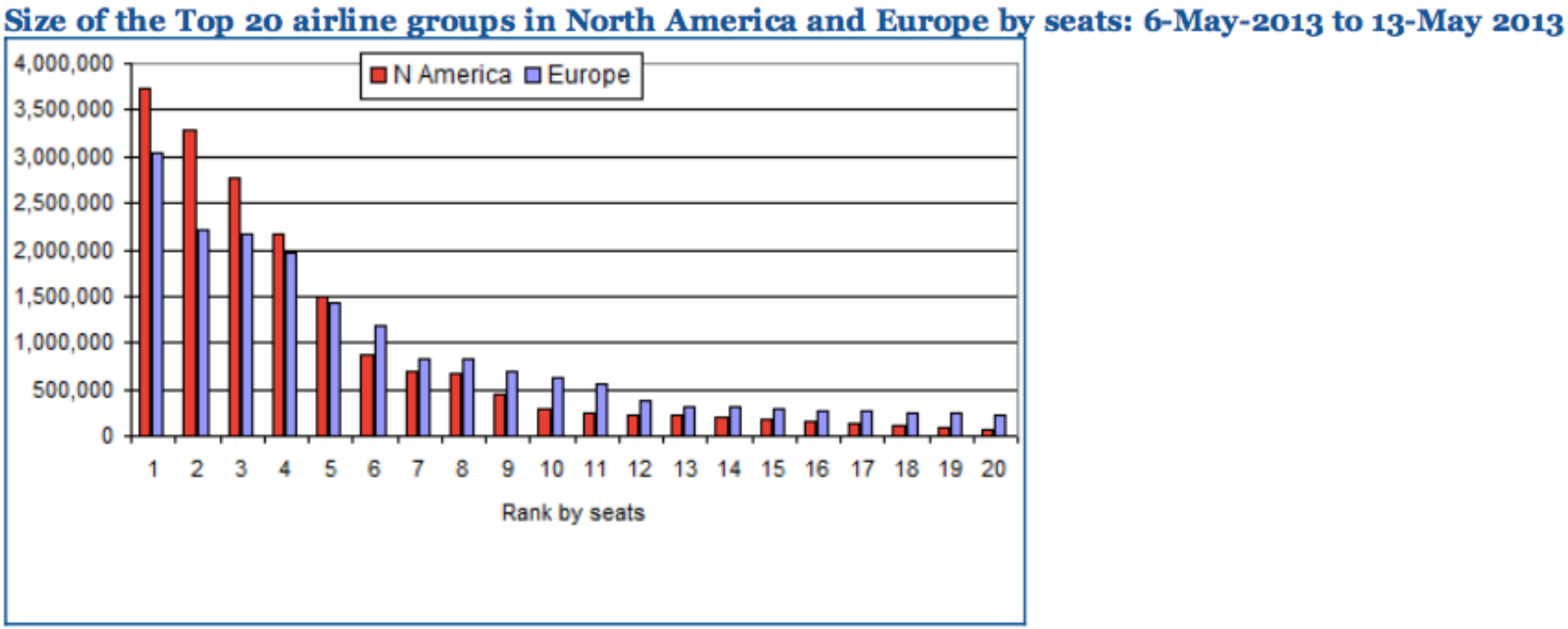


Chart 2: Relative Market Shares in the Post-Merger Environment

AIRLINE GROUP MARKET SHARES (2013/2014)			
European Union		United States	
Deutsche Lufthansa	11%	20%	American/US (expected)
Air France/ KLM	8%	16.30%	Delta
International Airlines Group	8%	15.60%	United

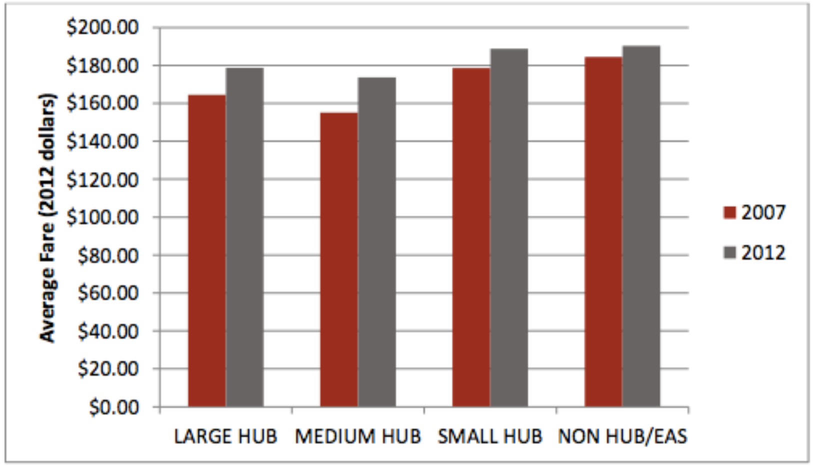
Common Source: Center for Aviation (CAPA) – (2013).

Chart 3: Substantial disparities in the market shares of the leading carriers in the United States and the European Union



Source: CAPA – Centre for Aviation & Innovata

<u>Chart 1: Hub Fare Increases in the United States</u>



<u>Chart 2: Fare Increases per US Carrier</u>

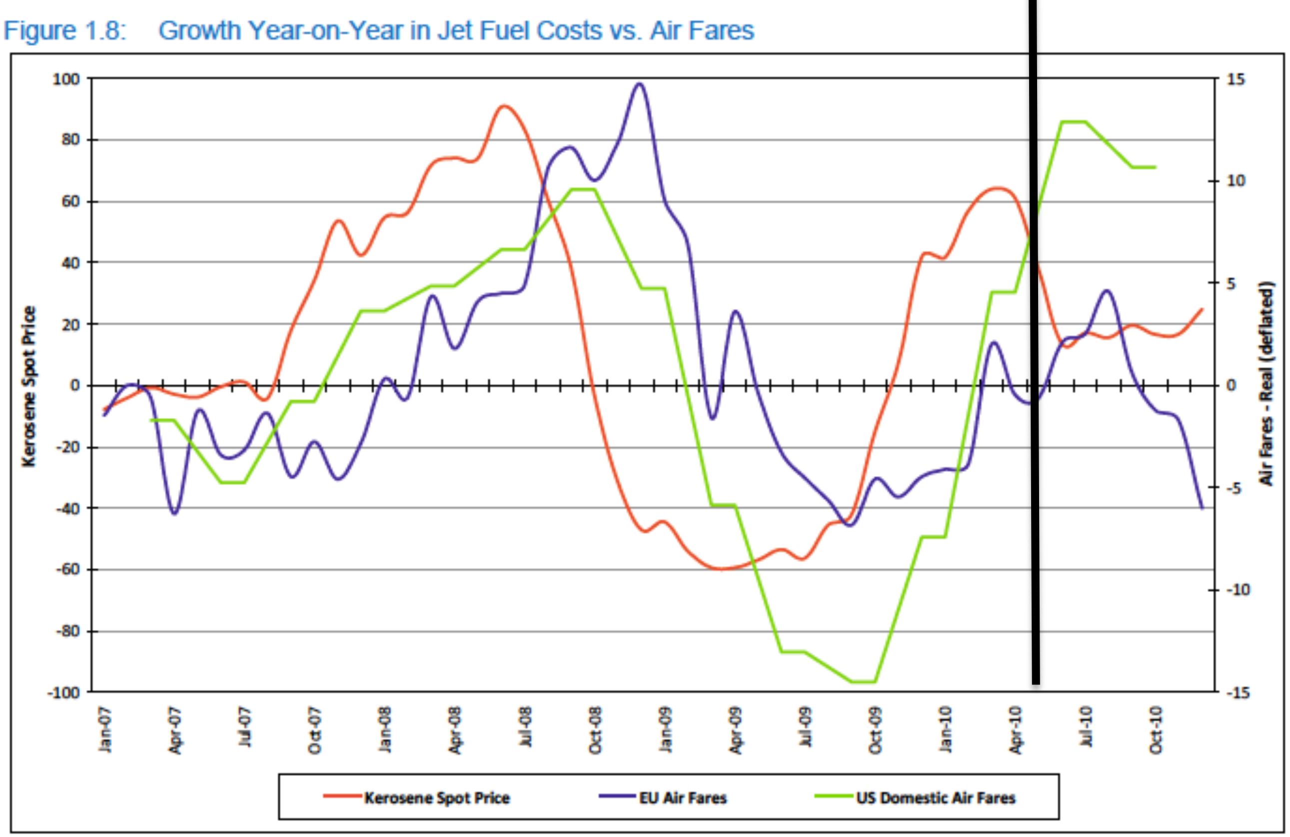
AIRLINE	2007 Avg. Fare*	2012 Avg. Fare	% Change in Avg. Fare
American Airlines	$181.93	$199.00	9%
DELTA	$186.65	$198.36	6%
UNITED	$196.62	$216.68	10%
US AIRWAYS	$177.93	$197.60	11%
AirTran	$111.59	$128.81	15%
FRONTIER AIRLINES	$142.86	$140.19	-2%
jetBlue	$144.89	$149.34	3%
SOUTHWEST	$112.46	$140.87	25%
Alaska Airlines	$156.60	$180.63	15%
HAWAIIAN AIRLINES	$138.59	$155.59	12%
allegiant	$97.21	$86.89	-11%
spirit airlines	$105.40	$71.06	-33%

*one-way, adjusted for inflation using CPI

Source for both tables: Michael D Wittman & William S Swelbar, "Evolving Trends of U.S. Domestic Airfares: the Impacts of Competition, Consolidation and Low-Cost Carriers" (2013) MIT Small Community Air Service White Paper 3 at 13 <http://dspace.mit.edu/bitstream/handle/1721.1/79878/ICAT-2013-07.pdf> .

<u>Chart 3: Comparison of *Trends* in Real Domestic Airfares in the European Union and the United States, from which inferences about the exercise of market power can be made</u>

Delta/Northwest merger already consummated and United/Continental merger agreed on



Source: EC, Commission, *Annual Analysis of the EU Air Transport Market* (September 2011) online: Air Market Observatory <http://ec.europa.eu/transport/modes/air/observatory_market/doc/annual-2010.pdf>.