**Follow-up Questions of Senator Klobuchar**
**Subcommittee on Antitrust Hearing on**
**"The American Airlines/US Airways Merger: Consolidation, Competition, and Consumers"**

**For William McGee**

1. In Mr. Parker and Mr. Horton's testimony, they talk about the strong competition you get from low cost carriers. However, Topaz International, a consulting company, did a study on low cost carriers that examined 100 major domestic city pairs. Topaz found that QUOTE "competing airlines were lower than Southwest Airlines over 60 percent of the time." What do you make of that study? Is Southwest still able to discipline the large network carriers to keep prices low?

2. Competition forces companies to take new steps to attract customers. In the airline industry, some airlines offer more leg room, Southwest offers first-come first-served seating and free checked bags, and Jet Blue provides each passenger with a personal television that receives DirecTV. However, as the industry becomes more concentrated, what incentive will there be for airlines to take steps to set themselves apart from the competition, if any competition exists at all. What affect will this merger in particular have on innovation in the airline industry?

3. Some critics of airline consolidation argue that mergers between the large legacy carriers make it very hard for smaller carriers to compete, especially for business customers. What is your view?

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   **RESPONSE:** Topaz International is not alone in noting that the presence of the domestic airline industry's largest low-cost carrier – Southwest – in any given market is no longer an automatic guarantee of lower fares. Several analysts have noted that as Southwest's pricing structure has become more complex – particularly after the introduction of Business Select fares in 2007 – its prices have risen as well. The American Antitrust Institute has also noted that the "Southwest Effect" (first so named by the U.S. Department of Transportation in 1993) has not been as strong in recent years.

   It remains true, as reflected in the quarterly DOT Domestic Airline Consumer Airfare Reports, that fares typically drop on routes also served by low-cost carriers, and typically rise on routes served only by legacy airlines such as American and US Airways. But unfortunately, that effect has been diminishing as concentration has increased.

2. **Competition forces companies to take new steps to attract customers. In the airline industry, some airlines offer more leg room, Southwest offers first-come first-served seating and free checked bags, and Jet Blue provides each passenger with a personal television that receives DirecTV. However, as the industry becomes more concentrated, what incentive will there be for airlines to take steps to set themselves apart from the competition, if any competition exists at all. What affect will this merger in particular have on innovation in the airline industry?**

   **RESPONSE:** Consumers Union believes that growing concentration in the airline industry has indeed reduced incentives to innovate, and is concerned that another merger, further increasing concentration, will further reduce those incentives. The innovations you mention – and others introduced over the years such as premium classes, airport lounges, frequent flyer programs, and in-flight entertainment and technological products – have generally been created and introduced by one carrier initially, in an environment of spirited competition, and then adopted by others. Our concern is not just that we will now have one less innovator; it's also that we will see less of that spirited competition.

3. **Some critics of airline consolidation argue that mergers between the large legacy carriers make it very hard for smaller carriers to compete, especially for business customers. What is your view?**

   **RESPONSE:** Business travelers are like other travelers in most respects. One important respect in which they are different is that a business of any significant size may do enough traveling to make it worthwhile to negotiate for lower bulk-rate fares. The more airlines that the business can negotiate with, the more incentive the airlines have to offer better bulk-rate deals. It is generally the major airlines who have flights on enough routes to make bulk-deal offers attractive. But if there are smaller airlines whose route maps are a good fit for the business seeking to get a bulk discount, those airlines could be a factor, too.

   The principal way the merger could make it harder for business travelers to get the benefits of competition from smaller airlines is the same way that it could make it harder for travelers in general to do so. The major legacy network carriers aggressively protect their fortress hubs. One industry analyst has likened them to "badgers in their lairs." They have shrewdly employed such tools as biased reservations systems, proprietary travel agency agreements, frequent flyer promotions, corporate discounts, and many other methods to capture and retain passenger traffic at their hubs.

   When there is robust competition among major carriers at a hub – harder to find these days – it is more difficult for any of them to effectively attack a low-cost carrier. For one thing, in that situation the low-cost carrier is just an additional source of competitive pressure the majors are already bringing. For another, for an attack to have the desired result, it would have to be coordinated among the majors, which would likely violate the antitrust laws. In contrast, when there is less competition among the majors, and especially in markets where there are only one or two majors, the low-cost airline is an easier target, the payoff for attacking is greater, and there is less need for coordinated conduct.

   As the airline industry becomes more concentrated, it becomes easier for the remaining majors to limit the competitive effectiveness of smaller airlines and new entrants. That in turn makes it more difficult for smaller airlines to obtain the financing they need to expand into new markets. And the result is less choice for business and recreational travelers alike.

**Questions for the Record from Senator Mike Lee**
**"The American Airlines/US Airways Merger:**
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**Tuesday, March 19, 2013 10:00 AM**

**William McGee (Consultant, Consumers Union (New York, NY))**

**1. Mr. McGee, in your testimony you note a number of harmful effects that could occur if the airline industry lacked robust competition. You note that lack of competition might result in fewer options for travelers, higher prices, and lower quality service. But it seems to me that all of these concerns assume that this merger is anticompetitive.**

> **a. Would you concede that the issues you have raised will not materialize if this transaction is in actuality not anticompetitive or turns out to be procompetitive in nature?**
>
> **b. Have you done a rigorous economic analysis of this transaction and do you have any data to suggest that this transaction will violate our antitrust laws?**
>
> **c. Without such analysis of this transaction, do you remain confident criticizing it as harmful to consumers?**

**RESPONSE:** We were careful in our testimony to make clear that we were not presuming to prejudge the merger's effects on competition or its legality under the antitrust laws. The Justice Department's Antitrust Division will be in the best position to assess the merger, once it has completed a thorough investigation.

Nonetheless, this merger has many hallmarks that give us concern that it could significantly harm competition and consumers. Our concerns are informed by having examined the publicly-available analyses of this merger prepared by the American Antitrust Institute and by the merging airlines, as well as by having examined the route footprints of these two airlines and other airlines ourselves. Moreover, we have been following developments in the airline industry for many, many years, both as consumer advocates and as publishers of Consumer Reports. Over the years, our readers have shared with us their the frustrations they have experienced first-hand with choice reductions, fare increases, and service degradations that have come in the aftermath of previous mergers among the major airlines. And this merger, as it comes on top of a series of mega-mergers in the domestic airline industry since 2001, could be particularly harmful.

What Consumers Union is asking for is not necessarily that the Antitrust Division challenge the merger in court, but that they undertake a thorough and rigorous investigation, and that this Subcommittee fully encourage and support such an investigation. We would hope the investigation would be more than just a piecemeal look at specific routes directly affected. We would hope that it would also include a close look at the broader macro effects on competition that could result from further concentrating the market – going from four major national network airlines down to three, for the first time in aviation history, since national airline passenger service first became fully established in the 1920s. We believe it is important to look at all the effects the merger could have on healthy market incentives to keep fares low and service quality high. The Antitrust Division's lawyers and economists are well-equipped to undertake this kind of rigorous investigation.

The airlines should have a full opportunity to present their side of things to the Division's investigators – as should everyone else. The airlines' incentives for merging are to gain greater strength in the marketplace. That may or may not be good for competition and consumers. In a marketplace as concentrated as this one, gaining that greater strength often comes at the expense of competition.

Once the investigation is concluded, and all the facts are in, and the rigorous analysis is completed, we would hope the Antitrust Division would take whatever enforcement action is warranted, which could mean challenging the merger, if their analysis shows that it will harm competition and consumers, and if the airlines are unwilling or unable to change the merger so that it won't cause that harm.

Finally, whatever action the Division takes, we ask for a full public accounting that would satisfy the public that our interests in keeping competition alive and well in the airline industry have been fully protected.

**2. In December of last year, consultants at PWC published an empirical study in which they concluded that criticism of past airline mergers may be unwarranted. Their study found that nationwide fares have risen only very modestly in recent years. The authors write: it "seem[s] clear that the four mega-mergers over the last seven years have not caused US domestic passengers to experience dramatically higher airfares or drastically reduced competition on most routes." [Aviation Perspectives, PWC, at 6 (Dec. 2012).]**

> **a. In your testimony, you argue that recent airline mergers have in fact resulted in higher prices and less service. What data or evidence do you have to support this assertion?**

**RESPONSE:** The Price Waterhouse paper to which you refer looks back at average changes in fares, and average changes in market concentration. We believe it is important to look back at fare changes on routes where the two merging airlines used to compete with each other before the merger, and perhaps to compare those fare changes to a baseline of average changes in fares over that same period.

For example, the American Antitrust Institute's August 2012 white paper, http://www.antitrustinstitute.org/~antitrust/sites/default/files/AAI_BTC_USAir-AA_White%20Paper_8-7.pdf, made this kind of comparison regarding hub-to-hub routes affected by the Delta-Northwest and United-Continental mergers. An article I wrote for USA Today in February, www.usatoday.com/story/travel/columnist/mcgee/2013/02/27/american-us-airways-merger-fares-rise-bill-mcgee/1949625, made this kind of comparison for routes affected by those two mergers as well as the America West-US Airways merger. Both examinations found significant increases in fare levels. This is the kind of focus the Antitrust Division is likely to take, as a starting point.

As the airline industry becomes more concentrated, there is also greater potential for anticompetitive effects that go beyond this route-by-route focus, as market structure changes on a nationwide scope. We are concerned we may be reaching that critical tipping point with this merger. So we do urge the Antitrust Division to look beyond just the pinpointed route-by-route effects, to also assess the larger macro picture.

**3. Some have expressed concern about the dominant position that the merged entity would have at Reagan National Airport. As I understand it, there are several airports throughout the country in which a single airline has a significant share of the market.**

> **a. Do you have concerns about the effect of this merger on any specific airports, and if so, which ones?**
>
> **b. Do your concerns apply to all airports in which a single airline holds a significant share of the market, and if not, what is different about the airports in which the merged entity would have a dominant position?**

**RESPONSE:** We have two distinct kinds of concerns regarding the merger's potential harmful effects on particular airports.

The first kind of concern is the reduction in competition on routes to and from the airport that both of the merging airlines provide service to before the merger. After the merger, all of the airlines serving one of those routes have one fewer competitor to worry about. If the elimination of one carrier is enough to reduce competitive pressure, the tendency will be for fares to increase.

Related to that is the potential for the merged airline to find after the merger that it is offering more service on a route than the amount of service that maximizes its profits. Service options that before the merger helped keep the two competing airlines attractive to consumers, after the merger become surplus capacity that is no longer needed. For the merged airline, eliminating that surplus capacity now makes business sense. But it didn't make business sense before the merger. And for consumers, eliminating that capacity can reduce choices and lead to increased fares.

The fewer airlines remain on the particular route after the merger, and the greater their combined market share, the more likely that the reduction in competitors will translate into a harmful reduction in competition. One airport with numerous routes we are concerned could be harmed in this way by the merger is Reagan Washington National Airport, where the combined operations of American Airlines and US Airways would control nearly 70% of the slots. At this high a level of market share, an airline could also gain monopoly power, the ability to single-handedly dictate terms by using its dominance to undermine efforts by other airlines to compete effectively.

Any of this would be unacceptable anywhere, but particularly at one of our nation's busiest airports.

The second kind of concern is the potential that, where the two merging airlines now have two hubs in fairly close proximity, the merged airline will decide that one hub is enough and is cheaper. That's another situation where what made business sense for the two separate airlines before the merger, as a way for them to each have their own strong networks, is transformed by the merger into duplication that cuts into profits. In this situation, the result could be, instead of a reduction in the number of flights and an increase in fares, the dramatic downgrading or entire elimination of a hub. That can have devastating effects on the abandoned hub city's local economy and on passengers who travel to and from it.

We saw that with TWA's former hub in St. Louis; with America West's former hub in Las Vegas; with Delta's former hub in Cincinnati; and with Continental's former hub in Cleveland, for example. With this merger, there are nine major hubs in the two separate airlines, with many pairs in close enough proximity that significant downgrading or even abandonment of one of them is not far-fetched.

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