DEPARTMENT OF JUSTICE

COMPETITION IN THE AIRLINE INDUSTRY

Testimony of

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Mr. Chairman, Senator Hollings, and other members of the Committee, I am pleased to be here to discuss how the antitrust laws protect competition in the airline industry.

Beginning in the 1970s, our nation has in several key industries acted on the recognition that competition serves consumers better than command-and-control economic regulation. In the airline industry, this recognition is reflected in the Airline Deregulation Act of 1978. In the deregulated airline environment, antitrust enforcement is critical to ensuring that consumers receive the benefits that flow from a competitive marketplace.

The Antitrust Division has been active in this industry from the beginning of the deregulated era. During the 1980s, when the Department of Transportation still retained the authority over airline mergers that had previously belonged to the Civil Aeronautics Board, the Antitrust Division recommended against approval of two mergers, TWA/Ozark and Northwest/Republic, which involved the merger of the only two hub carriers at St. Louis and Minneapolis, respectively. The merging carriers were the only airlines providing nonstop service between the hub city and smaller cities in the surrounding region, such as Bismarck, North Dakota, and Cedar Rapids, Iowa. Both mergers were approved over our objection.

MERGER ENFORCEMENT

Since 1989, when airline merger review authority was turned over to the Antitrust Division, there have been relatively few mergers proposed among the major airlines. One exception is the proposal last year by Northwest Airlines to purchase a controlling stake in Continental Airlines, which we challenged in a suit filed in October under section 7 of the Clayton Act. Section 7 prohibits mergers and acquisitions that are likely to substantially lessen competition in any market. The courts have interpreted this to prohibit mergers that create or enhance market power or make it easier for a firm to exercise market power. Market power is the ability of a firm to successfully raise its price above the competitive level without that move being defeated by counteractive competitive responses by its rivals.

Northwest and Continental are the fourth- and fifth-largest U.S. airlines, respectively, and compete to provide air transportation services on thousands of routes across the country. The proposed acquisition would allow Northwest to acquire voting control over Continental, as well as share in Continental's profits, diminishing substantially both Northwest and Continental's incentives to compete against each other. We concluded that the acquisition would lead to higher ticket prices and worse service for millions of passengers, especially those traveling on routes dominated by the two airlines.

Northwest and Continental are each other's most significant competitors -- if not only competitors -- for nonstop airline service between the cities where they operate their hubs. Northwest operates hubs at Detroit, Memphis, and Minneapolis. Continental operates hubs at Cleveland, Houston and Newark. The two airlines also have a dominant share of the traffic on connecting flights between numerous cities. Millions of passengers spend hundreds of millions of dollars each year traveling between these cities.

The stock Northwest acquired represents 51 percent of Continental's voting rights, as well as 14 percent of its equity, it represented. Although Northwest has placed that stock in a "voting trust" that places certain limits on its exercise of voting control for six years, and lesser restrictions for an additional four years, the Antitrust Division does not view that as a satisfactory answer to the long-term competitive concern. Continental is still fully aware that it is owned by Northwest, which can only discourage it from pursuing competitive strategies that benefit consumers but are adverse to Northwest. That is no substitute for the kind of competitive incentives that true independence provides.

Also in the merger enforcement area, the Antitrust Division has moved aggressively to block acquisition of gates or slots that would eliminate existing or potential hub competition, including Eastern's proposal to sell eight gates to USAir at the gate-constrained Philadelphia International Airport, and Eastern's proposed sale of slots and gates at Reagan Washington National Airport to United, which operated a significant hub out of nearby Dulles airport.

ANTITRUST ENFORCEMENT AGAINST AGREEMENTS IN RESTRAINT OF TRADE

In addition to its authority to review mergers under section 7 of the Clayton Act, the Antitrust Division also enforces section 1 of the Sherman Act, which prohibits agreements among two or more firms to refrain from competing in any market. This kind of conduct includes price fixing, bid rigging, market allocation, and group boycotts. It can also include other kinds of agreements that have the purpose and effect of suppressing competition among the firms that enter into the agreement.

A good example of a section 1 case is our 1992 enforcement action against Airline Tariff Publishing Co. and eight major airlines, where we alleged that the airlines were using the ATPCO electronic fare submission and dissemination system to fix prices. We ultimately entered into consent decrees banning improper signaling of future pricing intentions by the airlines, saving airline passengers billions of dollars in travel expenses.

ANTITRUST ENFORCEMENT REGARDING CODE-SHARE ALLIANCES

Let me now turn to our enforcement activity with regard to airline marketing alliances, which are essentially joint ventures between airlines. These alliances fall somewhere between an outright merger and a traditional arm's-length interline agreement. Marketing alliances come in all shapes and sizes. Some may involve sharing frequent flyer programs or airport lounges. Others may involve "code sharing," in which a carrier uses its partner's two-letter airline designator code for listing its own flights in computer reservation systems, in which case the alliance probably includes some effort to coordinate check-in, baggage handling, and gate locations. Occasionally, an alliance is accompanied by a stock investment by one airline in its partner. Alliances can involve commuter carriers, domestic carriers, foreign carriers, or a combination.

Most of our experience with alliances between major airlines has been in the international marketplace, between airlines of different nationalities who may be restricted from serving each other's domestic markets. Alliances between major U.S. carriers, as distinct from alliances between hub carriers and commuter carriers that serve those hubs, are a relatively recent phenomenon. The first significant alliance between major U.S. carriers is the Northwest/Continental alliance. Other airlines, specifically American Airlines and US Airways, and United Airlines and Delta Airlines, also considered alliances last year, but appear to have shelved plans to code-share. Our analysis of a domestic alliance will be similar in most respects to our analysis of international alliances we have examined, so with a few exceptions that I'll point out, what I am about to say will apply in either situation.

Alliances involving code-sharing are in many respects the most controversial. They have the potential to be procompetitive -- they can create new service, improve existing service, lower costs and increase efficiency, all to the benefit of the traveling public. Code sharing agreements also have the potential to be anticompetitive. They can result in market allocation, capacity limitations, higher fares, or foreclosure of rivals from markets, all to the injury of consumers. The ability to distinguish the latter from the former is crucial for aviation policy makers and antitrust enforcement authorities.

When we conduct an antitrust investigation of a code-share, we always analyze the specific terms of each agreement on a case-by-case basis. In assessing the effect on competition, the first necessity is to define the relevant market, which may be one city-pair route, or a set of such routes, and then to measure that market in terms of its participants and concentration. For any proposed code-share, we ask whether the code-sharing partners are actual or potential horizontal competitors. From an antitrust viewpoint, the greatest threat to competition comes when two of very few airlines that compete in a market enter into a code-sharing agreement in that market. The same concerns would be present if the two carriers were planning to merge. Any time two of very few airlines in a market act jointly, we are concerned about the effect on competition.

Having defined and measured the relevant market, the next issue we examine is the potential adverse competitive effects of the code share. Here we consider whether the code-share partners will both operate flights in that market and whether their capacity, scheduling, and pricing decisions will remain independent. By independent, I mean that the agreement is structured in a way that gives each carrier the strongest possible incentive to sell seats on the flights it operates rather than on those of its code-share partner, and to cut its prices and increase its operating capacity to gain market share.

If independent operations by the two carriers are not contemplated or likely, and we conclude that the code-share agreement will reduce or eliminate competition in city-pair markets between the code-share partners, we must consider the extent to which entry into these markets by new competitors is likely to occur in response to anticompetitive behavior of the code-share partners. If sufficient and timely entry can be expected, then the code-share agreement would not be likely to create or facilitate the exercise of market power by the code-share partners.

In the case of an international code share, an important factor we consider is whether a bilateral “open skies” treaty applies to the market. Open skies means that new entry by another carrier is possible, although we will still investigate how likely such entry would be in the event the code-share partners attempted to raise fares or reduce service. On the other hand, where entry is governed by a restrictive bilateral, the threat to competition of a code share on that city pair, particularly if the only two authorized carriers are involved, may be substantial.

And finally, if independent operations by the code-share partners in the relevant city-pair markets are not contemplated and sufficient and timely entry is not likely, we will consider evidence that one of the partners is likely to exit the market absent the code share, or that significant transaction-specific procompetitive efficiencies in serving other city pairs on a code-share basis outweigh the potential competitive harm in the overlap city pair.

In sum, we examine all of the facts and circumstances surrounding each code-share agreement and make our competitive assessment on a case-by-case basis.

We have applied this analysis to a number of proposed international code-share agreements. The majority have presented no horizontal competitive concerns. Others we have reviewed combined certain horizontal overlaps with significant end-to-end efficiencies. The Department’s policy has been to seek to exclude from a proposed code share those city pairs on which the proposed alliance partners are two of very few current or likely future competitors.

For an international code share agreement, the Department of Transportation has the authority to confer antitrust immunity, after consulting with us. For agreements where antitrust immunity has been sought, we have recommended that the Department of Transportation “carve out” certain unrestricted fares involving these city pairs from the order granting antitrust immunity for the alliance agreement, provided that the carve-out can reasonably be done without sacrificing important consumer benefits created by the alliance.

We believe that this carve-out approach may permit U.S. air passengers to obtain the benefits of increased efficiency and enhanced beyond-gateway service provided by these code-sharing agreements, while avoiding possible diminutions in gateway-to-gateway service or increased air fares as a result of an alliance. Of course, should a proposed code-share agreement present the potential for significant diminutions in gateway-to-gateway service while providing little likelihood for enhanced beyond-gateway service, we are fully prepared to recommend against the approval of the code-share agreement in its entirety.

I should make it clear that, although I have been discussing the way the Department of Justice evaluates international code shares, the Departments of Justice and Transportation share a common interest in protecting competition to ensure that consumers receive the best services at the lowest prices. To date, DOT has accepted all of the carve-outs the Justice Department has proposed, with the exception of the four New York/ Europe carve-outs we sought for the Delta alliance. Even then, DOT required the alliance partners to report fares and other data, which will allow us to review the effect of the alliance on price and service on these routes. If the data ultimately show that fares increase or service decreases on any of the four routes, DOT can remedy the harm by expanding the carve-out accordingly.

In addition, DOT has prohibited alliance partners from participating in “fare coordination” activities under the auspices of the International Air Travel Association. The Antitrust Division has for years raised concerns to DOT about this type of international cartel activity, and we fully support DOT’s efforts in this regard, which will clearly benefit international airline passengers.

Last summer we provided comments to DOT with respect to the proposed alliance between American Airlines and British Airways. In our comments, we concluded that the proposed alliance should not be approved unless it is significantly restructured. We noted that take-off and landing slots should be made available in sufficient number to ensure that additional airline carriers will provide substantial new air service between the United States and London’s Heathrow Airport. A bilateral open-skies treaty, while essential, by itself would not be sufficient to produce substantial public benefits that clearly outweigh the competitive harm because of constraints on service that exist at Heathrow Airport. We also recommended carve-outs of two routes -- between Dallas and London and Chicago and London -- where American and British Airways have hubs at both ends and where entry by new airlines is highly unlikely. As you know, the

American/ British Airways alliance is still pending before the Department of Transportation.

Our approach to domestic alliances will be similar to the approach we have taken with international alliances. Our concern will be whether the domestic alliance will result in a lessening of competition that will harm consumers. In general, there may be some differences between domestic and international alliances that we will take into account as appropriate. First, unlike some international alliances in which code-sharing may be the only way in which carriers can serve foreign markets, U.S. carriers have virtually unlimited rights to expand their operations within the U.S. -- subject to landing slot ceilings at a few airports -- and thus are, at a minimum, potential competitors of one another. Second, unlike many international alliances in which U.S. carriers and their alliance partners do not compete broadly against one another because of laws and treaties, major U.S. carriers -- even those with different regional strengths -- often compete with one another in significant markets and sometimes are the only competitors in those markets, such as hub-to-hub-markets.

This is not to imply that all alliances between U.S. carriers are competitively problematic. Alliances can and do take many different shapes and forms, and the antitrust consequences of an alliance depend both upon the terms of the alliance and the carriers involved. Certain kinds of alliances may deal with matters that are not competitively troublesome. Even those alliances that involve matters that may be competitively sensitive -- such as code sharing -- may involve carriers that do not have significant competitive overlap.

Yet, it is also true that some alliances may involve carriers that are substantial competitors, and code sharing that could be used as the means for coordinating service and fare offerings. Thus, the Department of Justice will have to determine whether proposed code sharing alliances between U.S. carriers are likely to act as a disincentive for the alliance partners to enter markets operated by the other or to compete vigorously in markets that they both serve. In short, are such alliances likely to divide and allocate markets, or to produce high fares? The Department of Justice can make these kinds of assessments only after carefully reviewing the actual terms of each alliance agreement. I can assure you that the Department of Justice will fully investigate the competitive effects of these alliances and will challenge any that we conclude would unreasonably restrain trade or substantially lessen competition.

ANTITRUST ENFORCEMENT AGAINST MONOPOLIZATION OR ATTEMPT TO MONOPOLIZE

In addition to our enforcement authority under section 7 of the Clayton Act and section 1 of the Sherman Act, the Antitrust Division also has authority to enforce section 2 of the Sherman Act, which prohibits monopolization or attempts to monopolize. This includes using exclusionary conduct to acquire or maintain a monopoly in any market.

Over the years, we have reviewed allegations that carriers sometimes add capacity or lower fares in an effort to drive their competitors out of the market, with the expectation that they thereafter will be able to reduce capacity and raise fares above competitive levels.

For example, a previous airline predation investigation by the Antitrust Division concerned Northwest Airlines's response to Reno Air's entry into the Reno-Minneapolis city-pair in 1993. Not only did Northwest institute service of its own on this route, which it had previously abandoned; it also opened a new mini-hub in Reno that overlaid much of Reno Air's own operation. Our investigation was well under way when the matter was resolved because, with the intervention of the Department of Transportation, Northwest decided to abandon its overlay of Reno Air's hub operation.

We are currently investigating certain carriers to determine whether they have employed predatory strategies to protect their hubs. We are looking into this matter very carefully. It is one of our high priorities, and we hope to reach some conclusions in the very near term.

CONCLUSION

Mr. Chairman, competition in the airline industry is critical for the millions of people who depend on air travel in their business and their family life. I assure you that the Antitrust Division will remain vigilant in monitoring the airline industry to ensure that the competitive benefits of deregulation for consumers are not thwarted by anticompetitive conduct on the part of airlines.