UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA
Department of Justice
Antitrust Division
450 Fifth Street N.W., Suite 8000
Washington, D.C. 20530,
Plaintiff,

v.

ALASKA AIR GROUP, INC.
19300 International Boulevard
Seattle, WA 98188,

and

VIRGIN AMERICA INC.
555 Airport Boulevard
Burlingame, CA 94010,
Defendants.

COMPLAINT

The United States of America ("Plaintiff"), acting under the direction of the Attorney General of the United States, brings this civil antitrust action to enjoin the proposed merger of Defendants Alaska Air Group, Inc. ("Alaska") and Virgin America Inc. ("Virgin"), and to obtain equitable and other relief as appropriate. The United States alleges as follows:

I. INTRODUCTION

1. The airline industry in the United States is dominated by four large airlines – American Airlines, Delta Air Lines, United Airlines, and Southwest Airlines – that collectively

account for over 80% of domestic air travel each year. In this highly-concentrated industry, the smaller airlines play a critical competitive role. In order to compete with the four largest airlines, these smaller airlines often must offer consumers lower fares, additional flight options, and innovative services. The proposed merger of Alaska and Virgin would bring together two of these smaller airlines – the sixth- and ninth-largest U.S. carriers, respectively – to create the fifth-largest U.S. airline.

2. Alaska and Virgin both provide award-winning service and tend to offer lower prices than the larger airlines, but they differ in at least one critical respect. Unlike Virgin, Alaska has closely aligned itself with American, the largest U.S. airline, through a commercial relationship known as a codeshare agreement, which allows each airline to market tickets for certain flights on the other's network. The codeshare agreement began in 1999 as a limited arrangement that permitted Alaska to market American's flights on a small number of routes Alaska did not serve on its own. Over the years, the two airlines have significantly expanded their relationship in size and scope through a series of amendments to the codeshare agreement. The most recent of these amendments was executed in April 2016 – around the same time Alaska agreed to purchase Virgin.

3. Although the codeshare agreement effectively extends Alaska's geographic reach – potentially strengthening Alaska's ability to compete against other carriers like Delta and United – it also creates an incentive for Alaska to cooperate rather than compete with its larger partner, American. Specifically, Alaska may choose not to launch new service on routes served by American, or it may opt to compete less aggressively on the routes that both carriers serve, to avoid upsetting American and jeopardizing the partnership. Alaska may also decide to rely on the codeshare relationship in lieu of entering routes already served by American because doing

so allows it to offer its customers the benefits of an expanded network without undertaking the risk and expense of offering its own competing service. As a result of these incentives, Alaska and American often behave more like partners than competitors.

4. Alaska's acquisition of Virgin would significantly increase Alaska's network overlaps with American, and would thus dramatically increase the circumstances where the incentives created by the codeshare threaten to soften head-to-head competition. Roughly two-thirds of Virgin's network overlaps with American's network, and Virgin has aggressively competed with American on many of these overlap routes in ways that have forced American to respond with lower fares and better service.

5. The proposed acquisition would diminish Virgin's competitive impact on the Virgin-American overlap routes by subjecting Virgin's network to the incentives that arise from Alaska's codeshare agreement with American. Virgin holds critical assets, including gates and takeoff and landing rights (known as "slots"), at key airports within American's network. American divested some of these assets to Virgin as part of the settlement of the United States's antitrust challenge to American's 2013 merger with US Airways. Once Alaska controls the Virgin assets, it likely will redeploy them in ways that accommodate rather than challenge American in order to preserve its codeshare agreement. To avoid competing head-to-head with its codeshare partner, Alaska will likely reduce service, decrease service quality, and/or raise prices on the Virgin-American overlap routes – or exit them entirely. Alaska will also be less likely to enter new routes in competition with American than Virgin is today. These harms will be heightened if Alaska continues to deepen its cooperation with American, which would have the effect of tying the nation's first- and fifth-largest airlines even more closely together.

6. Alaska's internal planning documents demonstrate how the incentives created by the codeshare agreement would likely reduce competition on the routes where American and Virgin compete today. In analyzing the proposed merger, Alaska executives reported to the company's board of directors that certain Virgin operations "would not have [the] support of the American partnership." Accordingly, early during the consideration process, Alaska executives developed a plan that called for changes "that we think would need to be made" to Virgin's service following the merger. The plan contemplated reducing or eliminating service on many of the routes where Virgin and American offer competing service today, including some of the most traveled routes in the country.

7. For these and the reasons discussed below, the proposed merger between Alaska and Virgin likely would lessen competition substantially in numerous U.S. markets for scheduled air passenger service in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and should be permanently enjoined.

II. JURISDICTION, INTERSTATE COMMERCE, AND VENUE

8. The United States brings this action pursuant to Section 15 of the Clayton Act, as amended, 15 U.S.C. § 25, to prevent and restrain Alaska and Virgin from violating Section 7 of the Clayton Act, 15 U.S.C. § 18. This Court has subject matter jurisdiction over this action under Section 15 of the Clayton Act, 15 U.S.C. § 25, and 28 U.S.C. §§ 1331, 1337(a), and 1345.

9. Defendants are engaged in, and their activities substantially affect, interstate commerce, and commerce throughout the United States. Alaska and Virgin each annually transport millions of passengers across state lines throughout this country, generating billions of dollars in revenue.

10. Venue is proper under Section 12 of the Clayton Act, 15 U.S.C. § 22, and 28 U.S.C. § 1391(b) and (c). This Court also has personal jurisdiction over each Defendant. Both Defendants are found and transact business, and have consented to venue and personal jurisdiction, in this District.

III. THE DEFENDANTS AND THE TRANSACTION

11. Defendant Alaska Air Group, Inc. is a Delaware corporation headquartered in Seattle, Washington. Last year, Alaska flew over 31 million passengers to approximately 112 locations worldwide, taking in more than $5.5 billion in revenue.

12. Alaska operates hubs in Seattle, Washington; Portland, Oregon; and Anchorage, Alaska, and has the largest share of traffic at each of these hubs. Alaska has maintained its status as the market share leader throughout the Pacific Northwest, which has helped Alaska achieve higher profit margins than most other domestic airlines for the past several years.

13. Defendant Virgin America Inc. is a Delaware corporation headquartered in Burlingame, California. Last year, Virgin America flew over 7 million passengers to approximately 24 locations worldwide, taking in more than $1.5 billion in revenue. Virgin America is one of several entities bearing the "Virgin" name pursuant to a licensing agreement with the Virgin Group, which owns approximately 18% of Virgin America's outstanding voting common stock.

14. Virgin America was founded in 2004. Unlike Alaska, Virgin does not have a hub-and-spoke network. Although Virgin has "focus cities" – Los Angeles, San Francisco, and Dallas – from which it provides service to many destinations, Virgin does not use these focus cities as points for transferring large volumes of connecting traffic. Instead, the bulk of Virgin's passengers fly on nonstop flights in markets where Virgin is typically not the dominant carrier.

15. On April 1, 2016, Alaska and Virgin agreed to merge for $2.6 billion in cash and the assumption of $1.4 billion in liabilities.

IV. COMPETITION BETWEEN AMERICAN, ALASKA, AND VIRGIN TODAY

A. The Formation and Expansion of the Codeshare Relationship Between American and Alaska

16. Although codeshare agreements can take various forms, they generally allow for flights operated by one airline to be marketed and sold by another airline under the marketing airline's own brand. A codeshare agreement can extend an airline's network by enabling passengers to seamlessly book a connecting itinerary consisting of flights operated by different airlines. For example, a passenger seeking to fly from Walla Walla, Washington to Charlotte, North Carolina could purchase tickets for the entire trip through Alaska, using an Alaska flight from Walla Walla to Seattle that connects to an American flight from Seattle to Charlotte. This arrangement allows Alaska to rely on the codeshare agreement with American to offer service to Charlotte, instead of having to launch its own competing service between Seattle and Charlotte in order to serve the customer.

17. The codesharing partnership between Alaska and American began in 1999. The initial scope of the agreement was very limited: it allowed Alaska to market American's flights on only 88 routes where Alaska did not otherwise provide service, and did not permit American to market any Alaska flights. Since 1999, however, Alaska and American have repeatedly expanded their codeshare arrangement, enabling American to also market certain Alaska flights and increasing the number of flights each partner may sell on behalf of the other.

18. American and Alaska most recently expanded the codeshare agreement in April 2016, around the same time that Alaska was concluding its agreement to acquire Virgin. In agreeing to the amendment, Alaska chose to continue to expand its partnership with American

even though it planned to grow its own network by acquiring Virgin. This April 2016 expansion further increased the number of routes included in the agreement, allowing Alaska to market American flights on over 250 routes, and American to market Alaska flights on about 80 routes.

19. The April 2016 expansion of the codeshare agreement also enabled American and Alaska to sell one another's flights on certain overlap routes where both companies offer competing nonstop service. Under this new arrangement, instead of strictly competing against one another to sell tickets between, for example, Seattle and Los Angeles, American and Alaska began selling each other's tickets for these routes as well. This type of codesharing on nonstop overlap routes, by definition, does not expand either airline's network. Instead, it provides them the opportunity to closely coordinate their service offerings on a route where they would otherwise be competing at arm's length for business. Such close contact between competing airlines on routes they both serve can diminish competition and facilitate collusion.

B. The Codeshare Relationship Incentivizes Alaska to Cooperate Rather than Compete with American

20. Today, Alaska is stronger than American in the Pacific Northwest, where American is comparatively weak, whereas American is stronger than Alaska throughout the rest of the United States. Through the codeshare agreement, Alaska offers its customers flights to more destinations, which helps Alaska retain the loyalty of frequent fliers who prefer to use one airline but want the ability to travel to domestic cities that Alaska does not serve independently. American derives similar benefits from the codeshare agreement – loyal American customers are provided greater ability to travel throughout the Pacific Northwest using Alaska's network.

21. Although the codeshare agreement provides both carriers commercial benefits by linking the Alaska and American networks, the agreement also makes Alaska dependent on American in a way that discourages competition between the two airlines. Specifically,

American has significant leverage over Alaska because Alaska derives considerable value from using the American network to provide service throughout many areas of the United States it does not otherwise serve, while American relies on Alaska to provide access to far fewer destinations. To avoid undermining this lucrative partnership, Alaska may forego launching new service on routes served by American, or it may opt to compete less aggressively on the routes they both serve.

22. In addition, Alaska may choose to rely on the codeshare agreement in lieu of entering some routes already served by American because doing so allows it to offer its customers the benefits of an expanded network without undertaking the risk and expense of commencing its own competing service. By relying on an American flight to provide its customers service, Alaska can boast a more extensive network without actually launching service in competition with American. In essence, by choosing to rely on the codeshare agreement, Alaska is forgoing entry that would likely provide lower prices and more flight options to consumers.

23. The incentives created by the codeshare agreement are illustrated by the five-year growth plan that Alaska prepared prior to agreeing to acquire Virgin. The plan envisioned further cooperation between Alaska and American, calling for Alaska to "strengthen the [American] partnership by trying to grow LA in a way that is complimentary [*sic*] to AA rather than competitive." But competitors are supposed to compete with, not complement, each other. Alaska would likely continue this strategy of avoiding growth that challenges American if it were to complete the merger. When Alaska was weighing whether to acquire Virgin, for example, a senior Alaska executive recognized that "LAX . . . expansion may be counterproductive to our relationship with AA."

C. Unhindered by a Codeshare Relationship, Virgin Competes Aggressively With American

24. In contrast to Alaska, Virgin has served as one of American's fiercest competitors. Virgin competes directly with American on twenty nonstop routes, which constitute approximately two-thirds of Virgin's entire network. In total, passengers spend about $8 billion per year to travel on these routes.

25. Virgin and American vigorously compete on so many nonstop routes in part because Virgin controls critical assets in cities where American maintains a hub. These assets include gates and/or takeoff and landing rights at airports such as Los Angeles International Airport, Washington Reagan National Airport, and Dallas Love Field. Virgin's presence at these important airports provides a critical alternative for consumers and helps keep American's prices lower than they otherwise would be.

26. Virgin's ownership of these assets and aggressive competition with American is no coincidence – consumers were promised the benefits of expanded Virgin service to counteract the anticompetitive effects threatened by the 2013 merger between American and US Airways. To resolve the United States's challenge to that merger, American agreed to divest a host of critical assets to low-cost competitors, including Virgin, at key U.S. airports. As contemplated by the settlement, Virgin has used the assets to compete directly with American. For instance, Virgin has utilized the two airport gates it acquired at Dallas Love Field to launch aggressive new service against American, forcing American to respond with lower prices. Virgin has estimated that its entry at Love Field caused American to lower certain fares on flights out of Dallas by more than 50%.

V. THE RELEVANT MARKETS

27. Scheduled air passenger service enables consumers to travel quickly and efficiently between various cities in the United States. Air travel offers passengers significant time savings and convenience over other forms of travel. For example, a flight from Washington, D.C. to Detroit takes just over an hour of flight time. Driving between the two cities takes at least eight hours. A train between the two cities takes more than fifteen hours.

28. Due to time savings and convenience afforded by scheduled air passenger service, few passengers would substitute other modes of transportation (car, bus, or train) for scheduled air passenger service in response to a small but significant industry-wide fare increase. Another way to say this, as described in the Department of Justice and Federal Trade Commission's *Horizontal Merger Guidelines* (2010), and endorsed by courts in this Circuit, is that a hypothetical monopolist of all scheduled air passenger service likely would increase its prices by at least a small but significant and non-transitory amount. Scheduled air passenger service, therefore, constitutes a line of commerce and a relevant product market within the meaning of Section 7 of the Clayton Act.

29. Moreover, most passengers book flights with their origins and destinations predetermined. Few passengers who wish to fly from one city to another would switch to flights between other cities in response to a small but significant and non-transitory fare increase. A hypothetical monopolist of all scheduled air passenger service on any particular route between two destinations likely would be able to profitably increase its prices by at least a small but significant and non-transitory amount. Accordingly, scheduled air passenger service between each origin and destination pair constitutes a line of commerce and section of the country under Section 7 of the Clayton Act.

30. Scheduled air passenger service on those twenty routes on which Virgin and American compete today, and the routes on which they would have likely competed in the future, are relevant markets within the meaning of Section 7 of the Clayton Act.

VI. THE TRANSACTION'S LIKELY ANTICOMPETITIVE EFFECTS

A. The Merger Is Likely to Lessen Competition on the Routes Where Virgin and American Compete Today

31. Alaska's acquisition of Virgin's network will extend the incentives created by the codeshare agreement to the extensive overlaps between Virgin and American, and will therefore reduce the vigorous competition that Virgin is presently providing against American on some of the nation's largest nonstop routes. Specifically, the merger is likely to substantially lessen competition on each of the twenty nonstop routes on which Virgin and American currently compete because Alaska will have an incentive to avoid aggressive head-to-head competition in order to preserve its codeshare relationship with American. Once Alaska has control of Virgin, it is likely to reduce capacity, decrease service quality, and/or raise prices on these routes. In some cases, Alaska may completely stop serving the routes with its own flights, instead simply marketing American's flights between the destinations, thereby eliminating a meaningful competitive choice for millions of consumers.

32. Alaska itself has recognized that its acquisition of Virgin's assets will likely reduce competition on the Virgin-American overlap routes. As part of Alaska's early analysis of a possible acquisition of Virgin, Alaska executives developed a plan for post-merger changes to Virgin's service that specifically called for reducing – and in some instances completely eliminating – service on many of the routes where Virgin and American compete today, including routes that are among the most heavily traveled in the country. If carried out, these service reductions would not only cost consumers tens of millions of dollars each year, they

would deprive consumers of some of the competitive benefits enabled by the American-US Airways merger settlement.

B. The Merged Firm Will Be Less Likely to Enter into New Competition with American than Virgin Would Be Standing Alone

33. Alaska's acquisition of Virgin will also lessen competition because Alaska is likely to enter fewer new routes in competition with American post-merger than Virgin would if Virgin remained a standalone airline. Alaska may avoid entering a route in competition with American for two reasons related to the codeshare: (1) it will fear endangering its lucrative relationship with American, and (2) it can already offer tickets on the route through the codeshare agreement. Virgin has no such inhibitions. In fact, Virgin's standalone growth plan called for the airline to enter several nonstop routes currently served by American but not Alaska. Alaska presently relies on its codeshare relationship with American to serve some of these routes, as well as others that may have been served by an independent Virgin in the future. Post-merger, Virgin's independent decision-making will be lost, and Alaska may avoid entering these types of routes. As a result, consumers will be deprived of the benefits of the future competition that Virgin would have provided.

VII. ABSENCE OF COUNTERVAILING FACTORS

34. New entry, or expansion by existing competitors, is unlikely to prevent or remedy the merger's likely anticompetitive effects. New entrants into a particular market face significant barriers to success, including difficulty in obtaining access to slots and gate facilities; the effects of corporate discount programs offered by dominant incumbents; loyalty to existing frequent flyer programs; an unknown brand; and the risk of aggressive responses to new entry by the dominant incumbent carrier. In addition, entry is highly unlikely on routes where the origin or

destination airport is another airline's hub, because the new entrant would face substantial challenges attracting sufficient local passengers to support service.

35. Defendants cannot demonstrate acquisition-specific and cognizable efficiencies that would offset the proposed acquisition's likely anticompetitive effects.

VIII. VIOLATION ALLEGED

36. The United States hereby incorporates the allegations of paragraphs 1 through 35 above as if set forth fully herein.

37. The effect of the proposed merger, if approved, likely will be to lessen competition substantially, or tend to create a monopoly, in interstate trade and commerce in the numerous U.S. markets for scheduled air passenger service identified above, in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

38. Unless enjoined, the proposed merger likely would have the following effects in the relevant markets, among others:

(a) actual and potential competition in the relevant markets would be eliminated, including competition between Virgin and American;

(b) ticket prices and other fees would be higher than they otherwise would;

(c) industry capacity would be lower than it otherwise would; and

(d) service quality would be lessened.

IX. REQUEST FOR RELIEF

39. Plaintiff requests:

(a) that Alaska's proposed merger with Virgin be adjudged to violate Section 7 of the Clayton Act, 15 U.S.C. § 18;

(b) that Defendants be permanently enjoined from and restrained from carrying out the planned merger of Alaska and Virgin or any other transaction that would combine the two companies;

(c) that Plaintiff be awarded its costs of this action; and

(d) that Plaintiff be awarded such other relief as the Court may deem just and proper.

Dated: December 6, 2016

Respectfully submitted,

FOR PLAINTIFF UNITED STATES:

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