VIII. The Merger of American Airlines and U.S. Airways

A. Introduction

This past fall, the Department of Justice ("DOJ") approved a merger between American Airlines ("American") and U.S. Airways,[1] and the two airlines officially merged on December 9, 2013.[2] American had recently emerged from bankruptcy prior to the merger, causing many to scrutinize the transaction.[3] The DOJ harbored additional antitrust concerns, but eventually reached a settlement with the airlines.[4] In recent mergers, large airlines have confronted logistical and financial obstacles after consolidating.[5] Using the experience gained from these transactions, post-merger American may be better situated to surmount such difficulties.[6]

This article discusses the events leading up to the American-U.S. Airways merger and the merger's impact on the broader airline industry. Part B summarizes the effect of American's bankruptcy filing. Part C examines the DOJ's initial suit to block the merger and the significance of certain settlement terms. Part D analyzes the issues in previous airline mergers and predicts how the American-U.S. Airways merger may improve efficiency. Part E concludes that the merger is likely to continue its initial success.

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[1] Jad Mouawad & Christopher Drew, *Justice Dept. Clears Airlines' Merger*, N.Y. TIMES, Nov. 13, 2013, at B1.
[2] Susan Carey & Jack Nicas, *New Airline Takes Off—American Joins With US Airways to Form World's Biggest Carrier by Traffic*, WALL ST. J., Dec. 10, 2013, at B3.
[3] James B. Stewart, *A Merger Too Far For U.S. And Airlines*, N.Y. TIMES, Aug. 17, 2013, at B1 ("The [DOJ's] complaint noted that US Air had record profits in 2012 and that American, although it is still operating under bankruptcy court supervision, had record revenue in its latest quarter, with $357 million in net profits.").
[4] Complaint at 3, United States v. US Airways Grp., No. 1:13-cv-01236 (D.D.C. Aug. 13, 2013) ("This merger will leave three very similar legacy airlines—Delta, United, and the new American—that past experience shows increasingly prefer tacit coordination over full-throated competition.").
[5] *See infra* Part D.1.
[6] *See infra* Part D.2.

B. Bankruptcy

The American-U.S. Airways merger will produce the United States' largest domestic airline carrier.[7] This merger is a stark turnaround for American considering its bleak economic status a few years prior.[8] In late 2011, American filed for bankruptcy after its fourth consecutive year of annual losses.[9] Since 2007, American had only posted one profitable quarter, and reported losses of $4.8 billion over a three and a half year span.[10] Prior to the bankruptcy announcement, American executives denied predictions that the airline would file.[11] Ultimately, American's $800 million labor costs and its inability to compete with more flexible rivals prompted American to file for bankruptcy.[12] In its restructuring plan, American froze pensions and reduced labor costs by seventeen percent.[13] In doing so, the airline was able to immediately add profit to its bottom line and create a more cost-effective corporate structure.[14]

Discussions of a potential merger with U.S. Airways began to surface during American's bankruptcy.[15] American grew into a more attractive merge partner for U.S. Airways once the restructuring restored the airline's profitability.[16] Indeed, operating under bankruptcy court supervision, American reported a $357 million net profit in its second quarter in 2013.[17] However,

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[7] Mouawad & Drew, *supra* note 1.
[8] *See* Chris Isidore & Blake Ellis, *American Airlines files for bankruptcy*, CNNMONEY (Nov. 29, 2011, 11:44 AM), http://money.cnn.com/2011/11/29/news/companies/american_airlines_bankruptcy.
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] Jason Whitely, *American Airlines exits bankruptcy, permitted to merge with US Airways*, WFAA BUS. NEWS (Nov. 27, 2013, 6:23 PM), http:/wfaa.com/news/business/American-Airlines-exits-bankruptcy-permitted-to-merge-with-US-Airways-233613961.html.
[14] *Id.*
[15] *Id.* ("U.S. Bankruptcy Judge Sean H. Lane said American didn't need to ask its creditors again for approval to exit bankruptcy and said the court will also grant permission for the merger to be consummated without delay.").
[16] *See* Stewart, *supra* note 3 ("American, although it is still operating under bankruptcy court supervision, had record revenue in its latest quarter . . . .").
[17] *Id.*

American's sudden profitability triggered the DOJ's scrutiny.[18] The DOJ was concerned that the merger could be an airfare-raising maneuver, rather than a legitimate means for American to survive bankruptcy.[19]

C. Recent Department of Justice Actions

1. Complaint

Six months after American and U.S. Airways announced their merger plan, the DOJ filed a suit to block the proposed merger of the two airlines.[20] In its complaint, the DOJ stated that the merger would reduce the number of "legacy" airlines from four to three, thereby "threaten[ing] substantial harm to consumers."[21] The merger would give the consolidated airline exclusive routes across the United States, including "a monopoly on 63% of the nonstop routes" from Reagan National Airport in Washington, D.C.[22] The DOJ predicted that if the merger occurred, some airline passengers would see an extraordinary increase in ticket prices.[23] Even if the merger only affected a small number of airline passengers, the resulting increase in airline ticket prices could cost American consumers millions of dollars annually.[24] Additionally, by reducing the number of remaining legacy airlines to such a small number, legacy airlines would have a higher incentive to cooperate to raise consumer prices, instead of competing to lower prices for consumers.[25]

In response, American and U.S. Airways argued that the government had approved similar airline mergers numerous times

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[18] Complaint, *supra* note 4, at 26.
[19] *Id*. ("American does not need this merger to thrive, let alone survive.").
[20] *Id.* at 1.
[21] *Id.* at 3. A legacy airline is one that existed before the Airline Deregulation Act of 1978. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-630, AIRLINE DEREGULATION: REGULATING THE AIRLINE INDUSTRY WOULD LIKELY REVERSE CONSUMER BENEFITS AND NOT SAVE AIRLINE PENSIONS 1 (2006). The four legacy airlines prior to the American-U.S. Airways merger were American Airlines, U.S. Airways, Delta, and United. Complaint, *supra* note 4, at 3.
[22] Complaint, *supra* note 4 at 6.
[23] *Id.*
[24] *Id.* at 3.
[25] *Id.*

over the past seven years.[26] Counsel for U.S. Airways suggested that the DOJ had "abandoned the framework" it had employed in the Delta-Northwest merger in 2008, the United-Continental merger in 2010, and the Southwest-AirTran merger in 2011.[27] Moreover, some experts have theorized that when two airlines merge and eliminate routes, it enables lower cost carriers, such as Southwest and Jet Blue, to enter the market, thereby increasing competition with the legacy airlines on certain routes.[28] Other commentators have observed that from 2004 to mid-2013—a time filled with some of the largest airline mergers in United States history—airline fares actually decreased when adjusted for inflation.[29] Fares decreased as the merged airlines were able "to eliminate unprofitable or redundant routes and invest in more fuel-efficient planes."[30]

The DOJ defended its suit, explaining that the number of recent airline mergers necessitated scrutiny of the current transaction.[31] The DOJ emphasized that it "consider[s] every merger one at a time,"[32] and stressed that the proposed merger's reduction in legacy airlines from four to three was "not the same as six to five, or five to four."[33] The Complaint further countered that even though a merger could encourage low-cost carriers to enter the market, the low-cost airlines may not pick up the less-profitable routes released by American.[34] The DOJ added that low-cost carriers have far "less

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[26] *See* Stewart, *supra* note 3 (observing that the Justice Department "had been notably lax on airline mergers").
[27] *Id.* (quoting Paul T. Denis, a partner at Dechert L.L.P., which represented US Airways).
[28] Hugo Martin, *Airline mergers are good for carriers, fares*, L.A. TIMES, Jan. 27, 2014, at A8 ("[W]hen big airlines eliminate routes, low-cost carriers such as Southwest and JetBlue enter the market and force larger carriers to keep fares competitive, said Jonathan Kletzel, U.S. transportation and logistics leader for PwC.").
[29] *Id.* ("Domestic airfares increased an average of only 2% from 2004 to mid-2013—a decrease of 0.5% when adjusted for inflation.").
[30] *Id.*
[31] Stewart, *supra* note 3 (quoting William Baer, Assistant Attorney General for the Antitrust Division, Department of Justice).
[32] *Id*.
[33] *Id.*
[34] Complaint, *supra* note 4, at 3–4 ("That enhanced cooperation is unlikely to be significantly disrupted by Southwest and JetBlue, which, while offering important competition on the routes they fly, have less extensive domestic and international route networks than the legacy airlines.").

extensive domestic and international route networks," and thus would not be able to act as a sufficient restraint on domestic airline fares.[35] Furthermore, commentators have observed that, while domestic airfare costs have declined over the past nine years, the decrease does not reflect the added costs of baggage fees and other passenger charges.[36] These consumer costs are not only the least popular feature about airlines, but are also an increasing source of revenue for the airline industry.[37]

2. Settlement

After months of negotiating with American and U.S. Airways, the DOJ settled with the two airlines on November 12, 2013, a few weeks before the scheduled trial date.[38] To mitigate the DOJ's concerns about a near-monopoly on numerous routes, American and U.S. Airways agreed to sell a combined 104 takeoff and landing slots at Reagan National Airport and thirty-four slots at La Guardia Airport in New York to lower-cost airlines.[39] Selling the landing gates essentially decreased the number of arrival and departure flights the consolidated airline would be able to make.[40] The DOJ was satisfied with this compromise, despite its earlier position questioning the ability of low-cost carriers to drive down prices.[41] Under the terms of the settlement, JetBlue and Southwest

[35] *Id.*
[36] Martin, *supra* note 28.
[37] *Id.* ("When asked to name the fee they hate the most, 48% of website visitors named baggage fees, 38% said flight change or cancellation fees, 6% said advance seat selection fees and 5% said they hate reservation-by-phone fees. Airlines charge $15 to $25 to check a first bag, with charges that can top $100 for oversized luggage.").
[38] Mouawad & Drew, *supra* note 1.
[39] *Id.* American Airlines and U.S. Airways additionally agreed to sell their rights to a small number of terminal gates at Chicago O'Hare International, Los Angeles International, Boston Logan International, Dallas Love Field, and Miami International. *Id.*
[40] *Id.* ("After completing the sale of its assets, the merged airline will operate 44 fewer daily departures from Reagan National Airport and 12 fewer daily departures at La Guardia than the two airlines together offer now.").
[41] *Compare id.* ("The Justice Department said the agreement would foster competition at busy markets like Washington and New York, opening opportunities for lower-cost carriers."), *with* Complaint, *supra* note 4, at 4

will have the option to purchase the takeoff and landing slots they already lease from American, as well as the option to purchase more slots.[42] The DOJ will outline procedures for the landing gate sales, intending low-cost carriers to purchase the majority.[43] However, other legacy airlines, such as Delta, have also expressed an interest in purchasing slots from the post-merger American.[44]

Some analysts believe that the DOJ's suit was merely an exercise to maintain its reputation.[45] Since the DOJ had allowed large airline mergers in the past, it was unlikely to succeed in blocking the American-U.S. Airways merger.[46] Moreover, market forces favored consolidation within the airline industry, lending further support to the merger.[47] Professor George Hoffer, a transportation economics professor at the University of Richmond, criticized the DOJ for maintaining an "indefensible" position in trying to prevent the "inevitable" merger: "Once you created a super-Delta and a super-United, you had to create super-American."[48]

On the other hand, some commentators have suggested that the DOJ's initially strong position did have a significant impact in reducing the number of takeoff and landing slots the combined airline would own.[49] American and U.S. Airways sold about fifteen percent of their combined slots across the country.[50] According to William Baer, the assistant attorney general for the antitrust division, the landing slots sale will help break up the "cozy arrangements" between the remaining legacy carriers.[51] The final deal is expected to

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("[C]ooperation is unlikely to be significantly disrupted by Southwest and JetBlue . . . .").

[42] Jeremy Dwyer-Lindgren, *UPDATED: American Airlines, US Airways Seal Deal With DOJ on Merger*, AIRCHIVE.COM (Nov. 12, 2013).

[43] *Id.*

[44] *Id.*

[45] Mouawad & Drew, *supra* note 1 ("Robert Mann, an aviation consultant, said the deal was 'basically a face-saver' for the Justice Department . . . .").

[46] *Id.*

[47] *See id.* ("Airline executives have argued over the years that consolidation and pruning of unprofitable routes was the only way to return a beleaguered industry to health.").

[48] *Id.*

[49] *Id.* (referring to the landing gate sales at La Guardia and Washington National as "a pound of flesh, or a couple of ounces" (quoting aviation consultant Robert Mann)).

[50] *Id.*

[51] *Id.*

force prices down and provide consumers with more flight options.[52] Mr. Baer noted that providing low-cost airlines with even a few opportunities to purchase gates has previously lowered airfare prices and increased passenger traffic.[53]

While American and U.S. Airways may have sold a large number of landing gates across the United States, some critics have noted that, when compared to the overall flights the consolidated airline will operate, the number is "pretty modest."[54] The sold landing gates represent only 112 daily flights out of the combined 6,700 flights the consolidated airline will run daily throughout the United States.[55] Additionally, experts have predicted that the DOJ's settlement agreement could adversely affect consumers flying to less popular destinations, since low-cost airlines do not have the proper resources to serve these "smaller communities."[56]

D. Past Airline Mergers and What to Expect from the Post-Merger American

1. Past Airline Mergers

Prior to the American-U.S. Airways merger, there have been three other major airline mergers within the past seven years.[57] Each of the prior three mergers has created the nation's largest domestic carrier at the time, with the exception of the Southwest-AirTran merger in 2011.[58] In a merger, airlines typically aim to consolidate millions or billions of dollars of assets in order to create a highly

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[52] *Id.*
[53] *Id.* ("[I]n the past, even modest opportunities for low-cost carriers to gain more slots have made a difference for consumers. When Southwest Airlines acquired 36 slots at Newark Liberty International Airport as a condition of the United-Continental merger, it added six nonstop flights from Newark with connections to 60 other cities. Fares dropped by 10 percent on the nonstop routes and passenger traffic rose by 36 percent . . . .").
[54] *Id.* (quoting Doug Parker, CEO of post-merger American, and former chairman of US Airways).
[55] *Id.*
[56] *Id.* ("[T]he most likely losers would be places like . . . Chattanooga, Tenn. . . . because the airlines in line to get those slots do not have small planes to serve smaller communities." (quoting aviation consultant Michael Boyd)).
[57] Stewart, *supra* note 3.
[58] *See* Complaint, *supra* note 4, at 14; Jad Mouawad, *Big Problems for Biggest Airline*, N.Y. TIMES, Nov. 29, 2012, at B1.

profitable airline.[59] There are many long-term benefits to a merger as well.[60] A merger enables the consolidated airline to eliminate unprofitable or redundant routes.[61] Additionally, a merger allows the combined airline to offset rising gas prices by using its extra capital to invest in more fuel-efficient planes.[62] Thus, a merger may ultimately result in reduced consumer costs, as airlines become more efficient.[63]

The recent United-Continental and Delta-Northwest mergers may offer some guidance as to the potential problems a post-merger airline could encounter. Almost immediately after the United-Continental merger, the consolidated airline began to experience difficulties.[64] One of the largest issues was the failure of its flight reservation system twice within two years of the merger.[65] This failure severely burdened customers, as the airline was forced to delay and cancel many flights.[66] Additionally, both United and Delta fell sharply in their on-time ratings after their respective mergers.[67]

While mergers are often intended to increase profits, they may have the opposite effect in the early years of a consolidation. United experienced a serious financial downturn in the months following its merger.[68] Many airlines reported profits in 2012, but United continued to report losses nearly two years after merging with Continental.[69] It wasn't until 2013 that United rebounded, reporting 6.5% to 7% profits in the first quarter, and outstripping its closest competitor by more than three-fold.[70] Delta also initially struggled to

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[59] *See* Mouawad & Drew, supra note 1.
[60] Martin, *supra* note 28.
[61] *Id.*
[62] *Id.*
[63] *Id.*
[64] Mouawad, *supra* note 58.
[65] *Id.*
[66] *Id.*
[67] *Id.* ("[United's] on-time arrival rate . . . was just 77.5 percent—six percentage points below the industry average . . . . Delta's on-time performance fell sharply in the year after its purchase of Northwest.").
[68] *Id.*
[69] *Id.* ("While most large airlines reported profits this year, United has lost $103 million in the first three quarters of 2012, with revenue up just 1 percent to $28.5 billion.").
[70] Terry Maxon, *United Airlines bucks trend on unit revenues, reports good growth*, DALLAS MORNING NEWS, Apr. 8, 2013, http://aviationblog.

increase revenues, but was able to do so eventually.[71] In addition to logistical and financial issues, a merger between airlines may also create challenges in assimilating the two business cultures.[72]

2. Expectation for Post-Merger American Moving Forward

Doug Parker, the CEO of post-merger American, asserted that "[a]s the largest airline in the world, we should be the most profitable."[73] However, if anything is to be learned from the recent airline mergers, it is that American may not find immediate financial and operational success.[74] Nevertheless, some factors in this merger may create a more efficient outcome than prior airline mergers. First, American's management has witnessed the difficulties that other large airline mergers experienced, and therefore, may be able to better prepare for such obstacles.[75] Second, Mr. Parker's personal experience could also be a valuable resource, as he was previously involved in U.S. Airways' merger with America West Airlines in 2005.[76] Mr. Parker's insight, combined with information from the Delta-Northwest and United-Continental mergers, could help post-merger American avoid many of the customer service and technological blunders that occurred in previous mergers.

Both Delta's and United's mergers were executed as the economy was still recovering from the financial crisis.[77] More recently, however, airlines are exceeding investors' expectations.[78] Since the American-U.S. Airways merger was implemented, fuel

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dallasnews.com/2013/04/united-airlines-bucks-trend-on-unit-revenues-reports-good-growth.html.

[71] Mouawad, *supra* note 58.

[72] *Id.* ("For many analysts, United's real challenge lies in combining different work groups with different cultures, values and ways of doing things.").

[73] Carey & Nicas, *supra* note 2.

[74] *See supra* Part D.1.

[75] Carey & Nicas, *supra* note 2.

[76] *Id.*

[77] *See* Stewart, *supra* note 3.

[78] David Koenig, *American Airlines 4Q Results Beat Expectations*, ASSOC. PRESS, Jan. 28, 2014, http://bigstory.ap.org/article/american-airlines-posts-2-billion-loss-charges ("American, United, Delta and Southwest all reported fourth-quarter results that beat analysts' forecasts for earnings and revenue.").

costs have been low and airfares have risen slightly, driving up the value of the entire airline industry's stock.[79] Analysts observed that post-merger American has "reaped the benefits"[80]—in the first seven weeks of the company's listing on the Nasdaq Stock Market, its stock increased over 25% in value.[81] Analysts speculate that this initial success bodes well for the newly consolidated airline.[82]

E. Conclusion

The American-U.S. Airways merger joined two companies with promising futures. Despite American's recent bankruptcy, the consolidated airline rebounded and posted profits in the quarter immediately prior to the DOJ's suit in 2013.[83] Although the DOJ approved the merger, it is unclear whether the sale of landing gates will have its desired effect of promoting competition.[84] Furthermore, the DOJ's initial complaint appeared to be correct as to airfare price increases.[85] Post-merger American had a five percent "increase in the amount that passengers paid for every mile they flew."[86] Despite these increased costs to passengers, post-merger American otherwise appears to be successfully avoiding many of the pitfalls that plagued previous airline mergers.[87]

Timothy Bolte[88]

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79 *Id.*

80 *Id.*

81 *See* Carey & Nicas, *supra* note 2 ("Shares of the combined company, now the world's largest airline by traffic, rose 2.7% to $24.60 in their first day of trading on the Nasdaq Stock Market."); Koenig, *supra* note 78 ("American's shares rose $1.59, or 5.3 percent, to $31.77 in afternoon trading, and the Fort Worth-based company led a broad rally in U.S. airline stocks.").

82 Koenig, *supra* note 78.

83 Stewart, *supra* note 3.

84 *See supra* Part C.2.

85 Complaint, *supra* note 4, at 3 ("With less competition, airlines can cut service and raise prices with less fear of competitive responses from rivals."); Koenig, *supra* note 78 ("As American Airlines flies into its first year after merging with US Airways, fares are up . . . .").

86 Koenig, *supra* note 78.

87 *Id*.

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