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Airline Joint Venture Agreements: Assessing Impact on Consumers and Labor

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I. Introduction

The U.S. airline industry is at an inflection point. After almost two decades of consolidation, four airlines control almost 70% of the national market.[1] While the airlines continue to test the regulatory waters on further consolidation, such as the proposed JetBlue-Spirit tie-up, they are also turning to a more creative means of enhancing "horizontal control" in order to maintain or strengthen their market positions. The airline joint venture agreement is a leading work-around to government pushback on further merger proposals. Joint ventures stop short of full metal integration via merger, but they often eliminate incentives for carriers to compete independently. The legality of the American-JetBlue joint venture ("Northeast Alliance" or "NEA") is currently being determined by a federal district court after the U.S. Department of Justice (DOJ) filed a lawsuit to enjoin it in September 2021.[2]

If joint venture agreements are to become the "go-to" strategy for airlines to solidify their hold on concentrated city-pair or airport-pair markets, now is the time to evaluate the competition issues they raise. This includes the full range of any adverse effects from anticompetitive joint venture agreements, including the impact of higher fares and fees, lower quality, and less choice on consumers, but also the prospect of lower wages and reduced bargaining power for vulnerable workforces such as pilots. The American Antitrust Institute (AAI) has long advocated for vigorous antitrust enforcement and regulatory policy that supports competition in the airline sector.[3] The analysis herein explains why it is imperative that antitrust enforcers and courts consider both consumer and labor market effects in evaluating the legality of airline joint ventures.

The analysis begins in Section II by providing context that explains why further attempts to maintain or expand horizontal control by domestic carriers can be problematic in highly concentrated passenger service markets. Section III assesses why some airline joint ventures eliminate incentives for partner carriers to compete independently, using the NEA as a case study. Section IV examines

[1] TranStats, Airline Domestic Market Share (Sept. 2021 – Aug. 2022), U.S. DEPT. OF TRANSPORTATION, BUREAU OF TRANSPORTATION STATISTICS, https://www.transtats.bts.gov/Homepage.asp.

[2] U.S. v. American Airlines Group Inc. and JetBlue Airways Corp., Complaint, Case 1:21-cv-11779 (Sept. 21, 2021, D. Mass.), https://www.justice.gov/opa/press-release/file/1434621/download. ("DOJ Complaint").

[3] The American Antitrust Institute (AAI) is an independent non-profit education, research, and advocacy organization devoted to promoting competition that protects consumers, businesses, and society. For more information, *see* www.antitrustinstitute.org.

key issues surrounding how airline joint ventures are challenged by the government, either proactively through Section 7 of the Clayton Act, or retroactively through Section 1 of the Sherman Act. Section V explains how anticompetitive reductions in output that may result from some airline joint ventures adversely affect consumers and workers. The final section looks at common arguments for why enhanced horizontal control is procompetitive and explains why such efficiencies "defenses" are particularly weak in airline markets.

II. Domestic Airline Competition: More Mergers or More Joint Ventures?

The domestic passenger markets have been home to a series of mergers that have eliminated seven major carriers over the last 17 years. During that period, both at the national level and in city- or airport-pair markets, consolidation has resulted in a steady loss of competition, with minimal meaningful entry of new carriers. Consolidation has dramatically changed the profile of competition in passenger service markets. The U.S. airline oligopoly, consisting of the three large legacy carriers (American, Delta, and United) and former low-cost carrier (LCC), Southwest, has come to control almost 70% of the national market.[4]

The "Big 4" engage in signaling to communicate that they intend to keep capacity tight and fares high.[5] Simultaneously, their dominance at key U.S. hubs and in some markets for takeoff and landing slots deters competition from smaller and lower-cost carriers, which may fear an aggressive response if they attempt to enter. Given high levels of concentration in city- or airport-pair passenger service markets, further enhancement of horizontal control through merger is likely to meet significant resistance from antitrust enforcers. For example, the proposed merger of JetBlue and ultra-low-cost carrier (ULCC), Spirit, would vaporize yet another U.S. carrier, and one of two major U.S. ULCCs. Combining JetBlue and Spirit would both eliminate important competition and offer limited, if any, benefits because of the carriers' starkly different business models.

Moreover, the well-worn argument that carriers need to become "bigger to compete better" should gain no ground with enforcers or courts. This rationale rests on the flawed notion that duopolies or oligopolies serve consumers and workers better than competition. This is never a valid justification for expanded horizontal control and puts both passenger service markets and markets for the purchase of airline labor on the slippery slope of ever-rising concentration.

In light of the dwindling tolerance for further consolidation in the domestic airline markets, the airline joint venture agreement is evolving as the go-to strategy for carriers to maintain or expand their market positions. Joint ventures stop short of full metal integration under merger. Yet they still cover a spectrum of economic coordination between the partner carriers, including agreements to: (1) transfer passengers traveling on connecting itineraries (i.e., "interline"), (2) share frequent flyer programs, (3) codeshare, (4) coordinate pricing and schedules, and (5) share revenue or profits.[6] Some forms of coordination eliminate incentives for the partner carriers to compete independently. For example, the DOJ settled the merger of Alaska and Virgin America by requiring modifications to the American-Alaska codeshare. Those modifications ensured that post-merger, a combined

[4] *Supra* note 1.

[5] The Big 4 include American, Delta, United, and Southwest *See, e.g., Data and Statistics: U.S. Airline Mergers and Acquisitions*, Airlines.org (Feb. 7, 2022), https://www.airlines.org/dataset/u-s-airline-mergers-and-acquisitions/.

[6] *See e.g.,* Paul Stephen Dempsey, Airline Alliances, McGill University, Institute of Air & Space Law (2011), https://www.mcgill.ca/iasl/files/iasl/ASPL614-Alliances.pdf.

Alaska-Virgin America had strong incentives to continue to compete aggressively on routes also served by American.[7]

Joint ventures that eliminate incentives for the partner carriers to compete independently stand to further tighten the oligopoly that dominates domestic passenger service markets. Moreover, if illegal joint ventures survive government challenge, they are likely to be replicated by other airlines, or prompt carriers that are party to existing joint ventures to expand their footprint and scope of coordination.

III. Unpacking Airline Joint Ventures: the American-JetBlue "Northeast Alliance"

In 2020, the largest domestic airline, American, and JetBlue proposed the NEA.[8] The NEA is a cooperative service agreement outlining significant coordination between two head-to-head rivals, including code-sharing, frequent flyer cooperation, revenue-sharing, sharing of existing assets, marketing, and planning.[9] The U.S. Department of Transportation (DOT) bypassed any public comment period on the NEA proposal, blessing it quickly and quietly under its 49 U.S.C. §41720 authority during the presidential transition in January 2021. DOT conditioned its approval of the American-JetBlue joint venture agreement on a small number of slot-pair divestitures and ongoing reporting, monitoring, and compliance commitments by the carriers.[10]

The NEA constitutes multiple agreements between the carrier partners.[11] These include coordination on network planning, including what routes American and JetBlue will fly, when to offer service on those routes, which airline will fly those routes, and what size planes to use. The NEA also includes an agreement to share pooled revenue, so that each airline receives the same revenue, regardless of which partners' planes are flown. This guarantee eliminates incentives for American and JetBlue to compete on routes covered by the NEA, since rivalry would reduce fares and, therefore, revenues. The NEA, therefore, creates incentives for American and JetBlue to allocate markets, the outcome of which is an anticompetitive reduction in output.

In the airline context, market allocation occurs when one carrier withdraws from a route that is served by the coordinating carriers. Other anticompetitive reductions in output could result from shifting smaller aircraft to routes that were flown with larger aircraft before the joint venture went into effect. The anticompetitive terms of the NEA are exacerbated by the presence of highly concentrated airport-pair markets originating or terminating at four major airports: Boston Logan

[7] Justice Department Requires Alaska Airlines to Significantly Scale Back Codeshare Agreement with American Airlines in Order to Proceed with Virgin America Acquisition, U.S. DEPT. OF JUSTICE (Dec. 6, 2016), https://www.justice.gov/opa/pr/justice-department-requires-alaska-airlines-significantly-scale-back-codeshare-agreement.

[8] JetBlue and American Airlines Announce Strategic Partnership to Create More Competitive Options and Choice for Customers in the Northeast, AA.COM (Jul. 16, 2020), https://news.aa.com/news/news-details/2020/JetBlue-and-American-Airlines-Announce-Strategic-Partnership-to-Create-More-Competitive-Options-and-Choice-for-Customers-in-the-Northeast-NET-ALP-07/default.aspx.

[9] Agreement with the U.S. Department of Transportation Regarding Northeast Alliance Between American Airlines, Inc. and JetBlue Airways Corporation, U.S. DEPT. OF TRANSPORTATION (Jan. 10, 2021), https://www.transportation.gov/sites/dot.gov/files/2021-01/Agreement%20terminating%20review%20DOT-AA-B6%20with%20appendix%20011021%20website.pdf. ("DOT Agreement").

[10] DOT Agreement, *supra* note 9.

[11] DOJ Complaint, *supra* note 2, at PP. 19.

International (BOS) and the three New York City (NYC) area airports: Newark Liberty International (EWR), John F. Kennedy (JFK), and LaGuardia (LGA).

The NEA's effect on these airports is significant.[12] For example, if American and JetBlue are permitted to operate with a unified economic objective under the NEA, duopolies would emerge with the next largest player at BOS (with Delta), EWR (with United), and JFK (with Delta). Duopoly market shares at these airports range between about 50% to over 80%.[13] The dramatic change in the structures of key airports supports the significant increases in market concentration in airport-pair markets that the DOJ complaint alleges on 11 nonstop routes originating from BOS, 17 nonstop routes originating at JFK and LGA, and 98 connecting routes.[14]

Congestion at the airports most affected by the NEA further exacerbates the NEA's anticompetitive effect. For example, in past enforcement actions, the DOJ has defined distinct markets for takeoff and landing slots, highlighting the importance of slot access to competition.[15] JFK and LGA are Level 3 slot-constrained airports under the Federal Aviation Administration's slot administration program. Under the NEA, American and JetBlue pool their takeoff and landing slots, creating a duopoly with Delta at JFK and LGA with control of over 75% of total available slots.[16]

In sum, the terms of joint venture agreements like the NEA have significant anticompetitive potential on their own. But by altering the competitive structure of airports and slot markets, joint venture agreements like the NEA also stand to eliminate the competitive intensity in city- or airport-pair markets that is vital to the welfare of airline consumers and workers.

IV. Antitrust Challenges to Airline Joint Venture Agreements: Section 7 Versus Section 1 Issues

The NEA attracted strong antitrust attention. Rather than treating the joint venture like a merger and challenging it under Section 7 of the Clayton Act before it became effective, the DOJ filed suit to enjoin the NEA under Section 1 of the Sherman Act, several months after it went into operation. This is an important distinction. Proactive Section 7 challenges of joint ventures are based on threatened harm to competition. Retroactive Section 1 challenges are, in contrast, based on realized harm to competition. Regardless of whether enforcement action is taken against an anticompetitive joint venture before or after the joint venture goes into effect, the goal is always to minimize harm to consumers and workers by accounting for how the joint venture undermines competition in affected markets.

[12] Airports are not relevant antitrust markets. But their structure directly affects the city- or airport-pair markets that are defined for antitrust purposes.

[13] Airport Snapshots, BUREAU OF TRANSPORTATION STATISTICS, U.S. DEPT. OF TRANS., https://www.transtats.bts.gov/airports.asp. Queried for BOS, EWR, JFK, and LGA.

[14] DOJ Complaint, *supra* note 2, at PP. 49-50. Increases in concentration exceed the thresholds in the U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 5.3 (2010) ("Horizontal Merger Guidelines").

[15] U.S. v. US Airways Group, Inc. and AMR Corporation, Complaint, Case 1:13-cv-01236, (Aug. 13, 2013, D.D.C.), at PP. 30-21.

[16] Slot Administration – Data: Holder and Operating Reports, Fed. Avia. Admin., U.S. Dept. of Trans., https://www.faa.gov/about/office_org/headquarters_offices/ato/service_units/systemops/perf_analysis/slot_administration/data/. *See* reports: "Winter 2020/2021, JFK Holder Totals" and "Winter 2020/2021, LGA Holder Totals."

In the case of the NEA, adverse competitive effects flow from, among other sources, the elimination of flights on cooperating routes by the partner carriers, and shifts in resources between the partner carriers. However, the ex-post nature of the government's current challenge to the NEA should not distract from threatened future harms. Among other things, the NEA implicates concurrent merger proposals, which could affect the structure of airline markets that are also affected by the joint venture. Notably, any approval and consummation of a JetBlue-Spirit merger during the pendency of the DOJ litigation would fundamentally complicate the NEA picture.

For example, if the JetBlue-Spirit merger is consummated, JetBlue would likely integrate and deploy resources (e.g., airplanes, ground operations, pilots, and crew) obtained through merger for the purposes of achieving coordination under the NEA. To the extent that different types of aircraft and labor compensation structures are adopted through a Spirit acquisition, the merger could facilitate anticompetitive reductions in output under the NEA. The JetBlue-Spirit merger therefore renders the NEA a "moving target" for antitrust review because it raises the prospect of threatened future harms in addition to current harms. Accordingly, AAI believes the JetBlue-Spirit merger proceeding should be stayed until the NEA matter is fully adjudicated. The competitive effects of one cannot be adequately understood until the other is resolved.

V. Widening the Lens on Airline Joint Ventures: Assessing Effects on Both Consumers and Workers

Mergers and conduct that expand horizontal control directly affect consumers and workers. Antitrust analysis of airline competition has historically focused exclusively on consumers. Enforcers have not focused the same attention on competition in airline labor markets. Moreover, airline labor organizations have not prioritized substantive labor-side competition issues in merger proceedings, focusing instead on post-merger integration issues, such as aligning collective bargaining agreements and meshing pilot and crew seniority.

Antitrust analysis of airline joint ventures should encompass competitive effects that threaten both consumers and workers. Any anticompetitive reductions in output in passenger service product markets have the direct effect of reducing the availability and frequency of passenger service for consumers. This can increase airline fares and fees, and reduce quality of service. But airline joint ventures can also directly and adversely affect competition in labor markets by artificially depressing demand for workers. The DOJ's recent success in obtaining an injunction to block the merger of book publishers Penguin and Simon & Schuster serves as a reminder that it is essential to assess the effects of horizontal combinations on upstream supplier markets, including labor markets.

In Penguin-Simon & Shuster, the government's claim was based on the effect of the merger in creating a more powerful buyer that could depress author compensation for book advances. There, the court held that an anticompetitive reduction in output in a supplier market establishes an antitrust violation, regardless of whether there is any corresponding effect in a downstream product market.[17] The court's approach in Penguin-Simon & Shuster in regard to upstream effects on workers can and should be used in other sectors where it is called for, including airlines.

On the labor side of the market, the effects of joint venture-related anticompetitive reductions in demand for labor that result from market allocation between the partner carriers would be felt in

[17] United States v. Bertelsmann SE & Co., Slip Op. at 21 n.13, 77, 79-80, No. 1:21-cv-02886-FYP (Nov. 7, 2022).

two major ways. One is reduced employee compensation and benefits, and another is the loss of employee bargaining power. Loss of bargaining power occurs because, under the joint venture, the partner carriers have a better "walk away" option during labor negotiations, should such negotiations break down. Standing alone, each carrier would have to sacrifice flights and revenue if it is unable to come to terms with, for example, pilots. Under the joint venture, however, each can credibly threaten to shift flights to its joint-venture partner without incurring losses. Consequently, the joint venture enables the airlines to more effectively coerce pilots and other workers into accepting lower compensation levels or inferior working conditions or benefits.

When the foregoing types of labor market harms are caused by diminished competition, they are of equal concern to the antitrust laws as harm to consumers from higher fares and ancillary fees, or lower quality service. Moreover, conduct that harms employer competition for workers' services is punishable for its own sake. That is, it violates the antitrust laws without regard to whether or how its upstream labor markets effects may translate into effects in consumer markets.[18]

While the NEA may cause competitive effects in labor markets that are felt differently across different airline workforces, there is likely to be an outsized effect on pilots, where the joint venture firms may have significant buyer market power. For example, pilot pay is tied directly to flying hours and the class of aircraft flown. As a result, pilots would keenly feel any wage depression and a loss of bargaining power resulting from anticompetitive reductions in output. Moreover, constraints on pilot mobility resulting from training, certification, and seniority mean that pilots may not have viable employment alternatives to the carriers that currently employ them.

VI. Debunking Efficiencies Claims: Why Anticompetitive Airline Joint Ventures are Unlikely to be Justified by Cost Savings and Network Benefits

Expanded horizontal control achieved through airline joint ventures and mergers is often defended with arguments that coordination will produce benefits that outweigh anticompetitive effects. In the airline context, these "efficiencies" claims include both cost savings and network benefits. Cost savings are the projected savings that result, for example, from better utilization of gate space and other facilities, and increased operational efficiency on routes where the carriers coordinate. Network benefits are those efficiencies projected to accrue from post-merger capacity management and enhanced connectivity for consumers.[19] They can arise from adding destinations to the network, offering more round-trip options on existing routes, converting interline service into single line service, and scheduling improvements. However, a closer look at various types of efficiencies claims involving enhanced horizontal control in airline markets calls their validity into question.

A. Antitrust is Inherently Skeptical of Efficiencies Claims

First, antitrust is fundamentally skeptical of efficiencies. For example, the Horizontal Merger Guidelines make clear that efficiencies must be "merger-specific and cognizable (i.e., verifiable)," and related to "improved quality, enhanced service, or new products."[20] The Horizontal Merger

[18] *See* Comments of the American Antitrust Institute, Public Workshop on Competition in Labor Markets, U.S. DOJ Antitrust Div. (Sept. 23, 2019), https://www.antitrustinstitute.org/wp-content/uploads/2019/10/AAI-Labor-Workshop-comments-10.23.19.pdf. ("AAI Comments").

[19] Network efficiencies are typically estimated by comparing predicted demand for the merged carriers' services under post-merger schedules with demand for services assuming the carriers remained standalone.

[20] Horizontal Merger Guidelines, *supra* note 14, at §10.

Guidelines further clarify that merger-specific and cognizable efficiencies "do not arise from anticompetitive reductions in output or service."[21]

Savings from labor cost reductions can contribute to the overall claimed cost savings resulting from an airline joint venture agreement. But the partner carriers may not define such labor cost savings to include reduced employee compensation from anticompetitive cuts or reductions to service on routes where the partner carriers coordinate, or shifting employees from the lower-cost airline partner to routes where the partner carriers coordinate. If parties attempted to do so, such cost savings would not be recognized under the Horizontal Merger Guidelines as merger-specific or cognizable.[22]

A second factor that mitigates against the consideration of claimed efficiencies resulting from enhanced horizontal control is high market concentration. For example, the network model of the legacy carriers concentrates the operations of a carrier at select hub cities to enable service to various destinations that radiate from those hubs. "Hub dominance" serves to constrain competition by increasing the risk of predation by the dominant carrier and facilitating the hoarding of takeoff and landing slots at congested airports. This prevents smaller, rival carriers from gaining the access and scale necessary to provide service. Under such circumstances, joint venture-coordinating carriers that are protected by hub-dominance have little incentive to realize claimed efficiencies, much less pass them on to consumers or workers.

B. "Out-of-Market" Efficiencies Claims are Rarely Cognizable

A third concern surrounding claimed efficiencies from enhanced horizontal control in airline markets is that competitive benefits on the consumer-facing side of a market do not offset the harms on the labor side of the market. Indeed, antitrust courts reviewing efficiencies claims are proscribed from attempting to calculate such "tradeoffs" because, for both legal and practical reasons, they may traffic only in partial equilibrium analysis, not general equilibrium analysis.[23] The upshot is that courts cannot balance harms in one well-defined market against claimed benefits in a different market.[24] Costs savings that redound only to the benefit of consumers in an output market therefore cannot save a merger that causes anticompetitive effects in a labor market. While the agencies, in their exercise of prosecutorial discretion, have the ability to consider such "out of market" efficiencies claims, they rightly do so only sparingly, and only when threatened harms from a merger are exceedingly small.[25]

Fourth, airlines have strong incentives to cast any anticompetitive reductions in output resulting from enhanced horizontal control under a joint venture as necessary to achieve "system-wide" efficiencies. That is the notion that adverse effects in some city- or airport-pair markets are justified

[21] *Id.*

[22] *See* Horizontal Merger Guidelines *supra* note 14, at §12 (example 24). *See also* Federal Trade Comm'n. and U.S. Dept. of Justice, Antitrust Guidelines for Collaborations Among Competitors, at § 3.36(a) (efficiency claims "arising from anticompetitive output or service reductions" are "insufficient as a matter of law").

[23] See AAI Comments, supra note 18. *See also*, Jonathan Baker, *The Antitrust Paradigm* 191 (2019) ("[O]nce the analysis extends beyond the market in which harm is alleged, there may be no principled stopping point short of undertaking what is unrealistic if not impossible: a general equilibrium analysis of harms and benefits throughout the entire economy.").

[24] AAI Comments, *supra* note 18.

[25] Horizontal Merger Guidelines, *supra* note 14, at §10, p. 30, n.14.

by cost-savings and network benefits achieved elsewhere in the networks of the coordinating airlines. This rationale is just another type of out-of-market efficiencies claim, which is not cognizable. Moreover, such network benefits have proven to be elusive. For example, AAI's retrospective analysis of past airline mergers reveals a failure to deliver on past efficiencies claims. This includes evidence of protracted and costly system integrations and quality problems. It also includes evidence of unrealized promises of greater connectivity after the Delta-Northwest, United-Continental, and Southwest-AirTran mergers.[26]

For example, the foregoing airlines cut airport-pairs from their systems post-merger and LCCs cut a substantially higher percentage of airport-pairs than did legacy airlines.[27] Moreover, recent AAI analysis of the proposed Spirit-Frontier merger found that from 2015-2021, the two carriers exited more routes than they entered, which further supports the notion that claims of enhanced connectivity are elusive, at best.[28] The reality is that airlines want to only serve profitable routes. That profit calculus can change quickly, and frequently, because is often subject to factors beyond the carriers' control, such as broader economic activity, competition, and city-specific economic development. Claims of network benefits resulting from enhanced horizontal control, therefore, should accordingly be discounted by enforcers and courts.

Finally, much like American and JetBlue have done, airlines may propose route "carve-outs" to address anticompetitive effects in some parts of their combined networks. However, such carveouts could disrupt the network economics that support claims of expanded connectivity under the NEA or other joint ventures.[29] This should give antitrust enforcers yet more pause in considering whether to exercise discretion to accept a negotiated remedy that would tolerate harm to competition in some markets in exchange for system-wide, out-of-market efficiencies. Such an approach is not only legally unsound and non-cognizable but would likely prove ineffective.

VII. Conclusion

AAI urges enforcers and courts to view current and future proposals to enhance horizontal control in airline markets with great skepticism. Anticompetitive agreements that eliminate incentives for the partner carriers to compete independently stand to further tighten the oligopoly that dominates the domestic passenger service, with adverse implications for both consumers and workers. The time for realistic and holistic assessments of the anticompetitive effects of such agreements is long overdue.

[26] Diana L. Moss, *Delivering the Benefits? Efficiencies and Airline Mergers*, American Antitrust Inst. (Nov. 21, 2013), at 7-9, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2547673.

[27] Id., at 13.

[28] Letter from the American Antitrust Institute to AAG Kanter re: Re: Antitrust Review of the Spirit Airlines-Frontier Airlines Merger (Apr. 5, 2022), https://www.antitrustinstitute.org/wp-content/uploads/2022/04/AAI_Spirit_Frontier_Letter-to-DOJ_4.5.22.pdf.

[29] DOJ Complaint, *supra* note 2, at PP. 80.