Planes, Trains, and Inefficiencies: An Analysis of the Proposed Delta-Northwest Airlines Merger & Its Effects on Consumers

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By: Richard R. Bradley

Recently, officials at Delta Airlines announced a proposed merger between Delta Airlines and Northwest Airlines. The cumulative effect of the proposed merger would create the largest airline in the world. Delta’s pilot union declared that “[t]he merged Delta will be a more stable, financially durable and investable airline that will provide benefit to Delta and Northwest employees, the communities we serve and, importantly, the traveling public.” Many, however, are not so optimistic. This article will briefly discuss: (1) airline deregulation and current market conditions in the airline industry; (2) possible antitrust ramifications; and (3) rights consumers have when “flying the friendly skies.”

I. Background

Deregulation of the airline industry in the United States commenced with the passage of the Airline Deregulation Act of 1978. Deregulation served to stimulate competition and paved the way for small, low-cost carriers to enter the market, such as

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1 B.B.A. (Finance) and B.A. (Economics), 2004, The University of Texas at Austin, J.D., University of Houston Law Center, 2007, Briefing Attorney in the Chambers of the Honorable Justice Dori Contreras Garza, Thirteenth Court of Appeals. The author was previously employed as an intern with the United States Department of Justice, Antitrust Division. The views expressed in this article are not purport to reflect those of the Thirteenth Court of Appeals or the United States Department of Justice, Antitrust Division.


4 “In 1945, the major airlines flew 3.3 billion revenue passenger miles (RPMs). By the mid 1970s, when deregulation was beginning to develop, the major carriers flew 130 billion RPMs. By 1988, after a decade of deregulation, the number of domestic RPMs had reached 330 billion.” The Airline Industry, available at http://adg.stanford.edu/aa241/intro/airlineindustry.html (last visited Apr. 15, 2008).
Southwest Airlines and JetBlue Airlines. Deregulation also resulted in an increase in airline productivity and a reduction in costs to the consumer. However, the unintended consequence of airline deregulation has been globalization and consolidation. Many of today’s airline carriers have entered into alliances, partnerships, and, in some cases, merged with other carriers. In the past twenty years, we have seen American Airlines merge with Trans-World Airlines, the former U.S. Air merged with America West Airlines to form U.S. Airways, and numerous proposed mergers, including discussion about a potential merger between Continental Airlines and United Airlines. The airline industry, however, has always been a volatile industry characterized by numerous bankruptcy filings and government bailouts. In fact, we have recently seen three

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5 The Airline Deregulation Act of 1978 ("ADA") was enacted to ensure "'maximum reliance on competitive market forces' [which] would best further 'efficiency, innovation, and low prices' as well as 'variety [and] quality . . . of air transportation' and "'[t]o ensure that the States would not undo [this] deregulation with regulation of their own." *Morales v. Trans World Airlines*, 504 U.S. 374, 378, 389-91 (1992) (quoting 49 U.S.C. app. § 1302(a)(4), (9) (1988)); see also Marvin S. Cohen, *Remarks at Deregulation and Expanding Antitrust Liability: A New Battleground For Private Antitrust Litigants*, 53 ANTITRUST L.J. 221, 222 (1984) ("When I was involved with getting the airline industry deregulated, we were quite hopeful that competition would substitute for regulation and that much of the antitrust enforcement would be done by private litigation.").


7 See *The Airlines Industry*, supra note 4.

8 In fact, hundreds of airlines have entered into alliances, such as marketing agreements, code-shares, franchises, and equity transfers. *Id.*


Currently, we are seeing numerous market failures in the airline industry. Increased oversight by the Federal Aviation Administration in response to the Southwest Airlines safety inspection fiasco, increasing costs of jet fuel, increased competition for access to gates at airports, and congestion are among the many issues airlines plaguing the airline industry. Airlines have revamped their business models, sought to merge business operations, filed for bankruptcy protection, and, ultimately increased airfare for consumers. As a result of these phenomena, airlines have seen a record number of cancelled flights, customer complaints, lost baggage, and other problems. The issues currently plaguing airlines have many airlines teetering on the cusp of bankruptcy. In fact, this has been the case for many years since deregulation.

II. Potential Antitrust Ramifications

11 See Yamanouchi & Johnson, supra note 10.  
13 See Kahn, supra note 6 (“The recent wave of mergers and airline failures has made the [airline] industry more concentrated at the national level than it was before deregulation.”). Kahn further comments on the “hub-and-spoke” approach used by airlines, which “tends to insulate an airline from direct competition on short trips originating or terminating at its hub.” Id. As a result of this approach “pricing may well become less competitive in the future.” Id. Therefore, the lessening of price competition will invariably result in an increase in prices for airfare.  
14 Traveler complaints rose by sixty percent in 2007. Up, Up and Away: Airline Complaints Soaring, ASSOCIATED PRESS, Apr. 7, 2008, available at http://www.msnbc.msn.com/id/23991380/ (last visited Apr. 14, 2008). Traveler complaints rose in 2007 for fifteen of the sixteen major U.S. airlines. Id. More than one-quarter of all flights arrived late, the rate of passengers bumped from overbooked flights, and bags lost, stolen, or damaged also increased in 2007. Id. I do recognize that the airlines have seen the number of passengers flying on its planes increase exponentially since the enactment of the ADA, which is one, albeit slight, explanation for the increase in customer complaints.
In response to the aforementioned issues affecting the airline industry, many have invariably relied on the “healing power” of the merger process to cure their cash flow woes. What we have seen in the subsequent years to the Airline Deregulation Act of 1978 is an increase of concentration in the airline industry. Because of this concentration and for many other factors, it is likely that government regulators, particularly the U.S. Department of Justice, Antitrust Division (“DOJ”), will not endorse the proposed merger between Northwest and Delta. In applying the DOJ’s horizontal merger guidelines, which govern mergers between entities within the same industry, the Northwest-Delta merger would like fail on several grounds.

After defining the relevant product and geographic markets (likely to encompass domestic air transportation and a small percentage of international air transportation), antitrust officials will likely conclude that the merger will result in a Herfindahl-Hirschman Index (“HHI”), a measure for calculating market concentration, value exceeding 1800. This value describes the defined product and geographic markets as highly concentrated and supports a presumption that the proposed merged entity possesses market, or monopoly, power in the given product and geographic markets.

15 In analyzing a potential merger between two companies within the same industry, the U.S. Department of Justice (“DOJ”), typically applies its horizontal merger guidelines. The guidelines involve multiple steps, which include the following: (1) product and market definitions using the 5% SSNIP (small, but significant, non-transitory increase in price) test; (2) calculation of market shares using the Herfindahl-Hirschman Index (“HHI”) for market concentration; (3) analysis of the potential lessening of competition through coordinated and unilateral effects; (4) an analysis of entry alternatives, including timeliness, likelihood, and sufficiency of entry; and (5) failing firm analysis. U.S. DEP’T OF JUSTICE, 1992 HORIZONTAL MERGER GUIDELINES (revised Apr. 8, 1997), reprinted in JOHN J. FLYNN, ET AL., ANTITRUST: STATUTES, TREATIES, REGULATIONS, GUIDELINES, POLICIES 258-289 (5th ed. 2005).

16 Monopoly power, also referred to as market power, is “the ability of a firm (or group of firms) to raise and maintain price above the level that would prevail under competition . . . . The exercise of market power leads to reduced output and loss of economic welfare.” ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, GLOSSARY OF INDUSTRIAL ORGANISATION ECONOMICS AND COMPETITION LAW, at 57, available at http://www.oecd.org/dataoecd/8/61/2376087.pdf (last visited Apr. 17, 2008). The actual or potential exercise of market power is used to determine whether a substantial lessening of competition exists or is likely to occur. Id.
The proposed merger will likely also encounter numerous obstacles with respect to unilateral and coordinated effects analysis. The proposed merger gives the potential newly-merged entity significant incentives to phase out of planes (especially in light of the FAA’s recent increased safety oversight), reduce the number of flights flown to a specific hub, reduce the number of flights to rural areas, increase costs to the consumers to finance the merger and other costs previously borne by either Northwest or Delta, or layoff employees performing overlapping tasks. There are likely numerous other effects to consider, but these effects would likely result in decreased output and an increase in costs to the consumer. Because of the reduced output and cost increase, other carriers are likely to follow suit given the airline industry is competitive and price responsive.17 Therefore, the coordinated effects of this merger would be an all-out price war between the airlines with the newly-merged airline exerting undue influence on the market price; thus, increasing the likelihood of a dramatic rise in prices for airfare. As a result of this influence, many more airlines will likely seek to merge and further concentrate the market or file for bankruptcy protection, potentially requiring the federal government to once again step in and provide subsidies. Furthermore, we are likely to see a drastic reduction in customer service provided by the carriers because of their desire to cut costs and remain competitive. In fact, over the past twenty years, the majority of the airlines have migrated from providing passengers with meals and beverages on flights, to merely

17 See Roger W. Jones, U.S. Dep’t of Justice, Antitrust Division, Transportation, Energy, and Agricultural Section, Predation in the Airline Industry, June 12, 1997, available at http://www.justice.gov/atr/public/speeches/1188.htm (last visited Apr. 17, 2008) (noting that low-cost airlines have repeatedly lowered costs to drive competitors from flying a certain route). The upshot of the DOJ’s findings are that once the competitor is driven from the route there is nothing stopping the presumed low-cost airline from increasing its prices to recoup the losses sustained during the “price war” with the competitor. In addition, given all of the problems in the current market, there is a strong incentive to collude with other airlines to maintain price levels to recoup costs of high priced jet fuel and various other inefficiencies endemic to the industry.
beverages and peanuts on flights, to potentially nothing at all. Moreover, airline complaint centers have experienced a historic increase in the number of complaints lodged and it will likely only get worse with further concentration in the market.\textsuperscript{18}

Based on these findings alone, it is unlikely that the DOJ will approve this merger. However, in a market of rising fuel costs, increasing costs to ensure safety, and in an overall economic downturn, it is likely that many more airlines will seek to merge to further concentrate the market in an attempt to remain profitable even though many of the current carriers are horribly inefficient and a potential merging of two inefficient entities will only serve to exacerbate the inefficiencies in the airline industry. Ultimately, consumers are most likely to bear the burden of the airline industry’s inefficiencies.

II. \textbf{What Can Consumers Do To Combat the Market Power of the Airlines?}

In light of the current state of the airline industry, consumer rights activists have intensified their efforts to lobby state legislatures for an airline consumers’ bill of rights.\textsuperscript{19}

\textsuperscript{18} \textit{See supra} note 14.

\textsuperscript{19} Ed Hewitt, \textit{The Airline Passenger’s Bill of Rights: Being Stuck for Hours Usually Prompts Such Talk, But This Could be Different}, Feb. 16, 2007, \textit{available} at http://www.msnbc.msn.com/id/17173370/ (last visited Apr. 17, 2008). In August 2007, New York became the first state to enact an airline passenger bill of rights. See Press Release, New York State, Governor Spitzer Signs Airline Passenger Bill of Rights (Aug. 2, 2007), \textit{available} at http://www.state.ny.us/governor/press/0802072.html (last visited Apr. 17, 2008) (stipulating, among other things, that “all airlines operating out of New York airports are required to provide passengers with food, water, fresh air, power, and working restrooms on any flight that has left the gate and been on the tarmac for more than three hours.”). However, the Second Court of Appeals in \textit{Air Transport Association of America, Inc. v. Cuomo}, concluded that the substantive provisions of the New York passengers’ bill of rights were preempted by the Airline Deregulation Act of 1978, specifically the following provision:

\begin{quote}
Except as provided in this subsection, a State, political subdivision of a State, or political authority of at least 2 States may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service of an air carrier that may provide air transportation under this subpart.
\end{quote}

\textit{Cuomo}, No. 07-5771-cv, slip op. at 6 (2d Cir. Mar. 25, 2008), available at http://www.ca2.uscourts.gov:8080/isysnative/RDpcT3BpbnNcT1B0XDA3LTU3NzEvY3Zfb3BuLnBkZg=/07-5771-cv_opn.pdf#xml=http://www.ca2.uscourts.gov:8080/isysquery/irlec47/25/hilite (citing 49 U.S.C. § 41713(b)(1)). Therefore, it appears that the only way an airline passengers’ bill of rights would
Without a bill of rights, airline passengers are often left to their own devices to rectify a myriad of problems they encounter with the airlines. There are no laws on the books that require airlines to compensate travelers for flight delays or cancellations caused by weather or mechanical problems. Such compensation is at the discretion of the carrier, which, in current times of financial difficulty, is extremely unlikely. Airlines are, however, required to compensate passengers who have a reservation but are denied boarding, which is known as overbooking. With respect to overbooking, federal law provides the following: (1) no compensation if alternative transportation gets a passenger to their destination within one hour of the original scheduled arrival; (2) the equivalent of the passenger’s one way fare up to a maximum of $200 for substitute domestic flights that arrive between one and two hours from the original scheduled arrival time or for

overcome a preemption presumption would be if Congress decides to act because any action on the part of a state will likely affect the “price, route or service of an air carrier.” See 49 U.S.C. § 41713(b)(1). The states are essentially rendered helpless to rectify the plight of airline consumers because of the preemption doctrine.

20 See 14 C.F.R. §§ 250.5 (2003) (compensation amount for passengers denied boarding involuntarily), 250.8 (1984) (noting that: (1) the airline must provide a passenger eligible for denied boarding compensation with “cash or an immediately negotiable check” on the day and place the denied boarding occurs), 250.9 (2003) (criteria for denied boarding compensation). Carriers are also authorized by law to offer free or reduced rate air transportation in lieu of cash if (1) the value of the transportation exceeds the cash payment otherwise required, and (2) the carrier informs the passenger of the amount of cash compensation otherwise due. Id. § 250.5. The Code of Federal Regulations does not require the airline to provide compensation in addition to getting the passenger to his or her destination; moreover, the compensation afforded is often a mere pittance of the value of the time lost by the passenger (i.e. nonrefundable tours, business meetings that cannot be rescheduled, etc.). Id. § 250.9. Section 250.9 merely provides that “if the airline cannot arrange ‘alternate transportation’ . . . for the passenger, the compensation is doubled ($400 maximum). . . . Acceptance of the compensation may relieve (name of air carrier) from any further liability to the passenger caused by its failure to honor the confirmed reservation. However, the passenger may decline the payment and seek to recover damages in a court of law or in some other manner.” Id. Compare 14 C.F.R. §§ 250.5 with Commission Regulation 261/2004, arts. 4-7, 2004 O.J. (L 046), available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004R0261:EN:HTML (last visited Apr. 18, 2008). European Parliament Regulation (EC) 261/2004 provides three levels of compensation for passengers who are delayed or denied boarding involuntarily: (1) in the event of long delays, typically two hours or more, passengers are entitled to free meals and refreshments, two free telephone calls, telex or fax machines, or emails; (2) if departure is delayed until the following day, passengers must be afforded hotel accommodation and transport between the airport and the hotel; and (3) when the delay lasts for longer than five hours, passengers may opt for a full refund of the ticket with a return flight to the first point of departure. See Commission Regulation 261/2004, arts. 4-7, 2004 O.J. (L 046).
substitute international flights that arrive one to four hours after the original scheduled
arrival time; and (3) if the delay is more than two hours for a domestic flight or four
hours for an international flight, compensation doubles to $400. In some instances, a
passenger may be eligible to request a refund for the remaining part of their trip even if
the trip was an otherwise nonrefundable ticket. It is also noteworthy to mention that U.S.
airline passengers are entitled to a maximum of $3,000 in compensation for lost,
damaged, or stolen baggage.  

Therefore, it is wise to not pack laptop computers, valuable jewelry or clothing, or any other items of high intrinsic value because the airlines are unlikely to provide adequate compensation to replace such items; moreover, packing such items in baggage to be checked in only increases the risk that these items will be stolen, especially considering baggage is handled by several individuals—
Transportation Security Administration workers, loading and unloading by airline
baggage handlers—before arriving safely at a passenger’s destination. Furthermore,
airlines are not obligated by law to compensate passengers for delayed baggage.

Other than the aforementioned provisions, U.S. airline passengers are essentially
left to negotiate, complain, yell, and scream at airline customer service representatives to
rectify a problematic situation. With the airline industry struggling to remain

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22 Airlines are generally exempt for any state or local consumer protection laws. See Morales, 504 U.S. at
390-91; see also Letter from the Nat’l Ass’n of Attorneys General to Senators Trent Lott, Thomas Daschle,
is the Department of Transportation. See Morales, 504 U.S. at 390-91. On the other hand, international
flights are governed by the Warsaw Convention. See generally El Al Isr. Airlines v. Tsui Yuan Tseng, 525
U.S. 155 (1999) (holding that a plaintiff’s claim is governed by the Warsaw Convention, which preempts
state law claims arising out of international air travel). Section 19 of the Warsaw Convention imposes
liability on air carriers for damages occasioned by delay in the transportation of passengers; however, an air
carrier can escape liability if it proves that it took all necessary measures to avoid the damages or that it
was impossible for him or them to take such measures. See Lee v. Am. Airlines, Inc., No. 3:01-CV-1179-P,
financially solvent, problems with cancellations, delays, and lost baggage appear to only get worse. It is incumbent upon passengers to be aware of compensation of which they are entitled to and to pack their patience when traveling on U.S. airlines. Essentially, the moral of the story is that passengers must hone their negotiation skills and read the contract accompanying their purchased ticket because most of the decisions pertaining to compensation are at the discretion of the airlines.

It is clear to this author that deregulation combined with the current economic downturn and the possibility of government bailouts for the industry has created perverse incentives for airlines to operate inefficiently. Given the current status of the industry, it follows that airlines will continually attempt to merge business operations or file for bankruptcy protection to remain profitable. Ultimately, airline passengers will bear the brunt of the market failures that exist in the airline industry, as airlines pass on the costs of their inefficiencies to their consumers. The Northwest-Delta proposed merger will only serve to exacerbate the problems in the industry. Market concentration is not the answer, nor is increased prices or reduced customer service. Maybe it is time for the airline industry to rethink their business models, especially with respect to outdated reservation systems, the traditional “hub-and-spoke” approach, and asset allocation. The down side is that no matter how the airlines conduct business, they essentially have monopoly power on long distance travel. Until a viable competitor emerges in the long-


24 See 14 C.F.R. 223.11 (1983) (“Air carriers may charge any rate or fare for interstate and overseas air transportation.”).

25 For more information on the “hub-and-spoke” approach, see 14 C.F.R. § 398.2 (1995).
distance travel product market, i.e. high speed rail, similar to that in Europe and Japan, and forces the airlines to streamline their processes to become more competitive, it is likely we will continue to see mergers and bankruptcy filings in the airline industry to the detriment of consumers.