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AIRLINE MERGERS

Issues Raised by the Proposed Merger of United and Continental Airlines

Statement for the Record by Susan Fleming,
Director, Physical Infrastructure Issues



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Highlights of [GAO-10-778T](#), testimony before the Committee on Commerce, Science, and Transportation, U.S. Senate

Why GAO Did This Study

Earlier this month, United Air Lines (United) and Continental Airlines (Continental) announced plans to merge the two airlines and signed a merger agreement. This follows the acquisition of Northwest Airlines by Delta Air Lines (Delta) in 2008, which propelled Delta to become the largest airline in the United States. This latest merger, if not challenged by the Department of Justice (DOJ), would surpass Delta's merger in scope to create the largest passenger airline in terms of capacity in the United States. The passenger airline industry has struggled financially over the last decade, and these two airlines believe a merger will strengthen them. However, as with any proposed merger of this magnitude, this one will be carefully examined by DOJ to determine if its potential benefits for consumers outweigh the potential negative effects.

At the Committee's request, GAO is providing a statement for the record that describes (1) an overview of the factors that are driving mergers in the industry, (2) the role of federal authorities in reviewing merger proposals, and (3) key issues associated with the proposed merger of United and Continental. To address these objectives, GAO drew from previous reports on the potential effects of the proposed merger between Delta and Northwest and the financial condition of the airline industry, and analyzed Department of Transportation (DOT) airline operating and financial data.

View [GAO-10-778T](#) or key components. For more information, contact Susan Fleming at (202) 512-2834 or flemings@gao.gov.

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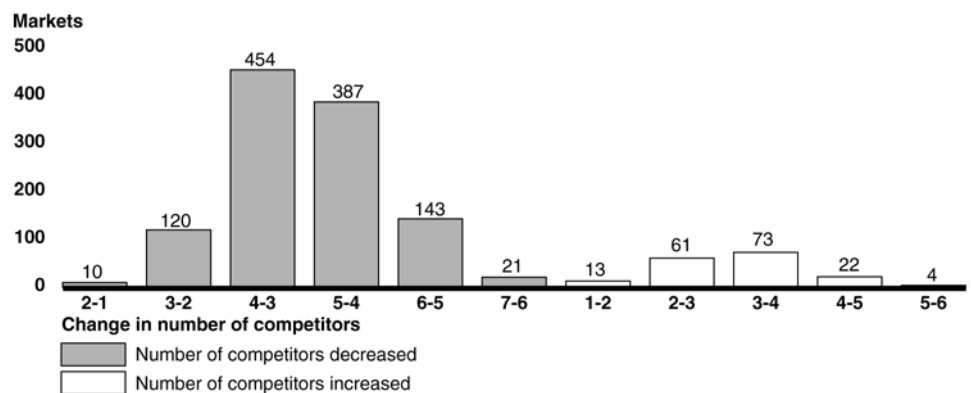
What GAO Found

As GAO has previously reported, airlines seek to merge with or acquire other airlines to increase their profitability and financial sustainability, but must weigh these potential benefits against operational costs and challenges. The principal benefits airlines consider are cost reductions—by combining complementary assets, eliminating duplicate activities, and reducing capacity—and increased revenues from higher fares in existing markets and increased demand for more seamless travel to more destinations. Balanced against these potential benefits are operational costs of integrating workforces, aircraft fleets, and systems.

DOJ's antitrust review is a critical step in the airline merger and acquisition process. DOJ uses an integrated analytical framework set forth in the *Horizontal Merger Guidelines* to determine whether the merger poses any antitrust concerns. Under that process, DOJ assesses the extent of likely anticompetitive effects of reducing competition in the relevant markets—in this case, between cities or airports. DOJ further considers the likelihood that airlines entering these markets would counteract any anticompetitive effects. It also considers any efficiencies that a merger or acquisition could bring—for example, consumer benefits from an expanded route network. Finally, it examines whether one of the airlines proposing to merge would fail and its assets exit the market in the absence of a merger.

One of the most important issues in this merger will be its effect on competition in the airline industry. For example, GAO's analysis of 2009 ticket data showed that combining these airlines would result in a loss of one effective competitor (defined as having at least 5 percent of total traffic between airports) in 1,135 markets (called airport pairs) affecting almost 35 million passengers while creating a new effective competitor in 173 airport pairs affecting almost 9.5 million passengers (fig.). However, in all but 10 of these airports pairs there is at least one other competitor.

Change in Effective Competitors for Airport-Pair Markets from United-Continental Combination, 2009



Source: GAO Analysis of DOT Origin and Destination Ticket Data.

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to provide a statement for the record on the potential implications of the merger proposal recently announced by United Air Lines (United) and Continental Airlines (Continental). Earlier this month, these two airlines announced plans for United to merge with Continental through a stock swap the airlines valued at \$8 billion. This follows the acquisition of Northwest Airlines (Northwest) by Delta Air Lines (Delta) in 2008, which propelled Delta to become the largest airline in the United States. The United-Continental merger, if not challenged by the Department of Justice (DOJ), would surpass Delta's in scope to create the largest passenger airline in terms of capacity in the United States. However, as with any proposed merger of this magnitude, this one will be carefully examined by DOJ to determine if its potential benefits for consumers outweigh the potential negative effects.

Extensive research and the experience of millions of Americans underscore the benefits that have flowed to most consumers from the 1978 deregulation of the airline industry, including dramatic reductions in fares and expansion of service. These benefits are largely attributable to increased competition from the entry of new airlines into the industry and established airlines into new markets. At the same time, however, airline deregulation has not benefited everyone; some communities—especially smaller communities—have suffered from relatively high airfares and a loss of service. We have been analyzing aviation competition issues since the enactment of the Airline Deregulation Act of 1978.¹ Our work over the last decade has focused on the challenges to competition and industry performance, including the financial health of the airline industry, the growth of low-cost airlines, changing business models of airlines, and prior mergers.² In the airline context, DOJ has the primary responsibility to evaluate most mergers in order to carry out its antitrust responsibilities.³ In its review, DOJ considers a number of factors,

¹Pub. L. No. 95-504, 92 Stat. 1705.

²A list of related GAO products is attached to this statement.

³Under the Hart-Scott-Rodino Act, an acquisition of voting securities and/or assets above a set monetary amount must be reported to DOJ (or the Federal Trade Commission for certain industries) so the department can determine whether the merger or acquisition poses any antitrust concerns. 15 U.S.C. § 18a(d)(1). Both DOJ and the Federal Trade Commission have antitrust enforcement authority, including reviewing proposed mergers and acquisitions. DOJ is the antitrust enforcement authority charged with reviewing proposed mergers and acquisitions in the airline industry.

including increases in market concentration; potential adverse effects on competition; the likelihood of new entry in affected markets and possible counteraction of anticompetitive effects that the merger may have posed; verified “merger specific” efficiencies or other competitive benefits; and whether, absent the merger, one of the airlines is likely to fail and its assets exit the market.

This statement presents (1) an overview of the factors that are driving mergers in the airline industry, (2) the role of federal authorities in reviewing merger proposals, and (3) key issues associated with the proposed merger of United and Continental. This statement is based on two previously issued reports—our 2008 report for this Committee on airline mergers and our 2009 report on the financial condition of the airline industry and the various effects of the industry’s contraction on passengers and communities⁴—as well as our other past work on aviation issues. In addition, we conducted some analysis of the proposed United and Continental merger, including analysis of the airlines’ financial, labor, fleet, and market conditions.

To identify the factors that help drive mergers in the airline industry, we relied on information developed for our 2008 and 2009 reports on the airline industry, updated as necessary. To describe the role of federal authorities, in particular DOJ and the Department of Transportation (DOT), in reviewing airline merger proposals we relied on information developed for our 2008 report, also updated as necessary.⁵ To identify the key issues associated with the proposed merger of United and Continental, we reviewed airline merger documents and financial analyst reports and analyzed data submitted by the airlines to DOT (Bureau of Transportation Statistics financial Form 41, origin and destination ticket, and operations data). We also analyzed airline schedule data. We assessed the reliability of these data by (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for

⁴GAO, *Airline Industry: Potential Mergers and Acquisitions Driven by Financial and Competitive Pressures*, [GAO-08-845](#) (Washington, D.C.: July 31, 2008); and *Commercial Aviation: Airline Industry Contraction Due to Volatile Fuel Prices and Falling Demand Affects Airports, Passengers, and Federal Government Revenues*, [GAO-09-393](#) (Washington, D.C.: Apr. 21, 2009).

⁵[GAO-08-845](#).

the purposes of this report. We conducted this audit work in May 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

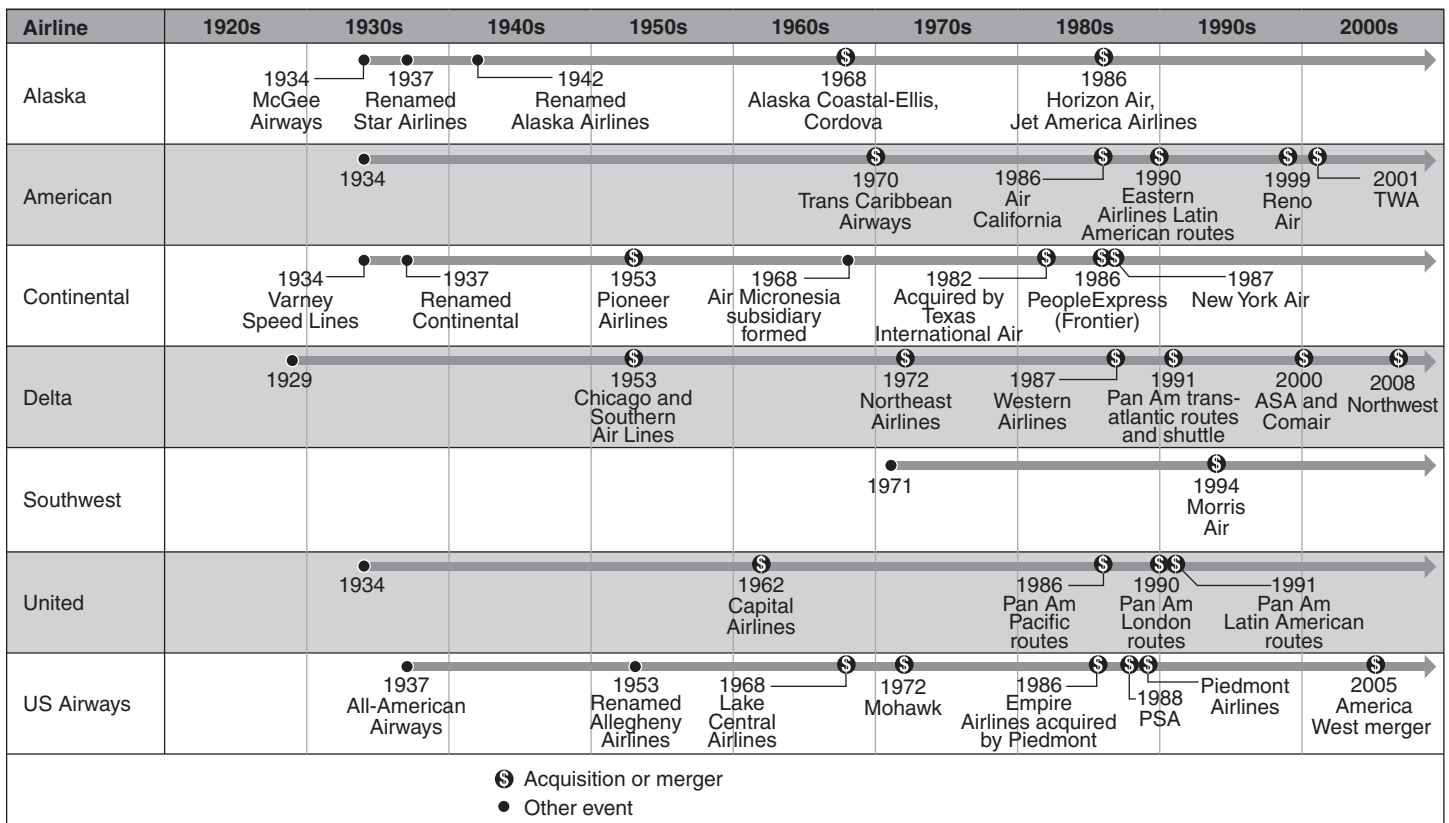
On May 3, 2010, United and Continental announced an agreement to merge the two airlines. The new airline would retain the United name and headquarters in Chicago while the current Continental Chief Executive Officer would keep that title with the new airline. The proposed merger will be financed exclusively through an all-stock transaction with a combined equity value of \$8 billion split roughly with 55 percent ownership to United shareholders and 45 percent to Continental shareholders. The airlines have not announced specific plans for changes in their networks or operations that would occur if the proposed merger is not challenged by DOJ.

The airline industry has experienced considerable merger and acquisition activity since its early years, especially immediately following deregulation in 1978 (fig. 1 provides a timeline of mergers and acquisitions for the seven largest surviving airlines). A flurry of mergers and acquisitions during the 1980s, when Delta Air Lines and Western Airlines merged, United Airlines acquired Pan Am's Pacific routes, Northwest acquired Republic Airlines, and American Airlines and Air California merged. In 1988, merger and acquisition review authority was transferred from the Department of Transportation (DOT) to DOJ. Since 1998, despite tumultuous financial periods, fewer mergers and acquisitions have occurred. In 2001, American Airlines acquired the bankrupt airline TWA, in 2005 America West acquired US Airways while the latter was in bankruptcy, and, in October 2008, Delta acquired Northwest. Certain other attempts at merging in the last decade failed because of opposition from DOJ or from employees and creditors. For example, in 2000, an agreement was reached that allowed Northwest to acquire a 50 percent stake in Continental (with limited voting power) to resolve the antitrust suit brought by DOJ against Northwest's proposed acquisition of a controlling interest in Continental.⁶ A proposed merger of

⁶GAO, *Aviation Competition: Issues Related to the Proposed United Airlines-US Airways Merger*, GAO-01-212 (Washington, D.C.: Dec. 15, 2000) p. 10, footnote 6.

United Airlines and US Airways in 2000 also resulted in opposition from DOJ, which found that, in its view, the merger would violate antitrust laws by reducing competition, increasing air fares, and harming consumers on airline routes throughout the United States. Although DOJ expressed its intent to sue to block the transaction, the parties abandoned the transaction before a suit was filed. More recently, the 2006 proposed merger of US Airways and Delta fell apart because of opposition from Delta’s pilots and some of its creditors, as well as its senior management.

Figure 1: Highlights of Domestic Airline Mergers and Acquisitions



Sources: Cathay Financial and airline company documents.

Since deregulation in 1978, the financial stability of the airline industry has become a considerable concern for the federal government owing, in part, to the level of financial assistance it has provided to the industry by assuming terminated pension plans and other forms of assistance. Between 1978 and 2008, there have been over 160 airline bankruptcies. While most of these bankruptcies affected small airlines that were

eventually liquidated, 4 of the more recent bankruptcies (Delta, Northwest, United, and US Airways) are among the largest corporate bankruptcies ever, excluding financial services firms. During these bankruptcies, United and US Airways terminated their pension plans and \$9.7 billion in claims was shifted to the Pension Benefit Guarantee Corporation (PBGC).⁷ Furthermore, to respond to the shock to the industry from the September 11, 2001, terrorist attacks, the federal government provided airlines with \$7.4 billion in direct assistance and authorized \$1.6 billion (of \$10 billion available) in loan guarantees to six airlines.⁸

Although the airline industry has experienced numerous mergers and bankruptcies since deregulation, growth of existing airlines and the entry of new airlines have contributed to a steady increase in capacity, as measured by available seat miles. Previously, we reported that although one airline may reduce capacity or leave the market, capacity returns relatively quickly.⁹ Likewise, while past mergers and acquisitions have, at least in part, sought to reduce capacity, any resulting declines in industry capacity have been short-lived, as existing airlines have expanded or new airlines have expanded. Capacity growth has slowed or declined just before and during recessions, but not as a result of large airline liquidations.

⁷PBGC was established under the Employee Retirement Income Security Act of 1974 (ERISA) and set forth standards and requirements that apply to defined benefit plans. PBGC was established to encourage the continuation and maintenance of voluntary private pension plans and to insure the benefits of workers and retirees in defined benefit plans should plan sponsors fail to pay benefits. PBGC operations are financed, for example, by insurance premiums paid by sponsors of defined benefit plans, investment income, assets from pension plans trusted by PBGC, and recoveries from the companies formerly responsible for the plans.

⁸The six airlines receiving loan guarantees were Aloha, World, Frontier, US Airways, ATA, and America West.

⁹GAO, *Commercial Aviation: Bankruptcy and Pensions Problems Are Symptoms of Underlying Structural Issues*, [GAO-05-945](#) (Washington, D.C.: Sept. 30, 2005).

Airline Mergers Are Driven by Financial and Competitive Pressures, but Challenges Exist

Volatile earnings and structural changes in the industry have spurred some airlines to explore mergers as a way to increase their profitability and financial viability. Over the last decade, the U.S. passenger airline industry has incurred more than \$15 billion in operating losses. Several major airlines went through bankruptcy to reduce their costs and restructure their operations, while others ceased to operate or were acquired. Most recently, U.S. airlines responded to volatile fuel prices and then a weakening economy by cutting their capacity, reducing their fleets and workforces, and instituting new fees, but even with these actions, the airlines experienced over \$5 billion in operating losses in 2008 before posting an operating profit of about \$1 billion in 2009.¹⁰ Furthermore, over the last decade, airfares have generally declined (in real terms), owing largely to the increased presence of low-cost airlines, such as Southwest Airlines, in more markets and the shrinking dominance of a single airline in many markets.

One of the primary financial benefits that airlines consider when merging with another airline is the cost reduction that may result from combining complementary assets, eliminating duplicative activities, and reducing capacity. A merger or acquisition could enable the combined airline to reduce or eliminate duplicative operating costs, such as duplicative service, labor, and operations costs—including inefficient (or redundant) hubs or routes—or to achieve operational efficiencies by integrating computer systems and similar airline fleets. Other cost savings may stem from facility consolidation, procurement savings, and working capital and balance sheet restructuring, such as renegotiating aircraft leases. Airlines may also pursue mergers or acquisitions to more efficiently manage capacity—both to reduce operating costs and to generate revenue—in their networks. Given recent economic pressures, particularly increased fuel costs, the opportunity to lower costs by reducing redundant capacity may be especially appealing to airlines seeking to merge. Experts have said that industry mergers and acquisitions could lay the foundation for more rational capacity reductions in highly competitive domestic markets

¹⁰Collectively, U.S. airlines reduced domestic capacity, as measured by the number of seats flown, by about 12 percent from the fourth quarter of 2007 to the fourth quarter of 2009. As we reported in April 2009, to reduce capacity, airlines reduced the overall number of active aircraft in their fleets by eliminating mostly older, less fuel-efficient, and smaller (50 or fewer seats) aircraft. Airlines also collectively reduced their workforces by about 38,000 full-time-equivalent positions, or about 9 percent, from the first quarter of 2008 to the first quarter of 2010. In addition to reducing capacity, most airlines instituted new fees, such as those for checked baggage, which resulted in \$3.9 billion in added revenue during 2008 and 2009.

and could help mitigate the significant impact that economic cycles have historically had on airline cash flow.

The other primary financial benefit that airlines consider with mergers and acquisitions is the potential for increased revenues through additional demand, which may be achieved by more seamless travel to more destinations and increased market share and higher fares on some routes.

- *Increased demand from an expanded network:* An airline may seek to merge with or acquire an airline as a way to generate greater revenues from an expanded network, which serves more city-pair markets and better serves passengers. Mergers and acquisitions may generate additional demand by providing consumers more domestic and international city-pair destinations. Airlines with expansive domestic and international networks and frequent flier benefits particularly appeal to business traffic, especially corporate accounts. Results from a recent Business Traveler Coalition (BTC) survey indicate that about 53 percent of the respondents were likely to choose a particular airline based on the extent of its route network.¹¹ Therefore, airlines may use a merger or acquisition to enhance their networks and gain complementary routes, potentially giving the combined airline a stronger platform from which to compete in highly profitable markets.
- *Increased market share and higher fares on some routes:* Capacity reductions in certain markets after a merger could also serve to generate additional revenue through increased fares on some routes. Some studies of airline mergers and acquisitions during the 1980s showed that prices were higher on some routes from the airline's hubs soon after the combination was completed.¹² Several studies have also shown that increased airline dominance at an airport results in increased fare

¹¹Respondents were travel managers responsible for negotiating and managing their firms' corporate accounts.

¹²See Severin Borenstein, "Airline Mergers, Airport Dominance, and Market Power," *American Economic Review*, Vol. 80, May 1990, and Steven A. Morrison, "Airline Mergers: A Longer View," *Journal of Transport Economics and Policy*, September 1996; and Gregory J. Werden, Andrew J. Joskow, and Richard L. Johnson, "The Effects of Mergers on Price and Output: Two Case Studies from the Airline Industry," *Managerial and Decision Economics*, Vol. 12, October 1991.

premiums, in part because of competitive barriers to entry.¹³ At the same time, though, even if the combined airline is able to increase prices in some markets, the increase may be transitory if other airlines enter the markets with sufficient presence to counteract the price increase. In an empirical study of airline mergers and acquisitions up to 1992, Winston and Morrison suggest that being able to raise prices or stifle competition does not play a large role in airlines' merger and acquisition decisions.¹⁴

Cost reductions and the opportunity to obtain increased revenue could bolster a merged airline's financial condition, enabling the airline to better compete in a highly competitive international environment. Many industry experts believe that the United States will need larger, more economically stable airlines to be able to compete with the merging and larger foreign airlines that are emerging in the global economy. The airline industry is becoming increasingly global; for example, the Open Skies agreement between the United States and the European Union became effective in March 2008.¹⁵

Despite these benefits, there are several potential barriers to successfully consummating a merger. The most significant operational challenges involve the integration of workforces, aircraft fleets, and information technology systems and processes, which can be difficult, disruptive, and costly as the airlines integrate.¹⁶

- *Workforce integration*: Workforce integration is often particularly challenging and expensive and involves negotiation of new labor

¹³See Severin Borenstein, 1989, "Hubs and High Fares: Dominance and Market Power in the U.S. Airline Industry," *RAND Journal of Economics*, 20, 344-365; GAO, *Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Markets*, GAO/RCED-97-4 (Washington, D.C.: Oct. 18, 1996); GAO, *Airline Competition: Effects of Airline and Market Concentration and Barriers to Entry on Airfares*, GAO/RCED-91-101 (Washington, D.C.: Apr. 16, 1991).

¹⁴See Steven A. Morrison, and Clifford Winston, "The Remaining Role for Government Policy in the Deregulated Airline Industry." *Deregulation of Network Industries: What's Next?* Sam Peltzman and Clifford Winston, eds. Washington, D.C., Brookings Institution Press, 2000 pp. 1-40.

¹⁵Open Skies seeks to enable greater access of U.S. airlines to Europe, including expanded rights to pick up traffic in one country in Europe and carry it to another European or third country (referred to as fifth freedom rights). Additionally, the United States will expand EU airlines' rights to carry traffic from the United States to other countries.

¹⁶Airlines also face potential challenges to mergers and acquisitions from DOJ's antitrust review, which is discussed in the next section.

contracts. Labor groups—including pilots, flight attendants, and mechanics—may be able to demand concessions from the merging airlines during these negotiations, several experts explained, because labor support would likely be required for a merger or acquisition to be successful. Some experts also note that labor has often opposed mergers, fearing employment or salary reductions. Obtaining agreement from each airline’s pilots’ union on an integrated pilot seniority list—which determines pilots’ salaries, as well as what equipment they can fly—may be particularly difficult. According to some experts, as a result of these labor integration issues and the challenges of merging two work cultures, airline mergers have generally been unsuccessful. For example, although the 2005 America West–US Airways merger has been termed a successful merger by many industry observers, labor disagreements over employee seniority, and especially pilot seniority, are not fully resolved. More recently, labor integration issues derailed merger talks—albeit temporarily—between Northwest and Delta in early 2008, when the airlines’ labor unions were unable to agree on pilot seniority list integration. Furthermore, the existence of distinct corporate cultures can influence whether two firms will be able to merge their operations successfully. For example, merger discussions between United and US Airways broke down in 1995 because the employee-owners of United feared that the airlines’ corporate cultures would clash.

- *Fleet integration:* The integration of two disparate aircraft fleets may also be costly. Combining two fleets may increase costs associated with pilot training, maintenance, and spare parts. These costs may, however, be reduced after the merger by phasing out certain types of aircraft from the fleet mix. Pioneered by Southwest Airlines and copied by other low-cost airlines, simplified fleets have enabled airlines to lower costs by streamlining maintenance operations and reducing training times. If an airline can establish a simplified fleet, or “fleet commonality”—particularly by achieving an efficient scale in a particular aircraft—then many of the cost efficiencies of a merger or acquisition may be set in motion by facilitating pilot training, crew scheduling, maintenance integration, and inventory rationalization.
- *Information technology integration:* Finally, integrating information technology processes and systems can also be problematic and time-consuming after a merger. For example, officials at US Airways told us that while some cost reductions were achieved within 3 to 6 months of its merger with America West, the integration of information technology processes took nearly 2 ½ years. Systems integration issues are increasingly daunting as airlines attempt to integrate a complex mix of modern in-house systems, dated mainframe systems, and outsourced

information technology. The US Airways-America West merger highlighted the potential challenges associated with combining reservation systems, as there were initial integration problems.

The Department of Justice's Antitrust Review Is a Critical Step in the Airline Merger and Acquisition Process

DOJ's review of airline mergers and acquisitions is a key step for airlines hoping to consummate a merger. For airlines, as with other industries, DOJ uses an analytical framework set forth in the *Horizontal Merger Guidelines* (the Guidelines) to evaluate merger proposals.¹⁷ In addition, DOT plays an advisory role for DOJ and, if the combination is consummated, may conduct financial and safety reviews of the combined entity under its regulatory authority.

Most proposed airline mergers or acquisitions must be reviewed by DOJ as required by the Hart-Scott-Rodino Act. In particular, under the act, an acquisition of voting securities or assets above a set monetary amount must be reported to DOJ (or the Federal Trade Commission (FTC) for certain industries) so the department can determine whether the merger or acquisition poses any antitrust concerns.¹⁸ To analyze whether a proposed merger or acquisition raises antitrust concerns—whether the proposal will create or enhance market power or facilitate its exercise¹⁹—DOJ follows an integrated five-part analytical process set forth in the

¹⁷The Guidelines were jointly developed by DOJ's Antitrust Division and the Federal Trade Commission and describe the inquiry process the two agencies follow in analyzing proposed mergers. The most current version of the Guidelines was issued in 1992; Section 4, relating to efficiencies, was revised in 1997. DOJ has proposed some changes in the Guidelines to better reflect its merger review process and the public comment period on these changes has been extended to June 4, 2010.

¹⁸See 15 U.S.C. § 18a(d)(1). Both DOJ and FTC have antitrust enforcement authority, including reviewing proposed mergers and acquisitions. DOJ is the antitrust enforcement authority charged with reviewing proposed mergers and acquisitions in the airline industry. Additionally, under the Hart-Scott-Rodino Act, DOJ has 30 days after the initial filing to notify companies that intend to merge whether DOJ requires additional information for its review. If DOJ does not request additional information, the firms can close their deal (15 U.S.C. § 18a(b)). If more information is required, however, the initial 30-day waiting period is followed by a second 30-day period, which starts to run after both companies have provided the requested information. Companies often attempt to resolve DOJ competitive concerns, if possible, before the second waiting period expires. Any restructuring of a transaction—e.g., through a divestiture—is included in a consent decree entered by a court, unless the competitive problem is unilaterally fixed by the parties before the waiting period expires (called a “fix-it first”).

¹⁹Market power is the ability to maintain prices profitably above competitive levels for a significant period of time.

Guidelines.²⁰ First, DOJ defines the relevant product and geographic markets in which the companies operate and determines whether the merger is likely to significantly increase concentration in those markets. Second, DOJ examines potential adverse competitive effects of the merger, such as whether the merged entity will be able to charge higher prices or restrict output for the product or service it sells. Third, DOJ considers whether other competitors are likely to enter the affected markets and whether they would counteract any potential anticompetitive effects that the merger might have posed. Fourth, DOJ examines the verified “merger specific” efficiencies or other competitive benefits that may be generated by the merger and that cannot be obtained through any other means. Fifth, DOJ considers whether, absent the merger or acquisition, one of the firms is likely to fail, causing its assets to exit the market. The commentary to the Guidelines makes clear that DOJ does not apply the Guidelines as a step-by-step progression, but rather as an integrated approach in deciding whether the proposed merger or acquisition would create antitrust concerns.

In deciding whether the proposed merger is likely anticompetitive DOJ considers the particular circumstances of the merger as it relates to the Guidelines’ five-part inquiry. The greater the potential anticompetitive effects, the greater must be the offsetting verifiable efficiencies for DOJ to clear a merger. However, according to the Guidelines, efficiencies almost never justify a merger if it would create a monopoly or near monopoly. If DOJ concludes that a merged airline threatens to deprive consumers of the benefits of competitive air service, then it will seek injunctive relief in a court proceeding to block the merger from being consummated. In some cases, the parties may agree to modify the proposal to address anticompetitive concerns identified by DOJ—for example, selling airport assets or giving up slots at congested airports—in which case DOJ ordinarily files a complaint with the court along with a consent decree that embodies the agreed-upon changes.

DOT conducts its own analyses of airline mergers and acquisitions. While DOJ is responsible for upholding antitrust laws, DOT conducts its own competitive analysis and provide it to DOJ in an advisory capacity. DOT reviews the merits of any airline merger or acquisition and submits its views and relevant information in its possession to DOJ. DOT also

²⁰United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (Washington, D.C., rev. Apr. 8, 1997).

provides some essential data that DOJ uses in its review.. In addition, presuming the merger moves forward after DOJ review, DOT can undertake several other reviews if the situation warrants. Before commencing operations, any new, acquired, or merged airlines must obtain separate authorizations from DOT—“economic” authority from the Office of the Secretary and “safety” authority from the Federal Aviation Administration (FAA). The Office of the Secretary is responsible for deciding whether applicants are fit, willing, and able to perform the service or provide transportation. To make this decision, the Secretary assesses whether the applicants have the managerial competence, disposition to comply with regulations, and financial resources necessary to operate a new airline. FAA is responsible for certifying that the aircraft and operations conform to the safety standards prescribed by the Administrator—for instance, that the applicants’ manuals, aircraft, facilities, and personnel meet federal safety standards. Also, if a merger or other corporate transaction involves the transfer of international route authority, DOT is responsible for assessing and approving all transfers to ensure that they are consistent with the public interest.²¹

In Creating the Largest U.S. Passenger Airline, a United-Continental Merger May Face Integration Challenges and Analysis of Some Overlapping Markets

If not challenged by DOJ, the merged United-Continental would surpass Delta as the largest U.S. passenger airline. As table 1 indicates, combining United and Continental Airlines would create the largest U.S. airline based on 2009 capacity as measured by available seat miles, and a close second based on total assets and operating revenue. The combined airline would also have the largest workforce among U.S. airlines based on March 2010 employment statistics, with a combined 76,900 employees as measured by full-time-equivalent employees (table 2). The airlines’ workforces are represented by various unions, and in some cases the same union represents similar employee groups, such as the union for the pilots (table 3). Finally, the combined airline would need to integrate 692 aircraft (table 4). The two airlines share some of the same aircraft types, which could make integration easier.

²¹49 U.S.C. § 41105. DOT must specifically consider the transfer of certificate authority’s impact on the financial viability of the parties to the transaction and on the trade position of the United States in the international air transportation market, as well as on competition in the domestic airline industry.

Table 1: Total Assets, Operating Revenue, and Capacity of Major U.S. Airlines (2009)

	Capacity as measured by available seat miles (thousands)	Total assets	Total operating revenue
United-Continental	217,166,074	\$125,742,402	\$28,720,624
Delta	197,701,800	195,546,148	28,909,882
American	151,772,113	89,629,364	19,898,245
Southwest	98,170,797	55,190,553	10,350,338
US Airways	70,721,007	28,901,241	10,780,838
Airtran	23,304,612	8,649,482	2,341,442
Alaska	23,148,960	18,045,385	3,005,999

Source: GAO analysis of Bureau of Transportation Statistics Form 41 data.

Table 2: Full-Time-Equivalent Employees of Top U.S. Airlines (March 2010)

Rank	Airline	Total full-time-equivalent employees (thousands)
1	Delta	74.7
2	American ^a	75.2
3	United	43.7
4	Southwest	34.6
5	Continental	33.2
6	US Airways	29.5
7	JetBlue	11.2
8	Alaska	9.2

Source: GAO analysis of Bureau of Transportation Statistics data.

^aIncludes American Eagle.

Table 3: Union Representation for Various Employee Groups

Employee groups						
	Pilots	Flight attendants	Mechanics	Public contact, ramp and stores, and other workers		Dispatchers
United	Air Line Pilots Association (ALPA)	Association of Flight Attendants (AFA)	International Brotherhood of Teamsters (IBT)	International Association of Machinists (IAM)		Professional Airline Flight Control Association (PAFCA)
	Pilots	Flight attendants	Mechanics	Fleet service	Ticket agents	Dispatchers
Continental	ALPA	IAM	IBT	IBT	Nonunion	Transport Workers Union (TWU)

Source: United Air Lines and Continental Airlines.

Note: In addition, The International Federation of Professional and Technical Engineers (IFPTE) represent more than 260 United engineers and related employees.

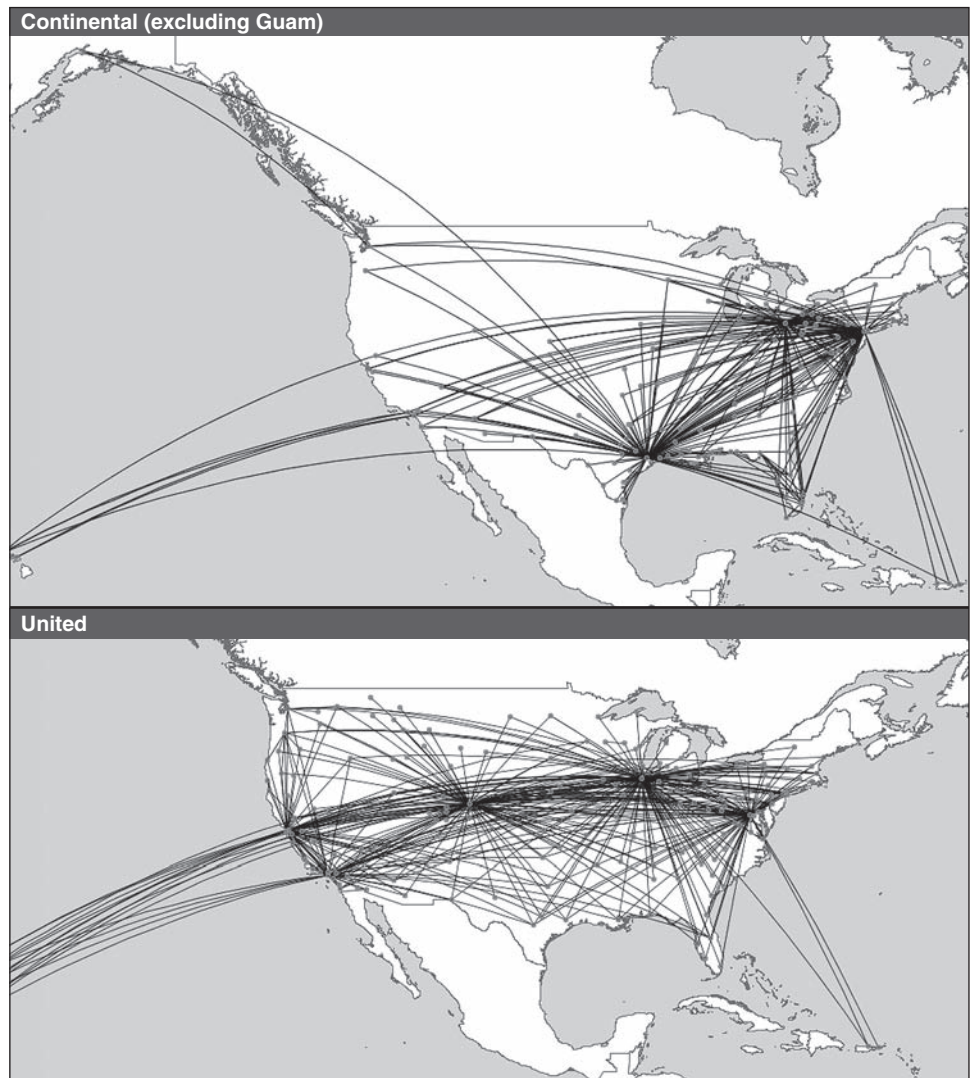
Table 4: United and Continental Aircraft Fleet

Aircraft	United	Continental	Merged
Boeing 737		226	226
Boeing 747	24		24
Boeing 757	96	61	157
Boeing 767	35	26	61
Boeing 777	52	20	72
Airbus 319/320	152		152
Total	359	333	692

Source: United Air Lines.

If not challenged by DOJ, the airlines would attempt to combine two distinct networks, United with major hubs, where the airline connects traffic feeding from smaller airports, in San Francisco (SFO), Los Angeles (LAX), Denver (DEN), Chicago O'Hare (ORD), and Washington DC Dulles (IAD) and Continental with hubs in Houston Intercontinental (IAH), Cleveland (CLE), Guam (GUM), and New York Newark (EWR), as shown in figure 2.

Figure 2: United and Continental Domestic Route Maps (May 2010)



Source: agpDat, Diio LLC.

The amount of overlap in airport-pair combinations between the two airlines' networks is considerable if considering all connecting traffic; however, for most of the overlapping airport-pair markets there is at least one other competitor. Based on 2009 ticket sample data, for 13,515 airport pairs with at least 520 passengers per year, there would be a loss of one

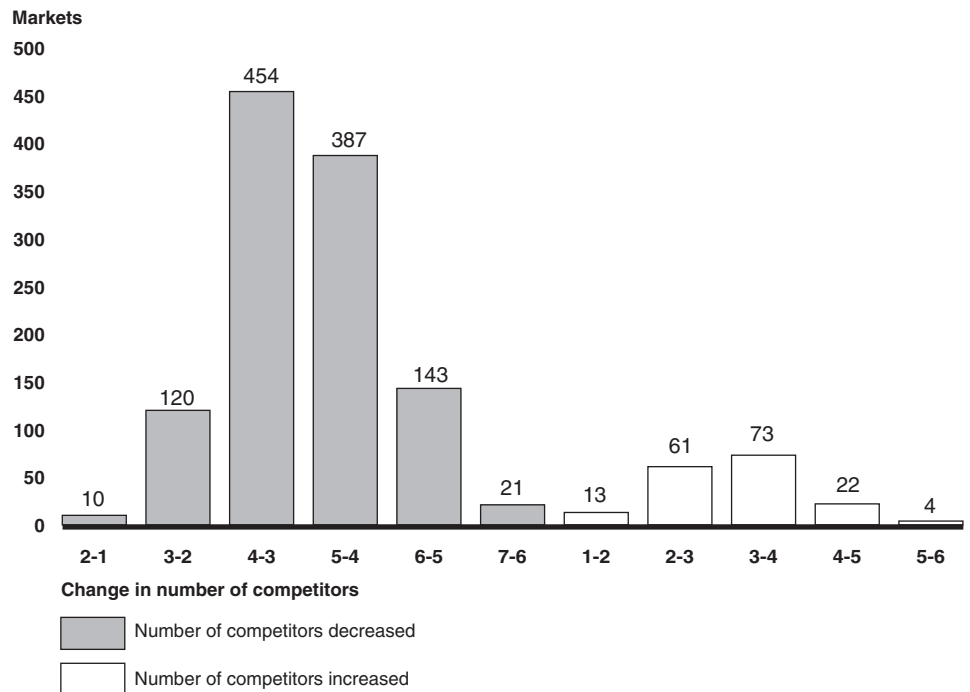
effective competitor in 1,135 airport-pair markets²² affecting almost 35 million passengers by merging these airlines (see fig. 3).²³ However, only 10 of these airport-pair markets would not have any other competitors in it after a merger. In addition, any effect on fares would be dampened by the presence of a low-cost airline in 431 of the 1,135 airport pairs losing a competitor.²⁴ The combination of the two airlines would also create a new effective competitor in 173 airport-pair markets affecting almost 9.5 million passengers.

²²It is generally preferable, time permitting, to assess city-pair, rather than airport-pair, changes in competition. Some larger U.S. cities (New York, Chicago, Los Angeles, Washington D.C.) have more than one commercial airport that can compete for passenger traffic. DOJ generally considers the relevant market to be a city-pair combination.

²³For this airport-pair analysis, we considered any airport-pair market with less than 520 annual passengers to be too small to ensure accuracy. We defined an effective competitor as having at least 5 percent of total airport-pair traffic. This is the same minimum market share that we have previously applied to assess whether an airline has sufficient presence in a market to affect competition. See [GAO-08-845](#), p. 21 and 42.

²⁴We defined low-cost airlines as JetBlue, Frontier/Midwest, AirTran, Allegiant, Spirit, Sun Country, and Southwest.

Figure 3: Change in Effective Competition from United-Continental Combination (2009)



Source: GAO Analysis of DOT Origin and Destination Ticket Data.

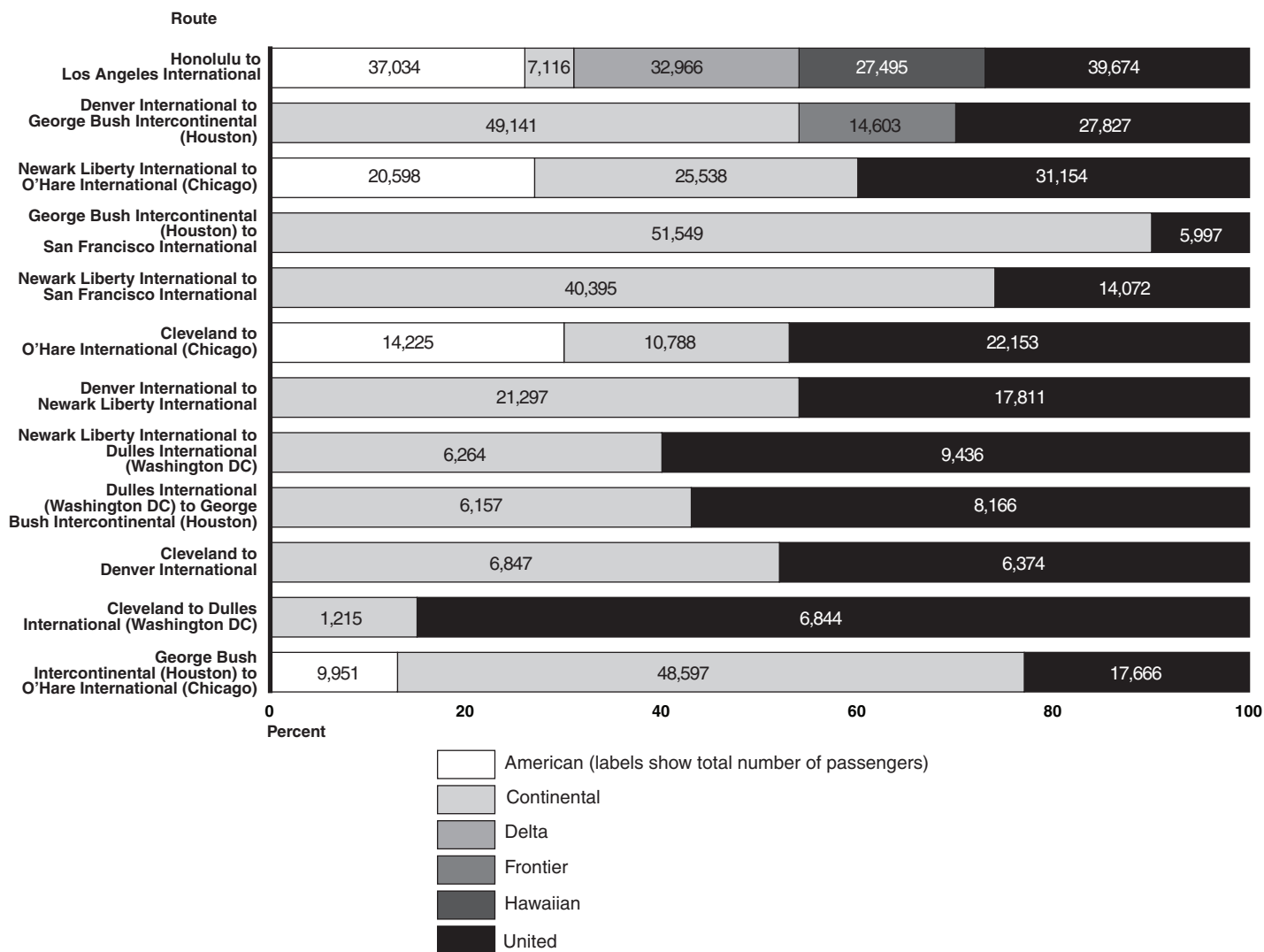
Note: All origin and destination airport pairs with at least 520 passengers. A competitor holds at least 5 percent of market share.

In examining nonstop overlapping airport pairs between United and Continental, the extent of overlap is less than for connecting traffic. However, the loss of a competitor in these nonstop markets is also more significant because nonstop service is typically preferred by some passengers. For example, based on January 2010 traffic data, the two airlines overlap on 12 nonstop airport-pair routes, which are listed in figure 4.²⁵ For 7 of these 12 nonstop overlapping airport-pair routes (generally between a United hub and a Continental hub), there are currently no other competitors. However, of these 7 airport-pair markets, all but the Cleveland-Denver market may have relevant competition between other airports in at least one of the endpoint cities. For example,

²⁵In March 2010, Continental initiated nonstop service between Los Angeles (LAX) and Kahului Airport (OGG) in Hawaii, which is also served by United. This compares to 12 nonstop overlaps (7 highly concentrated) in the Delta-Northwest merger.

passengers traveling from San Francisco (SFO) to Newark (EWR) could consider airlines serving other airports at both endpoints—Oakland or San Jose instead of SFO and John F. Kennedy (JFK) or LaGuardia instead of EWR.

Figure 4: Total Passengers on Overlapping Nonstop Airport Pairs (January 2010)



Source: DOT T-100 data.

If not challenged by DOJ, the combined airline could be expected to rationalize its network over time, including where it maintains hubs. Currently, the two airlines do not have much market share that overlaps at

their respective hubs (see table 5). However, it is uncertain whether the combined airline would retain eight domestic hubs. There is considerable overlap between markets served by United out of Chicago (ORD) and Continental out of Cleveland (CLE). For example, 52 out of 62 domestic airports served by Continental from Cleveland are also served by United from Chicago (ORD).

Table 5: Passenger Market Share at Hub Airports (2009)

Continental hub airports	Continental share (%)	United hub airports	United share (%)	Total (%)
Houston (IAH)	72		5	77
Newark (EWR)	68		5	73
Cleveland (CLE)	53		6	59
		1 Washington Dulles (IAD)	51	52
		4 Chicago (ORD)	38	42
		6 San Francisco (SFO)	33	39
		4 Denver (DEN)	29	33
		6 Los Angeles (LAX)	17	23

Source: GAO analysis of DOT Origin and Destination ticket data.

Both United and Continental have extensive world wide networks and serve many international destinations. Between the two airlines, over 100 international cities are served from the United States. The two airlines do not directly compete on a city-to-city route basis for any international destinations. Nevertheless, for international routes, airlines aggregate traffic from many domestic locations at a hub airport where passengers transfer onto international flights. In other words, at Newark, where Continental has a large hub, passengers traveling from many locations across the United States onto Continental’s international flights. Likewise, United aggregates domestic traffic at its Washington Dulles hub for many of its international flights. Hence, a passenger traveling from, for example Nashville, may view these alternative routes to a location in Europe as substitutable. Continental and United serve many of the same international destinations in Europe and the Americas from their Newark and Dulles hubs, respectively. These destinations include Amsterdam, Brussels, Frankfurt, London, Montreal, Paris, Rome, Sao Paulo, and Toronto. Similarly, both airlines also serve many international destinations from their Midwest hubs—most notably United’s hub at Chicago and Continental’s hub at Houston. Such destinations include Amsterdam, Cancun, Edmonton, London, Paris, San Jose Cabo, Tokyo, and Vancouver. In total, according to current schedules, they serve 30 common

international destinations, representing 65 percent of their total international seat capacity. Whether service to international destinations from different domestic hubs will be viewed as a competitive concern will likely depend on a host of factors, such as the two airlines' market share of traffic to that destination and whether there are any barriers to new airlines entering or existing airlines expanding service at the international destination airports.

To compete internationally, both Continental and United are part of the Star Alliance, one of the three major international airline alliances.²⁶ In 2009, Continental left the SkyTeam Alliance and joined the Star Alliance. As part of joining this alliance, the Star Alliance members, including Continental, applied for antitrust immunity, which allows the member airlines to coordinate schedules, capacity, and pricing in selected markets. DOT has authority to approve these antitrust immunity applications,²⁷ but DOJ may also comment if it has antitrust concerns. On June 26, DOJ filed comments that objected to immunity for the alliance in some markets and requested some conditions, called carve-outs, in which the immunity would not be granted. On July 10, 2009, DOT approved the Star Alliance application for antitrust immunity but with special conditions, including carve-outs.²⁸ Among the markets not granted immunity were New York-Copenhagen, New York-Lisbon, New York-Geneva, New York-Stockholm, Cleveland-Toronto, Houston-Calgary, Houston-Toronto, New York-Ottawa, and U.S.-Beijing.²⁹

²⁶An airline alliance is an agreement between two or more airlines to cooperate on a substantial level. The three largest passenger airline alliances are the *Star Alliance*, *SkyTeam* and *Oneworld*. Alliances provide a network of connectivity and convenience for international passengers. Alliances also provide a marketing brand to passengers making interairline codeshare connections within countries.

²⁷49 U.S.C. §§ 41308, 41309.

²⁸Department of Transportation, Joint Application of Air Canada, et al., Final Order, to Amend Order 2007-2-16 under 49 U.S.C. §§ 41308, 41309, DOT-OST-2008-0234 (July 10, 2009).

²⁹In addition, the order modified and placed conditions on pre-existing carve outs for this alliance.

Contact and Acknowledgments

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