Questions for the Record from Senator Mike Lee
"The American Airlines/US Airways Merger: Consolidation, Competition, and Consumers"
Tuesday, March 19, 2013 10:00 AM

Questions for Thomas Horton, CEO, American Airlines

1. We heard testimony at the hearing expressing concerns about coordinated conduct. The theory of coordinated conduct holds that tacit collusion occurs in industries where a few dominant players control a large portion of the market. In such situations, these few competitors know what their counterparts are doing with respect to prices and service and, without ever explicitly colluding, they are able to raise prices or cut back on services in tandem.

    a. Some analysts allege that U.S. carriers already engage in coordinated conduct and that it is commonplace for all airlines in a market to raise prices soon after a competitor does so. They point to the example of baggage fees, noting that after one airline began charging such fees, most others followed suit. Some see this as evidence that the airlines tacitly collude to raise prices and harm consumers. What is your response to these allegations?
    b. How might this merger affect the likelihood of coordinated conduct in the airline industry and the potential for resulting increased prices?

    Response of Mr. Horton:

    Fees are only one element of price, and competition will ensure that prices, of all types, remain competitive. Bag fees are an interesting example. Some airlines, like American and US Airways, have decided to offer customers more options by unbundling services. By unbundling bag fees, we are able to offer lower prices to those customers willing to travel without checked bags. Other customers are deciding to consume these optional services. The fact that bag and other ancillary fees are growing only means that airlines are offering more choices, not that overall prices are increasing. Indeed, I think the evidence is strongly to the contrary. Air fares, even with fees included, are a remarkable value, and air fares in real dollars have decreased over time. According to statistics published by Airlines For America, air fares, including ancillary fees, have increased by 20% from 2000 to 3Q 2012. During that same period, the Consumer Price Index rose 33%. Thus, adjusting for inflation, fares, inclusive of fees, have declined by over 10%. Even more remarkably, during that same period the spot price for fuel – which is our single largest component of costs – rose 260%.

    As illustrative of a highly competitive market, other carriers are making different choices from those made by American. Southwest, the nation's largest domestic carrier, does not

charge for bags and has made this a major point of differentiation in virtually all of its marketing. Spirit, the other hand, is a low cost airline, which now charges even for carry-on bags. By charging these and other fees, Spirit is able to offer ultra-low fares, and it has proven to be a strong and fast growing competitor, often at the hubs of some of the largest carriers. Even among network carriers, like Delta, American, and United, there are differences in fees charged in various markets, different approaches to exempting customers from paying such fees, and, most recently, in new pricing models pioneered by American that re-bundle pricing by packaging different services together. These different models and customer options provide evidence of a strong and dynamic market for consumers.

While it is true that carriers tend to match each other's prices, that matching only shows that the airline industry is highly competitive and that no carrier can afford to be at a consistent competitive disadvantage by charging uncompetitive high prices. For reasons I explained at the hearing, the airline industry will remain highly competitive, both among the four largest carriers, as well as with the strong and growing group of well managed smaller carriers, such as Alaska, JetBlue, Virgin America, Spirit, and Allegiant. We do not believe this merger will lead to coordinated activity or higher prices. Indeed, all of our analyses of this merger have assumed no price increases. We expect to win by capturing higher share and creating more travel options, not by charging customers more.

2. Some critics contend that airline prices have risen significantly over the last decade and they worry that this merger will result in additional fare increases for consumers. I understand that ancillary revenue from charges like baggage fees were as high as $12 billion in 2011 for the top five US carriers alone.

    a. How do you respond to those who worry over increased ticked prices and additional fees and who fear that this merger will only contribute to the problem?

    See response to question 1.

3. In the last decade, the airline industry has experienced a great deal of consolidation. If this merger is consummated, the number of legacy carriers will have decreased from six to three. This deal would also leave this country's domestic airline industry with only four carriers comprising more than 80 percent of the market. Some analysts fear that this merger is one step too far and will leave the airline industry too concentrated.

a. In your view, how much consolidation is too much? Is there a point when antitrust officials should worry about additional airline mergers given the high level of industry concentration?

Response of Mr. Horton:

I would expect that each merger would be evaluated on its own merits, and as airlines become larger through mergers or otherwise, it will become more difficult to put together complementary networks, like we have here. This merger creates all the benefits of a significantly expanded network, with minimal loss of competition.

4. Some proponents of this deal have suggested that without this merger, American Airlines would not be a viable company for more than a few more years.

a. As I understand it, the parties to this transaction are not claiming the so-called "failing firm" defense as a matter of antitrust law. Do you believe it is important for this Subcommittee to consider whether American is a viable competitor absent this merger?

Response of Mr. Horton:

We are not claiming that American is a failing firm for purposes of merger analysis. In fact, the new American is emerging as a strong, profitable, and vibrant competitor.

5. In response to concerns about competition, proponents of the merger have suggested that the transaction will have important pro-competitive effects. They argue that the combination of the routes currently held by American and USAir will create a strong domestic carrier able to compete with Delta, United, and Southwest. They also point to pro-competitive effects with respect to international flights.

a. How specifically do you believe this merger benefits competition -both domestically and internationally?

Response of Mr. Horton:

The merger has many procompetitive benefits including: (1) creating a larger network of online services that will connect more people to more places, and at the times they want to travel; (2) allowing American and US Airways to identify and capture cost synergies, leading to more affordable prices; (3) increasing the size and the scope of the **one**world alliance, resulting in three roughly comparably sized and highly competitive global alliances; (4) creating more options for frequent flyers to earn and use miles; (5) placing American on a stronger financial footing, thereby increasing its ability to grow and invest in the type of service and product exemplified by our new 777-300s; and (6) adding US

Airways' European and Middle Eastern services to the scope of American's international services, and giving our alliance partner customers access to an expanded network on which to fly, earn, and redeem frequent flyer miles. For more details concerning the potential consumer benefits, I would reiterate Doug Parker's and my comments before the Committee, in which we described the opportunities to create better travel options, as well as our vision of creating an airline that is both more profitable and better able to serve its customers.