Different U.S. and EU Competition Regimes Create Uncertainty for Airline Consolidations

By James V. Dick and Marshall S. Sinick

In recent years, competition authorities in the United States and Europe have sought to enhance their cooperation in order to achieve greater compatibility in the procedures and substantive analyses they apply to the review of proposed mergers and acquisitions. In late January 2013, however, the European Commission (EC) disapproved the proposed acquisition of TNT Express (TNT) by the United Parcel Service (UPS). This decision is a reminder that more must be done: the convergence of competition standards applied by the EC and the U.S. Department of Justice (DOJ) may be a real achievement, but the application of those standards in practice still does not produce uniform, or even consistent, results.[1] Analytical divergence continues to create uncertainty and risks politicizing future consolidation in the airline industry.

According to Joaquin Almunia, EC Vice President for Competition Policy, the EC determined that UPS's acquisition of TNT would have reduced competition among integrators (i.e., companies offering small package express delivery services) in 15 European countries.[2] In some of those country markets, he said, the number of competitors would be reduced from four to three; in others, from three to two.[3] DOJ did not publicly express its position on the proposed acquisition, but it almost certainly would have considered any anticompetitive impact in the United States to be curable. Indeed, it is quite likely that—had DOJ been in the EC's shoes—it would have analyzed the same set of facts differently and approved the acquisition with remedial conditions.

The foreseeable consequences of such decisional differences could affect the future of both aviation-related mergers and global alliances. The UPS-TNT case may presage a material increase in months of regulatory uncertainty and substantial regulatory expenses. Such growing uncertainty about whether a merger or acquisition will be approved (and, if it is, subject to what conditions) would also likely impact airports because scheduling rationalization and terminal relocations are often among the first changes to result from such consolidations.

In this article, we address (1) the competition standards applied by DOJ and the EC, (2) the economic policy and remedial approaches the DOJ and EC use in evaluating their respective competition law standards, and (3) the need for closer coordination between DOJ and the EC, and further convergence in their competition analyses.

DOJ and EC Standards Governing Mergers and Acquisitions

The principal statutory standard for DOJ's evaluation of prospective mergers and alliances is set forth in section 7 of the Clayton Act.[4] That section prohibits business combinations where ". . . in any line of commerce or in any activity affecting commerce in any sector of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly."[5] DOJ and the Federal Trade Commission (FTC) have issued Horizontal Merger Guidelines to provide greater transparency to their application of section 7 to particular mergers and acquisitions.[6] The original Merger Guidelines were issued in 1982 and have been revised and reissued several times since then. The "unifying theme" of the current version, the 2010 Horizontal Merger Guidelines, "is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise."[7] A merger enhances market power, the Guidelines explain, "if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives."[8]

The basic standard for the EC's evaluation of mergers and acquisitions is found in Council Regulation (EC) No. 139/2004 of January 20, 2004, better known as the EC Merger Regulation:

> A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market.[9]

EC commentary clarifies the meaning of this standard: "The Merger regulation prohibits mergers or acquisitions that would significantly reduce competition. . . . If the Commission finds the transaction would distort competition, it may stop the deal unless the company proposes remedies to solve the competition problem."[10] The EC has also issued guidelines "as to how the Commission assesses concentrations [including mergers and acquisitions] when the undertakings concerned [i.e., the parties] are actual or potential competitors [in] the same

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relevant market."[11] In language parallel to the DOJ/FTC Guidelines, the EC Guidelines state that horizontal mergers that "creat[e] or strengthen[ ] a dominant position" may "significantly impede effective competition . . . by eliminating important competitive constraints on one or more firms . . . ,"[12] thereby enabling the dominant firm to exercise market power by "profitably increas[ing] prices, reduc[ing] output, choice or quality of goods and services, diminish[ing] innovation, or otherwise influenc[ing] parameters of competition."[13]

Divergence, Convergence, and a Return to Divergence

Despite the general similarity between the EC and DOJ merger standards, there have been material differences in the underlying economic and consumer welfare policies of the competition authorities. The divergence seemed especially great a little over a decade ago in connection with General Electric's proposed acquisition of Honeywell. DOJ had favorably reviewed the transaction and would have approved it subject to certain divestitures and conditions, including the divestiture of Honeywell's helicopter engine business and the licensing of a new competitor to maintain and repair certain Honeywell engines.[14] The EC blocked the transaction before it could be implemented, however, on the grounds that the deal would strengthen GE's dominant position in the market for large jet engines and enable Honeywell to gain a dominant position in the small engine, avionics, and nonavionics systems markets in which it competed.[15]

According to one senior DOJ official at the time, the EC's decision "triggered a firestorm of criticism, not just from the U.S. antitrust agencies and senior administration officials, but also from the business community generally and from leading economists, antitrust legal scholars, and editorial writers."[16] Charles James, then head of DOJ's Antitrust Division, stated that the "analysis employed by the EC is antithetical to the goals of antitrust law enforcement."[17] One of his deputies said that the United States and EC reached different conclusions because the EC incorrectly "used [the antitrust laws] to protect competitors *from* competition in order to preserve competition"[18] at the expense of protecting consumers, and suggested that the EC's decision gave undue weight to the complaints of GE's and Honeywell's European competitors.[19]

After considering their disparate conclusions concerning the GE/Honeywell acquisition, competition officials on both sides of the Atlantic tried to mend fences by increasing their level of coordination to achieve greater convergence. The following year, in 2002, the DOJ, FTC, and EC jointly released the first "Best Practices on Cooperation in Merger Investigations," two objectives of which included "enhanc[ing] cooperation between the U.S. antitrust agencies and the European Commission in merger review, and minimiz[ing] the risk of divergent outcomes. . . ."[20] The 2002 "Best Practices" were revised and strengthened in 2011. A key goal of the 2011 "Best Practices" is to "[p]lace greater emphasis on coordination among the agencies at key stages of their investigations, including the final stage in which agencies consider potential remedies to preserve competition."[21]

Enhanced cooperation has not always led to similar results, however. In December 2011, DOJ approved—subject to certain divestitures and other conditions—a proposed merger between Deutsche Borse and NYSE Euronext, which are among the world's largest operators of equities and equity derivatives exchanges.[22] But a few weeks later, and less than three months after the issuance of the 2011 "Best Practices," the EC blocked that transaction on the ground that it would have created a "quasi-monopoly" in the market for European financial derivatives traded globally on exchanges.[23]

In light of this recent divergence, the question for prospective airline merger partners is whether the EC's UPS-TNT decision signals a troubling return to the view that government regulators, rather than markets, are best positioned to maximize consumer welfare. The EC's refusal to permit the consummation of other airline acquisitions in recent years, including Ryanair/Aer Lingus[24] and Olympic Air/Aegean Airlines,[25] only compounds that concern.

The EC's decision in the UPS-TNT case appears to rest in large part on conclusions regarding the scope of the relevant market and the competitive viability of divested assets that DOJ would have been unlikely to draw. An essential component of any competition law evaluation of a business combination is the need to define the transaction's likely effect within a relevant product and geographic market.[26] The breadth of the market definition can often be determinative of the decisional result. In the UPS-TNT case, it appears that the narrow market definition adopted by the EC all but predetermined the EC's negative view. The EC's definition of the relevant market as only consisting of the four existing integrators appears questionable. That definition ignores the cross-elasticity between express air services and truck, high-speed rail, postal service competitors, and combination aircraft belly capacity.[27] Indeed, even under the EC's narrow, integrator-only market definition, the potential reduction would have been from four to three competitors in many markets.[28] This would compare favorably to the far larger U.S. express air service market, which has only three integrators and lacks an equivalent to the well-regarded European high-speed rail network.

In addition to defining the relevant market very narrowly, the EC required the parties to prove that

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UPS's proposed divestitures would remedy the anti competitive effects of the merger with greater certainty than DOJ would likely have required. UPS offered to divest TNT's subsidiaries in the 15 countries where the EC believed the merger would have restricted competition, plus Spain and Portugal, and to allow the purchaser to access UPS's intra-Europe air network for five years.[29] The EC "carried out an in-depth assessment [of this proposed remedy], including a market test where customers and other interested parties were consulted," but it concluded that the remedy was inadequate.[30] According to some commentators, the EC imposed an unrealistically high burden on UPS, requiring it to virtually assure the creation of another integrator with almost the same market presence as TNT.[31]

Increased Uncertainty for Prospective Mergers and Acquisitions

The EC's apparent reluctance to rely on market forces to foster reasonable competitive responses has caused some commentators to wonder how far the EC has really moved from "the more statist tradition that places greater confidence in the utility of governmental intervention in markets," as one DOJ official described it shortly after the EC's GE-Honeywell decision.[32] For airlines considering potential mergers or acquisitions, the EC's apparent tendency to require that business combination parties offer to create a "new" competitor as a condition of approval would present a difficult challenge.

The proposed American Airlines (AA)/US Airways (US) merger, for example, will require review by the EC as well as DOJ, regardless of how it is structured. In terms of seat capacity, AA is currently the fifth-largest carrier between North America and Europe, with a 6.7% share of that market.[33] US is the ninth-largest, with a 4.6% share.[34] The merger would create the third-largest carrier in that market, with a combined share of 11.3%, placing it just ahead of British Airways and Lufthansa, but behind Delta and United.[35] Only six European airports are now served by both AA and US—Frankfurt, London Heathrow, Madrid, Manchester, Paris-CDG, and Zurich—and AA and US serve these cities from different U.S. cities.[36] Given the merger's relatively small impact on European airlines' transatlantic markets and the fact that AA and US have no overlapping city-pair routes between the United States and Europe, one would expect this merger to be approved with few if any slot divestitures or other conditions. The apparent rationale behind the EC's UPS-TNT Express decision, however, creates uncertainty as to the EC's likely response to the AA/US combination.

In the context of increasingly important global alliances, the troubling new concern would be whether the members of any alliance involving a number of overlapping routes will now be required to find and induce another prospective competitor to enter.[37] It may no longer be enough for the alliance carriers to commit to hold aside attractive landing slots and related terminal facilities for prospective new entrants (should such entrants emerge). Rather, the prospective alliance and/or merger partner might have to arrange for another airline to become an actual competitor. In many, if not most, instances, a requirement to create a "prepackaged" competitor poised to replace an alliance partner or merged carrier could pose an insurmountable problem.

The Need for Convergence and Consistency

The airline industry may now have to contend once again with uncertainty and expense as part of any proposed business combination. For national competition authorities, such divergent views also pose the problem of inconsistent and ultimately less effective remedies. Given their separate competition law frameworks and procedures, it is not realistic to expect DOJ and the EC to reach identical outcomes in every case. As Assistant Attorney General Charles A. James said in 2001 following the EC's decision to block the GE/Honeywell acquisition, however: "The importance of reaching consistent outcomes is obvious. Besides imposing substantial costs on the merging firms involved, divergent outcomes undermine the public's confidence in the work we do and risk politicizing antitrust—both of which can have adverse effects on sound and predictable antitrust enforcement."[38]

Despite the progress that has been made toward the goal of convergence since 2001, further steps can and should be taken to maximize the adoption of common analyses and approaches to merger review. If convergence is to get back on track, early and frequent discussions and information sharing among DOJ/DOT and the EC are imperative. The value of these exchanges could be facilitated by the transaction parties granting appropriate confidentiality waivers. Reliance on more frequent exchanges under the umbrella of the International Competition Network[39] may also enhance the prospects for more consistent decisional results. The significant potential consumer welfare and economic stakes involved in most airline consolidations are such that the United States and EC should continue to make it a priority to narrow their competition law decisional differences.

Endnotes

1. While this article only addresses the lack of convergence between the United States and the EC, the same disparity concerns also apply to a growing number of other national competition authorities, for example, Brazil and Chile, which have become more active in reviewing aviation transactions.

2. Press Release, European Comm'n, Mergers: Commission Blocks Proposed Acquisition of TNT Express by UPS (Jan. 30, 2013) [hereinafter Jan. 30 EC Press Release]; Bill Donahue, *EU Officially Kills $6.8B UPS-TNT Merger*, Law 360. com (Jan. 31, 2013).

3. Jan. 30 EC Press Release, *supra* note 2; Donahue, *supra* note 2.

4. 15 U.S.C. § 18.

5. *Id.*

6. The FTC does not have jurisdiction over mergers and acquisitions in the airline industry. *See id.* § 45(a)(2).

7. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines, sec. 1, at 2 (2010) [hereinafter 2010 Merger Guidelines].

8. *Id.*

9. EU Official Journal Council Regulation (EC) No. 139/2004, Jan. 20, 2004, art. 2, ¶ 3.

10. *Competition Policy in the European Union*, European Comm'n (Feb. 3, 2011), http://ec.europa.eu/dgs/competition/factsheet_general_en.pdf.

11. *Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings*, 2004/C 31/03, ¶ 5 (Feb. 5, 2004) [hereinafter *EC Horizontal Merger Guidelines*].

12. *Id.* ¶ 22.

13. *Id.* ¶ 8.

14. *See* Deborah Majoras, Deputy Assistant Att'y Gen., Antitrust Div., Dep't of Justice, Remarks: GE-Honeywell: The U.S. Decision (Nov. 29, 2001) [hereinafter Majoras Speech].

15. *Id.*

16. *Id.*

17. Charles A. James, Assistant Att'y Gen., Antitrust Div., Dep't of Justice, Address: International Antitrust in the Bush Administration (Sept. 21, 2001) [hereinafter James Speech].

18. William J. Kolasky, Deputy Assistant Att'y Gen., Antitrust Div., Dep't of Justice, Address: U.S. and EU Competition Policy: Cartels, Mergers, and Beyond (Jan. 25, 2002) (emphasis in original).

19. *Id.* The EC's analysis of predatory pricing exemplifies its greater concern for the protection of competitors. U.S. antitrust laws generally do not condemn prices above short-run marginal or average variable costs even if the prices offered are below other competitors' costs and even if the intent is to exclude rivals. *See, e.g.*, Atl. Richfield v. USA Petroleum Co., 495 U.S. 328, 346 (1990) ("Low prices benefit consumers regardless of how those prices are set."). The concept of predatory pricing within U.S. aviation markets is close to being an anachronism. *See* Commentary: *Predatory Pricing Cleared for Takeoff*, Bloomberg Businessweek, May 13, 2001. The near impossibility of establishing predatory pricing in the airline industry flows from the requirement that a plaintiff demonstrate that the defendant not only is engaging in below-cost pricing, but also that there is a dangerous probability that the defendant will be able to recoup its losses through higher prices once its rivals are driven from the market. *See* Brooke Grp. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993). The EC, by contrast, does not require that predatory prices always be below average variable costs nor does it require the demonstration of a dangerous probability of recoupment of losses. The EC may find prices above average variable cost but below average total cost (i.e., average variable cost + fixed costs) to be predatory if they are intended to eliminate a competitor. Azko Chemie BV v. Comm'n of the European Communities, C-62/86 [1991] E.C.R. 1-03359 (E.C.J. reversing the Commission's decision on other grounds). The EC does not consider evidence of an opportunity for recoupment to be a requirement for finding predatory pricing: "It must be possible to penalize predatory pricing whenever there is a risk that competitors will be eliminated. . . . The aim pursued, which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competitors." Tetra Peak Int'l SA v. Comm'n of the European Communities, [1996] ECR 1-05951, at 214 [*Tetra Peak II*].

20. Press Release, Antitrust Div., Dep't of Justice, United States and European Union Antitrust Agencies Issue "Best Practices" for Coordinating Merger Reviews (Oct. 30, 2002).

21. Press Release, Antitrust Div., Dep't of Justice, United States and European Union Antitrust Agencies Issue Revised Best Practices for Coordinating Merger Reviews (Oct. 14, 2011).

22. Press Release, Antitrust Div., Dep't of Justice, Justice Department Requires Deutsche Borse to Divest Its Interest in Direct Edge in Order to Merge with NYSE Euronext (Dec. 22, 2011).

23. Press Release, European Comm'n, Mergers: Commission Blocks Proposed Merger Between Deutsche Borse and NYSE Euronext (Feb. 1, 2012).

24. The EC blocked Ryanair's attempts to acquire Aer Lingus in 2007, 2009, and 2013. *See* Press Release, European Comm'n, EU Commission Prohibits Ryanair's Takeover of Aer Lingus (Feb. 27, 2013).

25. Press Release, European Comm'n, Mergers: Commission Blocks Proposed Merger Between Aegean Airlines and Olympic Air (Jan. 26, 2011).

26. *See, e.g.*, 2010 Merger Guidelines, *supra* note 7, sec. 4; *EC Horizontal Merger Guidelines*, *supra* note 11, ¶ 10. Intertwined with the market definition issue is the equally important requirement to determine which other entities should be considered as participants in the defined market. That determination would include whether the transaction's proponents must demonstrate that other prospective participants could likely enter in the event of market changes including, for example, price increases or a reduction in supply.

27. *See, e.g.*, W. Parcel Express v. United Parcel Serv., 190 F.3d 974, 976 (9th Cir. 1999) (ground-based package delivery companies considered actual competitors of integrators); *see also* Dep't of Justice, Business Review Letter (Mar. 6, 2001) (approving a Delta/Air France marketing joint venture for air cargo; noting intra-Europe competition from trucking companies).

28. Press Release, European Comm'n, Mergers: Commission Opens In-Depth Investigation into Proposed Acquisition of TNT Express by UPS (July 20, 2012).

29. Jan. 30 EC Press Release, *supra* note 2.

30. *Id.*

31. *E.g.*, Cecile Kohrs Lindell, *Convergence Myth Weakened as UPS/TNT Express Shot Down by EC*, Forbes, Jan. 15, 2013.

32. *Id*. (quoting Majoras Speech, *supra* note 14).

33. *American-US Airways Merger: The Competitive Impact on European Carriers*, CAPA Centre for Aviation (Feb. 21, 2013), http://centreforaviation.com/analysis/american-us-airways-merger-the-competitive-impact-on-european-carriers-98405 .

34. *Id*.

35. *Id*.

36. *Id*. AA's alliance partner British Airways and US overlap in the Philadelphia/London Heathrow market.

37. The commitments that the EC recently accepted with respect to the Star Alliance carriers' A++ joint venture agreement, however, may suggest that the EC may treat more favorably transactions involving national flag carriers. *See* Press Release, European Comm'n, Antitrust: Commission renders legally binding commitments from Star Alliance members Air Canada, United, and Lufthansa on transatlantic air transport passenger market (May 23, 2013). In that proceeding, Lufthansa, one of Europe's preeminent airlines, has committed to make available to a prospective new entrant on routes of concern slots, related airport infrastructure, frequent flyer participation, favorable prorates, and combinable fares. EU Public Case Reporter No. 39595. The EC's acceptance of these commitments suggests that the EC is prepared to accept a willingness to facilitate *potential* new entry rather than virtually require a prepackaged new entrant poised to initiate service, as in the UPS-TNT merger proceeding. Whether that arguably inconsistent approach would be the result of a national champion, Lufthansa, being the transaction's proponent, however, is beyond the scope of this paper.

38. James Speech, *supra* note 17.

39. *See* Press Release, Antitrust Div., Dep't of Justice, U.S. and Foreign Antitrust Officials Launch International Competition Network (Oct. 25, 2001).