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Spirit Airlines, Inc. v. Northwest Airlines, Inc.: A Case for Increased Regulation of the Airline Industry

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SPIRIT AIRLINES, INC. V. NORTHWEST AIRLINES, INC.:
A CASE FOR INCREASED REGULATION OF THE
AIRLINE INDUSTRY

ERICA WESSLING*

ABSTRACT

The relatively short history of the airline industry is characterized by sudden shifts and divergent standards that attempt to negotiate a complex market. High demand, uniqueness of service, and difficulty of market entry render the market particularly susceptible to monopolization among competitors. Recently, the rise of the low-cost carrier business model has exposed high barriers to entry into the airline market. In attempts to remedy the harm against both prospective market entrants and consumers, low-cost carriers have levied price predation claims against entrenched legacy airlines. Due to the difficulty in negotiating the divide between predatory behavior and lawful competition, courts have been justifiably reticent to penalize carriers for competitive pricing of passenger fare. However, despite the likely legality of the pricing structure of incumbent airlines, other exclusionary practices, such as gate monopolization, fortify high barriers to entry and highlight the need for a shift in judicial and regulatory standards. Through analysis of the decision in Spirit Airlines, Inc. v. Northwest Airlines, Inc., this Note analyzes antitrust issues within the helpful framework of contestability theory and considers judicial and regulatory changes to benefit new entrant airlines and consumers.

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INTRODUCTION

Due to the unique nature of the airline industry, reassessment of judicial standards and increased regulation is crucial in order to promote healthy competition among air carriers and to protect consumers. Recently, the rise of the low-cost carrier business model in the 1990s has added an additional layer to this dynamic industry.¹ Difficulties faced by low-cost carriers entering the market affirm the applicability of contestability as a theoretical guide, even if it is unattainable in reality.² Barriers to entry include monopolistic gate leasing agreements and the hub dominance of high-cost legacy carriers.³ These obstacles highlight the need for a shift in antitrust and regulatory policy in order to facilitate competition.

The success of low-cost carriers has provoked a retaliatory response by incumbent legacy carriers, which “appear[] to be on a homicidal mission to destroy the low-fare airlines.”⁴ As a result, a slew of price predation claims have been made by low-cost carriers against entrenched legacy carriers.⁵ These cases contest and attempt to delineate the fine line that divides illegal predatory practices from fair competition. In particular, the decision of the court in *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*⁶ demonstrates the need for a shift in the analysis of price predation claims under the Sherman Antitrust Act.⁷

This Note proposes that high barriers of entry to the airline market, while providing the opportunity for price predation, should not be considered by courts as dispositive of price predation. Instead, high barriers to entry

¹ Paul Stephen Dempsey, *Predation, Competition & Antitrust Law: Turbulence in the Airline Industry*, 67 J. AIR L. & COM. 685, 704 (2002) [hereinafter Dempsey, *Turbulence in the Airline Industry*]; see also Michael E. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy*, 4 YALE J. ON REG. 393, 478 (1987) [hereinafter Levine, *Airline Competition*].

² Dempsey, *Turbulence in the Airline Industry*, *supra* note 1, at 704; see also Levine, *Airline Competition*, *supra* note 1, at 397.

³ Dempsey, *supra* note 1, at 692; Severin Borenstein, *On the Persistent Financial Losses of U.S. Airlines: A Preliminary Exploration*; Nat’l Bureau of Econ. Research, Working Paper no. 16744 at 10–11 (Jan. 2011), available at <http://perma.cc/UP6Y-9P59>.

⁴ Dempsey, *supra* note 1, at 688. The success of the low-cost carrier business model has prompted legacy carriers to defend their market dominance out of fear that increased competition will undermine their ability to maintain the high passenger fares that subsidize the “bells and whistles” of their expensive business model. *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 922 (6th Cir. 2005). Whereas the profitability of low-cost carriers depends solely upon low fares, hub-and-spoke model legacy carriers seek to secure consumer loyalty by means of special programs, such as frequent flyer miles. *Id.*

⁵ Dempsey, *supra* note 1, at 690.

⁶ *Spirit*, 431 F.3d at 917.

⁷ 15 U.S.C. §2 (2004).

indicate the need for stricter regulations promulgated with the purpose of facilitating or providing equal grounds for market entry. Such changes would promote fair and healthy competition in the airline industry, thereby generating consumer benefit.

Part I of this Note will discuss the historical background and commercial framework of the airline industry, the theory of perfect market contestability, and the rise of the low-cost carrier business model. Part II will then discuss the *Spirit* decision. The conclusion will critique the *Spirit* court's price predation analysis, focusing on the court's inappropriate focus on predatory intent, mischaracterization of the relevant market for price predation purposes, and failure to utilize the theoretical guidelines provided by market contestability. Further, this Note contends that, although high barriers to entry may enhance opportunities for price predation, they are not dispositive of anti-competitive behavior in violation of antitrust laws. Instead, such barriers to entry confirm that the airline industry is not perfectly contestable and demonstrate the need for increased regulation.

I. BACKGROUND

A. History and Effects of the Airline Deregulation Act of 1978

In 1938, the Civil Aeronautics Board (CAB) was established to oversee the "economic regulation of the burgeoning airline industry" and to monitor "substantial competitive impulses" among airlines.⁸ The CAB was granted authority to regulate interstate air travel and retained sole authority over matters such as issuing operating permits and approving and assigning routes.⁹ The purpose for establishing the CAB was to hinder "destructive and cannibalistic" competitive practices among airlines in an industry that naturally tends to form monopolies.¹⁰ The CAB sought to ensure fair practice regarding market entry and to restrict anti-competitive tactics.¹¹ Under a generous grant of authority, the CAB regulated most air carrier business activity, including "entry and exit from individual city-pair markets, air fares, methods of competition, mergers and acquisitions, and inter-carrier agreements."¹²

In 1978, Jimmy Carter approved the Deregulation Act ("Act") with the purpose of limiting the scope of federal aviation regulations in order to

⁸ Timothy M. Ravich, *Re-Regulation and Airline Passengers' Rights*, 67 J. AIR L. & COM. 935, 959, 960 (2002). When the CAB was created, airlines primarily transported mail, not passengers. *Id.*

⁹ *Id.* at 960.

¹⁰ *Id.*

¹¹ *Id.*

¹² Stephen E. Creager, *Airline Deregulation and Airport Regulation*, 93 YALE L.J. 319, 319-20 (1983).

encourage a “market-driven commercial aviation system.”¹³ The Act served to lessen the control of the CAB and the Federal Aviation Administration (FAA) over the commercial aviation industry.¹⁴ Although the FAA retained some control to regulate airway safety matters, most authority to influence the “day-to-day” operation of airports was greatly restricted by the Act.¹⁵

Prior to the Act, the CAB was the final regulatory authority charged to approve all airline route decisions.¹⁶ Proponents of deregulation contend that the CAB’s exercise of its broad powers unnecessarily impeded market entry and prevented the airline market from approaching an optimal competitive state.¹⁷ For instance, the CAB granted none of the seventy-nine applications it received from new entrants seeking access to a route between 1950 and 1974.¹⁸ Meanwhile, incumbent domestic airlines secured their “advantageous positions” by means of the benevolent oversight of the CAB prior to 1978.¹⁹ Despite the salutary effects of deregulation, entrenched incumbent airlines have retained a large degree of control and can prevent new airlines from entering the market.²⁰ One concern is that incumbents may utilize this power to thwart new entrants while remaining “immune” from antitrust allegations.²¹

One of the effects of deregulation was to transfer much of the “administrative regulatory burden” of air transportation from airlines to airports.²² Further, current regulation of airport user fees prevents airports from dealing with this “burden.”²³ Ensuring fair and efficient access to airport gates, routes, and terminals has been one of the greatest post-deregulation problems.²⁴ With the diminishment of CAB authority following deregulation, slots are allocated among commercial carriers by means of a scheduling committee,

¹³ Ravich, *supra* note 8, at 961.

¹⁴ Creager, *supra* note 12, at 320.

¹⁵ Ravich, *supra* note 8, at 961; Creager, *supra* note 12, at 320.

¹⁶ Creager, *supra* note 12, at 332.

¹⁷ *Id.*

¹⁸ *Id.* at 328 n.56.

¹⁹ *Id.* at 339.

²⁰ *Id.* at 333.

²¹ *Id.* at 339. Despite its goal of facilitating optimal competition, the Act did not address the potential harm of dominant incumbent airlines. Critics of deregulation argue that, far from balancing out a market dominated by incumbents, deregulation “shifted the effective power of approval of new air routes from the CAB ... to incumbent airlines.” *Id.* at 332.

²² *Id.* at 319.

²³ *Id.*

²⁴ *Id.* Proposed solutions to the issue of fair opportunity for new entrants by means of regulatory policy include “allocating access to airports by auction, subjecting the airport terminal subleasing policies of airlines to a heightened antitrust scrutiny, foreclosing the ability of certain airlines to veto plans to expand airport terminal capacity, and requiring new entrant airlines to bear the full cost of their entry.” *Id.*

which permits the airlines the opportunity to bargain.²⁵ Should this process fail, the FAA has retained some authority to intervene.²⁶

The 1978 Airline Deregulation Act (“Act”) was promulgated under the theory that regulation interfered with the “naturally competitive” airline industry.²⁷ Analysts contended that the airline market would achieve “perfect competition” in the absence of regulation.²⁸ The Act entrusted airline competitors with greater business discretion under the belief that competition would lead to “optimal price and output conditions” due to the “perfectly contestable” nature of the airline industry.²⁹ The Act was further intended to facilitate market entry for new competitors, which was necessary to achieve any semblance of perfect competition.³⁰

Deregulation in 1978 was followed by the entry of new airlines into the market.³¹ The mid-1990s was marked by a “second wave” of new entrants into the airline market.³² Between 1990 and 1995, as many as five new airlines entered the market each year.³³ A “record” forty-two airlines submitted applications for the Certificate of Public Convenience and Necessity in 1993, which is a prerequisite for competing as a commercial airline carrier.³⁴ Despite an auspicious start, the second half of the decade “was an era of bankruptcies, liquidations and retrenchments for upstart airlines.”³⁵ During

²⁵ *Id.* at 327.

²⁶ *Id.* at 327 n.53. Other slot allocation options under the FAA include a lottery system, an auction, the “grandfathering of slots based on historical pattern,” and administrative review. *Id.* The need for some regulatory authority to provide fair opportunity for market entry for new airlines is evidenced by the airport’s difficulty to manage slot allocation. *Id.* For instance, when the slot committee denied New York Air’s slot request at Washington National Airport in the fall of 1980, the FAA intervened to approve the slot request. *Id.* In this instance, the FAA served to remedy the pre-deregulation tendency of the CAB to thwart most new entrants. *See id.* at 319.

²⁷ Levine, *Airline Competition*, *supra* note 1, at 398.

²⁸ *Id.* at 400. In the 1970s, advocates of deregulation “suggested that performance without deregulatory intervention would approximate perfect competition.” *Id.* “Even when analysts recognized that small numbers of competitors were characteristic of airline markets, a feature which conventionally suggested imperfect competition, they tended to predict competitive performance.” *Id.*

²⁹ Levine, *Airline Competition*, *supra* note 1, at 403.

³⁰ Dempsey, *supra* note 1, at 702. Though the notions of perfect competition and perfect contestability are “both unattainable ideal states,” some economic theorists espouse that perfect contestability serves as a more useful framework to guide analysis of the airline industry. Elizabeth E. Bailey, *Deregulation and the Theory of Contestable Markets*, 1 YALE J. ON REG. 111, 112 (1984) [hereinafter Bailey, *Deregulation*].

³¹ Dempsey, *supra* note 1, at 703. These new entrants to the airline market included Midway Airlines, America West, and People Express. *Id.*

³² *Id.* at 704.

³³ *Id.* at 688.

³⁴ *Id.* at 705.

³⁵ *Id.* at 688.

the dry spell of 1995 to the first months of 1999, “not a single new airline began service.”³⁶

Empirical data suggest that deregulation minimally benefited enterprises seeking to compete with incumbent airlines.³⁷ Statistics regarding the profitability of the U.S. passenger airline market over the last several decades are bleak.³⁸ Domestic passenger airlines lost \$59 billion between 1979 and 2009.³⁹ Further, the airline industry operated at a profit during only eight of the first thirty-one years following deregulation.⁴⁰

Airline carriers have been spiraling downward in a trend of unprofitability since deregulation.⁴¹ The 2000s have been described as “financially disastrous” for U.S. domestic airlines⁴² and analysts have noted the “volatility of airline profits.”⁴³ Data further suggest that airline carriers have been gaining momentum in their unprofitable plunge.⁴⁴ For instance, of the roughly \$60 billion in losses incurred by the domestic airline carrier market over the last thirty years, the majority occurred in the last decade.⁴⁵ From 2008 to 2009, aggregate net losses for domestic passenger airlines were \$14 billion from a total revenue of \$270 billion.⁴⁶

Other forces apart from deregulation have contributed to the decreased profitability of the domestic airline industry. Certain contributing variables include “demand and cost shocks.”⁴⁷ Cost factors contributing to decreased profitability include high taxes and increased fuel costs.⁴⁸ Tax and fuel are considered exogenous factors, with fuel costs being “approximately the same for all airlines.”⁴⁹ Fuel price increases in 2008 undermined airline profitability by necessitating a reduction in flight schedules.⁵⁰ Additional costs include

³⁶ *Id.*

³⁷ Borenstein, *supra* note 3, at 2. *Cf.* Levine, *Airline Competition*, *supra* note 1, at 397. (“Evidence of impediments to contestability in air transport markets does not affect the policy conclusion that airline deregulation has been a very considerable improvement over the previous regulated regime.”).

³⁸ Borenstein, *supra* note 3, at 2.

³⁹ *Id.*

⁴⁰ *Id.* at 3.

⁴¹ *Id.* at 2.

⁴² *Id.*

⁴³ *Id.* at 3.

⁴⁴ *Id.* at 2.

⁴⁵ *Id.*

⁴⁶ *Id.* at 2.

⁴⁷ *Id.* at 12.

⁴⁸ *Id.*

⁴⁹ *Id.* at 4, 10–11.

⁵⁰ *Id.* at 6.

airport-imposed passenger facility charges upon airlines which may consist of up to \$4.50 per passenger at commercial airports run by public agencies.⁵¹

Weak demand is one of the more decisive factors adversely affecting airline profitability.⁵² Decreased demand flows in part from heightened safety concerns and increased inconvenience of travel resulting from the September 11, 2001 terrorist attacks.⁵³ From 2000 to 2002, demand decreased at the “unprecedented” rate of 20 percent.⁵⁴ More expensive passenger fares may have weakened demand for air travel as well. In the late 1990s, decreased city-pair competition was accompanied by increased average airfare.⁵⁵ Furthermore, intense competition from new entrant low-cost carriers played a great role in undercutting demand for incumbent legacy carriers.⁵⁶

B. Commercial Framework of the Airline Industry

An airport slot is the “right to operate a service at a particular time.”⁵⁷ The FAA originally distributed airport slots.⁵⁸ The international standard for “airport slot management” is set forth in the Worldwide Slot Guidelines of the International Air Transport Association (IATA).⁵⁹ Slot allocation permits airlines to “acquire, retain and exchange” the slots needed to operate.⁶⁰ The IATA intends for the slot distribution process to facilitate the efficient use of airport space for which there is high demand in order to maximize benefit to the greatest extent possible for passengers.⁶¹ The crucial need for airport slots as a prerequisite to competitive viability for airline carriers is evidenced by the use of airport slots as bartering chips. For instance, in August 2010, Continental agreed to lease eighteen pairs of take-off and

⁵¹ *Id.* at 4. These fees are used “to fund FAA approved projects that enhance safety, security, or capacity; reduce noise; or increase air carrier competition.” *Passenger Facility Charge (PFC) Program*, FEDERAL AVIATION ADMINISTRATION (last modified Feb. 11, 2015, 4:53 PM), <http://www.faa.gov/airports/pfc/>, archived at <https://perma.cc/GNV2-VEF6?type=source>.

⁵² Borenstein, *supra* note 3, at 3.

⁵³ *Id.* at 7.

⁵⁴ *Id.*

⁵⁵ Dempsey, *supra* note 1, at 688.

⁵⁶ Borenstein, *supra* note 3. The threat posed to legacy carriers by low-cost carriers will be discussed in greater detail later in this section.

⁵⁷ Charlie Leocha, *Who Owns Airport Slots? The American People or the Airlines?*, CONSUMER TRAVELER (Aug. 30, 2010), <http://consumertraveler.com/today/who-owns-airport-slots-the-american-people-or-the-airlines/>, archived at <http://perma.cc/CLA8-37NF>.

⁵⁸ *Id.*

⁵⁹ *Worldwide Airport Slots*, IATA, <http://www.iata.org/policy/slots/Pages/slot-guidelines.aspx> (last visited Mar. 26, 2015), archived at <http://perma.cc/3T88-FA2G>.

⁶⁰ *Id.*

⁶¹ *Id.*

landing slots at Newark to Southwest Airlines in order to obtain approval for a proposed merger.⁶²

Airports are categorized according to the service they provide, such as commercial, cargo, and general aviation airports.⁶³ Commercial service airports provide service to a minimum of 2,500 passengers each year, with primary airports each accommodating at least 10,000 passengers each year.⁶⁴ Primary airports are further classified by hub type, which includes large, medium, small, or non-hub and is determined by number of passengers per year.⁶⁵ Large hubs service at least 1 percent of annual passenger boardings.⁶⁶ Medium and small hubs serve less than 1 percent of annual airline passengers, with non-hubs accommodating between 2,500 and 10,000 passenger boardings per year.⁶⁷

The ‘hub and spoke system’ has emerged as the “route structure of choice for deregulated airlines.”⁶⁸ The word ‘hub’ itself was “virtually absent from pre-deregulation theoretical comment on the industry.”⁶⁹ Following deregulation, most of the legacy airlines, except for Southwest Airlines, have adopted the hub-and-spoke model.⁷⁰ Hub dominance must be monitored with care, due to its correlation with monopolization and “escalating fares” for airline passengers.⁷¹

In the 1990s, a correlation was noted between increased hub concentration and a decline in competitive service.⁷² Department of Transportation (DOT) research also confirmed that the most concentrated hubs produced the highest air fares.⁷³ After comparing prices at fifteen concentrated hub airports and thirty-eight unconcentrated hub airports, the General Accounting Office concluded that passenger fare is often as much as 27 percent greater at concentrated hubs.⁷⁴ Passengers departing from airport hubs may pay “50 percent more than they would had deregulation not occurred.”⁷⁵ Furthermore,

⁶² Leocha, *supra* note 57.

⁶³ *Airport Categories*, FED. AVIATION ADMIN. (last modified Oct. 21, 2014, 4:36 PM), http://www.faa.gov/airports/planning_capacity/passenger_allcargo_stats/categories/, archived at <http://perma.cc/9PLZ-6VVJ>.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ Levine, *Airline Competition*, *supra* note 1, at 411.

⁶⁹ *Id.* at 413.

⁷⁰ Dempsey, *supra* note 1, at 692.

⁷¹ *Id.* at 695.

⁷² *Id.* at 688.

⁷³ *Id.* at 696.

⁷⁴ *Id.*

⁷⁵ Dempsey, *supra* note 1, at 695.

when one airline carrier controls more than half of the hub market, passengers often end up paying “significantly more than the industry norm.”⁷⁶

Classic hubs are large airports that service major cities or highly populated areas.⁷⁷ Such hubs typically cater to passengers on long distance flights and utilize shorter “spoke” flights as needed to connect passengers to their final destination.⁷⁸ However, decreased efficiency due to waiting on connecting baggage and passengers is the cost of providing a greater variety of destination options by means of “spoke” flights.⁷⁹

Hub dominance has stifled competition by permitting hub-dominant airlines to monopolize routes.⁸⁰ Hub dominance “enables the dominant airline to increase the number of city-pair monopolies radiating from the hub, allowing monopoly fares to be imposed on origin-and-destination passengers.”⁸¹ Airlines adamantly prefer this route structure, despite the heightened costs of “hubbing,” which result from “lowering aircraft, gate, and labor utilization and increasing fuel consumption.”⁸²

Countervailing benefits of the hub-centric strategy include “scheduling flexibility and insulation from new competition.”⁸³ Once they have established a hub, airlines may then add on spokes to gain “incremental connecting passengers,” thereby maximizing revenue potential.⁸⁴ After establishing hub-dominance, an airline may easily “increase the number of city-pair monopolies radiating from the hub,” and thereby maintain inflated passenger fare.⁸⁵

The opportunity to lease gates plays a critical role in an airline’s ability to generate profit.⁸⁶ Greater control of a hub’s gates enables airlines to secure “scheduling flexibility and insulation from new competition.”⁸⁷ Restricting access to gates therefore poses one of the most significant barriers to entry for an airline competitor and implicates market contestability.⁸⁸

⁷⁶ *Id.*

⁷⁷ Ryan Griffin, *State Aid, the Growth of Low-Cost Carriers in the European Union, and the Impact of the 2005 Guidelines on Financing of Airports and Start-Up Aid to Airlines Departing from Regional Airports*, 71 J. AIR L. & COM. 341, 345 (2006).

⁷⁸ *Id.* at 344.

⁷⁹ *Id.* at 346.

⁸⁰ Dempsey, *supra* note 1, at 692.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 927 (6th Cir. 2005).

⁸⁷ Dempsey, *supra* note 1, at 692.

⁸⁸ *Spirit*, 431 F.3d at 927. The notion of perfect market contestability will be discussed later in this section.

Although determination of route schedules and pricing has been almost entirely unregulated since the 1978 Airline Deregulation Act,⁸⁹ runway access remains largely regulated by local government.⁹⁰ Airlines usually ensure gate access through “long-term exclusive-use leases with the local airport authority.”⁹¹ Further, there is no “formal market mechanism” in the distribution of gates by local airport commissions.⁹² The current regulatory scheme does not preclude large airline carriers from forming “relationships with airports that allow [them] to restrict the availability of gates, landing slots and other resources to potential entrants.”⁹³ As a result, access to gates by new market entrants is “not determined by open competition.”⁹⁴

Hub dominance through gate monopolization by large airline carriers has raised concerns regarding alleged unlawful suppression of competition.⁹⁵ In addition to airline competition, such practices also implicate consumer welfare, as airline carriers holding a greater number of gate leases are able to exact higher passenger fares.⁹⁶ Other competitive practices by large airline carriers trigger suspicion of unlawful competitive behavior.⁹⁷ These practices include “frequent-flyer and corporate discount programs that exchange discounts for customer loyalty.”⁹⁸ Further practices that enable legacy carriers to derive benefit to the exclusion of low-cost carriers include “exclusive alliances with regional feeder carriers, their ability to bias the computer reservations systems they own against competing interline connections, [and] their ability to bribe travel agents with commission overrides to steer business their way.”⁹⁹

In the airline industry, market concentration is analyzed based on overlapping city-pair routes.¹⁰⁰ The Transportation Research Board of the National

⁸⁹ Pub. L. No. 95-504, § 2493, 92 Stat. 1705 (1978).

⁹⁰ *Spirit*, 431 F.3d at 928 (quoting Gautam Gowrisankaran, *Competition and Regulation in the Airline Industry*, FED. RESERVE BD. OF S.F. ECON. LETTER, Number 2002-01, p. 1).

⁹¹ *Spirit*, 431 F.3d at 928. “In 1996, the GAO found that 76 of the 86 gates at the Detroit airport were covered by long term leases until 2008 and Northwest had 64 of such leases.” *Id.*

⁹² *Id.*

⁹³ Borenstein, *supra* note 3, at 9; Borenstein, *supra* note 3, at 9-10.

⁹⁴ *Spirit*, 431 F.3d at 927.

⁹⁵ Dempsey, *supra* note 1, at 692.

⁹⁶ *Id.*

⁹⁷ Borenstein, *supra* note 3, 9-10.

⁹⁸ *Id.* at 9.

⁹⁹ Dempsey, *supra* note 1, at 702.

¹⁰⁰ Craig Peters, *Evaluating the Performance of Merger Simulation: Evidence from the U.S. Airline Industry*, 49 J.L. & ECON. 627, 631 (2006); see also Bailey, *Deregulation*, *supra* note 30, at 113. The unattainable ideals of perfect competition and perfect contestability are distinguishable. *Id.* However, both theoretical market states claim “totally unimpeded” “entry into and exit from the industry” as a factor. *Id.* Perfectly competitive industries

Research Council espouses that airline competition is properly analyzed in terms of city pairs.¹⁰¹ Competition for airline passengers is thus framed in consideration of “thousands of combinations of origin and destination (O-D) points.”¹⁰²

C. *The Theory of Perfect Market Contestability*

Under the contestability theory, “perfectly contestable” markets enable new entrants to provide a competitive check on the pricing of incumbent businesses.¹⁰³ While the degree to which a market is contestable hinges on many variables, freedom of entry and exit for new market entrants is generally considered the single most influential factor.¹⁰⁴ Contestability of markets hinges on low barriers to entry, so that new entrants may offer competitive prices.¹⁰⁵ Similarly, ease of exit serves the essential purpose of promoting investment by preserving the ability to abandon an unprofitable investment.¹⁰⁶

Proponents of the contestability theory within the context of the airline industry maintain that low barriers to entry enable new market entrants to become viable competitors, thereby restricting the ability of entrenched airlines to extract excessive profits.¹⁰⁷ The view that competition provides a natural check on unfair pricing relies on low barriers to entry, such that “if fares rose, other airlines could easily enter the market.”¹⁰⁸ Competitive pricing provided by new entrants would then provide consumers with lower-cost options and force incumbents to lower fares in order to remain viable in the market.¹⁰⁹

It is useful to consider three features when calibrating the degree to which a market approaches the ideal of perfect contestability.¹¹⁰ The first feature is

also must consist of “a large number of miniscule firms.” *Id.* at 118. This supports the argument for increased regulation in Part II, ensuring that at least some low-cost carrier new entrants can remain viable promotes healthy competition by creating a market resembling the theoretical model of perfect competition. *See id.* at 115. The ideal of perfect competition has been criticized for “its lack of realism and its inflexibility.” *Id.*

¹⁰¹ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 933 (6th Cir. 2005).

¹⁰² *Id.*

¹⁰³ Bailey, *Deregulation*, *supra* note 30, at 112.

¹⁰⁴ *Id.* at 113.

¹⁰⁵ *Id.* at 111.

¹⁰⁶ *Id.* at 120.

¹⁰⁷ Peter C. Carstensen, *Evaluating “Deregulation of Commercial Air Travel: False Dichotomization, Untenable Theories, and Unimplemented Premises*, 46 WASH. & LEE L. REV. 109, 115 (1989).

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ Bailey, *Deregulation*, *supra* note 30, at 120, 121. Because the notion of perfect contestability, like perfect competition, “is highly improbable in reality,” analysts deem

freedom of exit, which enables the new entrant to walk away from an unprofitable investment.¹¹¹ Second, markets are considered contestable when potential entrants can readily respond to opportunities to enter the market, thereby serving as a “threat” to incumbent businesses and ensuring competitive pricing.¹¹² The third factor indicating market contestability is the “sluggishness” in the competitive pricing responses of incumbent enterprises.¹¹³

Strict adherence to the idea of perfectly contestable markets suggests that such markets do not require regulatory interference.¹¹⁴ Despite the accepted notion that unrestricted entry and exit is crucial for promoting market contestability, public interest necessitates imposing regulatory restrictions in certain circumstances.¹¹⁵ For instance, regulatory policies impeding exit have been motivated by such concerns as maintaining access to service for remote consumers and preserving jobs.¹¹⁶

During the deregulation of the airline industry, the Civil Aeronautics Board propounded the contestability of aviation markets.¹¹⁷ Contestability theory advocates have cited the successful unregulated airline markets in California and Texas while contending that natural competition would produce lower fares and a more salubrious environment for new enterprises.¹¹⁸ Simple consideration of the mobility of aircraft seemed to support the notion

markets contestable even when “the requirements of contestability are fulfilled only approximately.” *Id.* at 114. A second “formal definition” identifies contestable markets as those in which there are no sunk costs, which are “outlay[s] that cannot be recouped without substantial delay.” *Id.* at 113–14.

¹¹¹ *Id.* at 120. “[F]reedom of exit is merely the obverse of freedom of entry.” *Id.* Following an unsuccessful venture, a recent entrant may exit a perfectly contestable market without sunk costs, thereby decreasing risk and encouraging competitive investment. *Id.* at 114.

¹¹² *Id.* A “standby” new entrant’s ability to seize opportunities to offer competitively priced, yet profitable, fares depends on the carrier’s ability to “choose the timing, place, and manner of entry that best suits the circumstances.” *Id.* This Note contends that legacy carrier’s monopolization of gate leases serves as a major impediment to contestability in light of this second factor. *Id.* at 131.

¹¹³ *Id.* at 121. While the third factor is not “essential,” a lag period protects the new entrant. *Id.* Though this may seem to inflate the price in the short term, helping new entrants stay afloat ultimately aids competition by preventing market domination by incumbents. Some even maintain “that regulation-induced lags in pricing may well be salutary.” *Id.*

¹¹⁴ *Id.* at 111.

¹¹⁵ *Id.* at 120. Such restrictions undermine contestability, because “[a]ny impediment to exit by definition increases the riskiness, and hence the real cost, of opening for a business.”

¹¹⁶ *Id.* Countervailing public interest issues have arisen in both the railroad and airline industries. *Id.* Such protectionist regulatory policy comes at the cost of inhibiting competition. *Id.* at 120. As opposed to the indirect, cross subsidy approach, critics have suggested direct subsidization. *Id.*

¹¹⁷ *Id.* at 127–28.

¹¹⁸ Carstensen, *supra* note 107, at 115.

of inherent competitive checks on passenger fare through entry of new competitors in a perfectly contestable market.¹¹⁹

This simplistic view of market entry fails to take into account that physically transferring investment capital is the final phase in the laborious process of launching and establishing passenger service. More significant contestability considerations include the variety of obstacles that create high barriers to entry in the airline industry.¹²⁰ For instance, new market entrants—and thus market contestability—are hampered by “network-reinforcing marketing practices like price discrimination, customer loyalty programs, travel agency incentive programs, and computer reservations system (CRS) search bias, as well as the use of historic airport facilities commitments.”¹²¹

The variety of obstacles contributing to high barriers to entry in the airline industry indicate that the airline industry is far from achieving perfect contestability and that complete deregulation does not produce optimal competition.¹²² In light of these entry obstacles for new airlines, proponents of perfect contestability must temper the notion that completely deregulated markets are “the best of all possible worlds” against the reality that some market intervention may be necessary to protect both airline competitors as well as air passengers.¹²³

D. The Low-Cost Carrier Business Model

Consistent with their name, low-cost air carriers utilize operational strategies that minimize cost and promote efficiency, thereby enabling them to provide lower passenger fares.¹²⁴ Herb Kelleher established the prototype for the low-cost carrier model when he started Southwest Airlines in 1971.¹²⁵ Other established low-cost carriers include Frontier, Vanguard, Reno, Kiwi, and Spirit.¹²⁶ Following the deregulation of the United States airline industry, low-cost carriers have served to promote efficiency, increase destination options, and decrease passenger fare.¹²⁷

¹¹⁹ Elizabeth E. Bailey, *Contestability and the Design of Regulatory and Antitrust Policy*, 71 AM. ECON. ASS'N. 178, 179–80 (1981) [hereinafter Bailey, *Contestability*]. Cf. Bailey, *Deregulation*, *supra* note 30, at 128 (“[T]he majority of U.S. city-pair markets are natural monopolies (and so are likely to be served by only one carrier even under free entry) and all markets are likely to show high concentration.”).

¹²⁰ Levine, *Airline Competition*, *supra* note 1, at 335.

¹²¹ Michael E. Levine, *Airline Alliances and Systems Competition: Antitrust Policy Toward Airlines and the Department of Justice Guidelines*, 45 HOUS. L. REV. 333, 335 (2008) [hereinafter Levine, *Airline Alliances*].

¹²² Levine, *Airline Competition*, *supra* note 1, at 397.

¹²³ Bailey, *Deregulation*, *supra* note 30, at 112.

¹²⁴ Griffin, *supra* note 77, at 345.

¹²⁵ *Id.* at 343.

¹²⁶ Dempsey, *supra* note 1, at 698.

¹²⁷ Griffin, *supra* note 77, at 343–44.

The Department of Transportation concurs that low-cost carriers produce consumer savings while increasing route density.¹²⁸ Further benefit includes the effect of low-cost carriers in providing a competitive check on passenger fare prices offered by incumbent legacy carriers.¹²⁹ In dominated hub markets, low-cost carrier service may provide consumers with savings of up to seventy dollars per passenger, or 40 percent, for one-way fares.¹³⁰

Low-cost carriers in the United States have been noted as “the world’s most mature.”¹³¹ In addition to challenging the traditional business model of incumbent airlines, domestic low-cost carriers provide steep competition for one another as route density increases.¹³² For example, whereas low-cost carriers only overlapped on twenty-three routes in 2005, they competed for market share on 139 routes by the end of 2009.¹³³

The efficiency of the low-cost carrier business model has enabled new entrant airlines to provide lower passenger fares while maintaining competitive pressure on entrenched legacy airlines.¹³⁴ For instance, American Airlines, one of the largest domestic carriers, incurs costs on domestic flights that are 26.9 percent greater than Southwest and exceed JetBlue’s costs by 62.5 percent.¹³⁵ The two mainstays of the low-cost carrier strategy are “simple products and low operating costs.”¹³⁶ Other crucial low-cost carrier tactics include “a single passenger class, a single type of airplane, a simple fare scheme, unreserved seating, flights to secondary airports, point-to-point rather than hub and spoke networks, emphasis on direct ticket sales, and elimination of in-flight meals and other in-flight services.”¹³⁷

Elimination of costs by low-cost carriers depends on uniformity and simplicity of service.¹³⁸ Low-cost carriers maximize efficiency by eliminating first- and business-class tickets as well as reserved seating.¹³⁹ Offering only one class of ticket further serves to maximize the number of passengers per flight and to reduce turnaround time by enabling passengers to board the

¹²⁸ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 926 (6th Cir. 2005) (citing U.S. Department of Transportation, *The Low Cost Airline Service Revolution*, Apr. 1996 at 9).

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ Andrew Compart, *Low-Cost Clash*, 172 AVIATION WK. & SPACE TECH. 22 (June 8, 2010).

¹³² *Id.*

¹³³ *Id.*

¹³⁴ Griffin, *supra* note 77, at 344.

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.* at 345.

¹³⁹ *Id.*

aircraft more quickly.¹⁴⁰ Low-cost carriers also streamline cost through the elimination of complimentary services and features, such as airplane window blinds, reclining seats, seat pockets, and headrest covers.¹⁴¹

The low-cost carrier strategy also incorporates use of secondary airports.¹⁴² Flying into secondary airports minimizes an air carrier's operating costs, because secondary airports often charge less stringent landing and service fees.¹⁴³ Taking advantage of these lower fees is critical for streamlining operational expenses, because such airport fees are one of airlines' major costs.¹⁴⁴ Airlines obtain further benefit through use of secondary airports by means of increased efficiency.¹⁴⁵ The decreased congestion of secondary airports enables low-cost carriers to achieve faster turnaround times, thereby maximizing the daily number of flights provided by each airplane.¹⁴⁶

Low-cost carriers further minimize costs by utilizing only one model of aircraft and engine.¹⁴⁷ A "uniform fleet" provides for decreased cost of training for pilots, flight attendants, and maintenance crews.¹⁴⁸ Maintaining one type of plane is less expensive, because airlines can stock up on spare parts without worrying that they will become useless.¹⁴⁹ Further, operating with one style of aircraft contributes to operating efficiency, because switching between aircraft models would require training for pilots, mechanics, and crew.¹⁵⁰

Even though the survival of low-cost carriers precariously hinges upon the single variable of competitive pricing, whereas legacy carriers extract benefit through a variety of aggressive tactics, low-cost carriers have nevertheless threateningly encroached upon market share.¹⁵¹ The success of low-cost carriers has placed "enormous pressure on the established carriers."¹⁵² Legacy carriers, whose business model relies on brand-name recognition, have realized that consumers are motivated more by lower prices than by loyalty to a particular brand.¹⁵³

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.* at 344.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 345.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *See id.* at 345; *see also* Dempsey, *supra* note 1, at 702.

¹⁵² Dempsey, *supra* note 1, at 703.

¹⁵³ *Id.* at 702-03.

The success of the low-cost carrier business model comes from the ability to fuel demand by means of “lower but still profit-producing fares.”¹⁵⁴ Soon after entering the market in 1971, low-cost carriers established themselves as viable competitors and have been recognized as “the driving force in the industry” since the mid-1990s.¹⁵⁵ By 2006, low-cost carriers had obtained roughly 35 percent of the United States domestic airline market.¹⁵⁶ By this time, Southwest Airlines had become the fourth-largest domestic airline, as based upon volume of passengers.¹⁵⁷ Low-cost carriers have maintained a trend of prosperity since the 1990s.¹⁵⁸ As a result, low-cost carriers were competing with legacy carriers on more than 60 percent of city-pairs by 2011.¹⁵⁹ In addition, the relative success of legacy carriers as compared to low-cost carriers is compromised by the fact that legacy carrier operating costs have exceeded those of their low-cost counterparts by at least 40 percent since the early 2000s.¹⁶⁰ Data indicates that low-cost carriers consistently incurred fewer losses than legacy carriers in the last decade.¹⁶¹ This disparity in efficiency and success is exacerbated by the particular demands of the aviation industry, in which a successful airline must “earn[] consistent profits through the typical cycles in the airline business environment.”¹⁶²

In addition to forcing legacy carriers to share the market, the prevalence of low-cost options has caused anxiety among traditionally dominant carriers by reducing their ability to sell more expensive fares.¹⁶³ With the entry of each new low-cost carrier, the proportion of low to high cost passenger fares increases accordingly.¹⁶⁴ In some instances, the average fare has dropped from \$173 to approximately \$115.¹⁶⁵ The prevalence of low-cost options has “dramatically” reduced demand for more costly passenger fares.¹⁶⁶

Low-cost carriers’ threatening encroachment upon the market share and profits of established airlines has incited various retaliatory responses among legacy carriers.¹⁶⁷ Major air carriers have exercised defensive tactics “when a small affordable air carrier enters the market they dominate.”¹⁶⁸

¹⁵⁴ Compart, *supra* note 131.

¹⁵⁵ Dempsey, *supra* note 1, at 704.

¹⁵⁶ Griffin, *supra* note 77, at 346.

¹⁵⁷ *Id.*

¹⁵⁸ Borenstein, *supra* note 3, at 11.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.* at 13.

¹⁶² *Id.*

¹⁶³ See *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 927 (6th Cir. 2005).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ Dempsey, *supra* note 1, at 688–99.

¹⁶⁸ *Id.* at 689.

This has been identified by some as a “campaign to eradicate competition” out of fear that these new low-cost entrants would force legacy carriers to lower passenger fares.¹⁶⁹

The panicked response of legacy carriers has been described by aviation law scholar Paul Stephen Dempsey as a “homicidal mission to destroy the low-fare airlines.”¹⁷⁰ The Justice Department reported as early as 1993 that legacy carrier American Airlines estimated the invasion of low passenger fares threatened \$3.6 billion in annual revenue.¹⁷¹ By the late 1990s, various legacy carriers had established adversarial stances against particular low-fare competitors, including United against Frontier and Western Pacific, American against Vanguard and Western Pacific, Delta against ValuJet, and Northwest against Spirit Airlines.¹⁷²

Defensive measures adopted by legacy carriers in order to maintain their stranglehold on the market include the expansion of legacy carrier networks by means of mergers and megacARRIER alliances.¹⁷³ Legacy carriers also provide nonstop fares corresponding to low-cost carrier connecting fares in an attempt to maintain their market share.¹⁷⁴ A further strategy of “saturat[ing] the route” with low fares in order to undermine low-cost carrier ticket sales has spurred claims of price predation.¹⁷⁵ These allegedly predatory tactics practiced by large incumbent airlines include adding both flights and seats to routes threatened by low-cost carriers in order to force them from the market, reducing prices to “below-cost levels,” and tampering with computer reservations to ensure that competitor’s connections are less convenient.¹⁷⁶ Legacy airlines have even been accused of bribing travel agents with commissions in order to secure reservations.¹⁷⁷

Although the DOT was initially able to thwart price predation through “moral persuasion,” the DOT recognized the futility of this approach and set forth an official policy statement regarding anti-competitive and exclusionary practices by 1998.¹⁷⁸ The DOT established guidelines geared towards preventing the practice of hub-dominant carriers of adding flights and seats while lowering passenger fares.¹⁷⁹ According to the DOT, predation

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 688.

¹⁷¹ *Id.* at 699.

¹⁷² *Id.* at 689. Northwest’s alleged attempt to force Spirit Airlines out of the market through price predation will provide the basis for discussion in Part II of this Note.

¹⁷³ Borenstein, *supra* note 3, at 13; *see also* Dempsey, *supra* note 1, at 701.

¹⁷⁴ Dempsey, *supra* note 1, at 689.

¹⁷⁵ *Id.* at 689.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 690.

¹⁷⁸ *Id.* at 689–90.

¹⁷⁹ *See* Charles E. Koob, *Whither Predatory Pricing? The Divergence Between Judicial Decisions and Economic Theory: The American Airlines and Virgin Atlantic Airways Cases*,

includes “any response to new entry by a hub-dominant airline that makes economic sense only because the hub carrier can exclude the new entrant from the market and thereafter return to its pre-entry fares.”¹⁸⁰

Following thirty-two claims of alleged price predation against legacy carriers, the DOT issued a statement on Unfair Exclusionary Conduct in 1998, and a corresponding policy in 2001.¹⁸¹ Seventeen of these claims were made by new entrants to the airline market, supporting the widely adopted conclusion that incumbent airlines were targeting their younger low-cost competitors.¹⁸² The Department of Justice (DOJ) first alleged antitrust violations based on price predation against one of the major legacy carriers, American Airlines, in May of 1990.¹⁸³ Action by the DOJ was triggered by the acute suppression of competition as a result of the conduct of legacy carriers, such as American Airlines.¹⁸⁴

According to the Supreme Court, price predation occurs when a competitor sets prices “below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run.”¹⁸⁵ Varying theories exist concerning cost measurement for the purposes of identifying predatory pricing.¹⁸⁶ While analysts have not settled upon a “perfect touchstone,” courts generally look to “the relation of the suspect price to the firm’s costs.”¹⁸⁷ Because courts are wary of inhibiting healthy, consumer-beneficial competition, courts tend to strictly construe predatory pricing standards.¹⁸⁸ Generally, pricing is predatory when it is less

3 SEDONA CONF. J. 9, 12 (2002); *see also* DOT Proposal, Unfair Exclusionary Conduct in Air Transportation Industry, 7 Trade Reg. Rep. (CCH) ¶ 50, 163, 49, 227 (1998).

¹⁸⁰ Koob, *supra* note 179, at 11–12.

¹⁸¹ *See* Dempsey, *supra* note 1, at 690; *see also* DOT Proposal, *supra* note 179; DOT, Enforcement Policy Regarding Unfair Exclusionary Conduct in the Air Transportation Industry, Docket OST-98-3713 (Jan. 17, 2001).

¹⁸² *See* Dempsey, *supra* note 1, at 690.

¹⁸³ *Id.* at 690–91; *see also* Koob, *supra* note 179, at 11.

¹⁸⁴ *See* Dempsey, *supra* note 1, at 691. In 1999 alone, the discontent of consumers was evidenced as complaints increased by 115 percent. *Id.* The purpose of antitrust law is to secure “the protection of competition, not competitors.” *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). The ultimate goal of the protection of fair and open competition is to benefit the consumer, who is “the presumptively ‘proper’ plaintiff.” *SAS of Puerto Rico, Inc. v. Puerto Rico Tel. Co.*, 48 F.3d 39, 44 (1st Cir. 1995).

¹⁸⁵ *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117 (1986).

¹⁸⁶ *See* Christopher R. Leslie, *Predatory Pricing and Recoupment*, 113 COLUM. L. REV. 1695, 1753 (Nov. 2013).

¹⁸⁷ *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F. 2d 227, 232 (1st Cir. 1983). Determining price predation upon “intent to harm” is not a widely adopted court standard, and has been criticized for ambiguity as well as the ready means by which firms may simply avoid displaying any signs of intent. *Id.*

¹⁸⁸ *Id.* at 232. Pricing that appears too low to cover an appropriate measure of costs may result from a variety of non-predatory purposes and variables, such as promotional or free

than the figure produced by dividing the airline's average variable costs¹⁸⁹ for a flight by the number of seats for that flight.¹⁹⁰

Due to the dangerous overlap between predatory behavior and aggressively competitive pricing, the Supreme Court established a high threshold for antitrust injury based upon predatory pricing through the *Brooke Group* test.¹⁹¹ Under the first prong of the test, a plaintiff must establish that the defendant unprofitably set prices below an appropriate measure of cost.¹⁹² The second prong stipulates that the defendant must have had a "reasonable prospect of recouping its investment in below-cost prices."¹⁹³ This period of recoupment enables the business to recover for losses sustained during the seemingly irrational period of unprofitable predatory pricing.¹⁹⁴

In order to determine the ability of a business to successfully recoup losses incurred through a sub-competitive predatory pricing period, the Supreme Court looks to the nature of the market.¹⁹⁵ The possibility of recoupment depends primarily upon market concentration, the feasibility for the defendant to acquire the plaintiff's share of the market, and high barriers to entry.¹⁹⁶ While the Court is reticent to find for plaintiffs in price predation cases, it has at least acknowledged that the nature of the airline industry "can at a minimum allow unfair exclusionary practices to succeed."¹⁹⁷

samples as well as anticipated decrease in incremental or variable costs. *Id.* Courts attempt to filter predatory pricing claims in order to protect legitimate competition. *Id.*

¹⁸⁹ This is often used by courts as an "appropriate measure of cost." *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 917 (6th Cir. 2005); *see also* James L. Robenalt, *Predatory Pricing in the Low-Fare Airline Market: Targeted, Discriminatory, and Achieved with Impunity*, 68 OHIO ST. L.J. 641, 650 (2007).

¹⁹⁰ *See, e.g.*, Robenalt, *supra* note 189, at 659.

¹⁹¹ *See* Koob, *supra* note 179, at 10; *see also* DOT Proposal, Unfair Exclusionary Conduct in Air Transportation Industry, 7 Trade Reg. Rep. (CCH) ¶ 50, 163, 49, 227 (1998); *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 210 (1993).

¹⁹² *Brooke*, 509 U.S. at 510.

¹⁹³ *Id.*

¹⁹⁴ *Id.* at 210.

¹⁹⁵ *See* Koob, *supra* note 179, at 10; *see also* *Brooke*, 509 U.S. at 226.

¹⁹⁶ *Id.*

¹⁹⁷ Koob, *supra* note 179, at 12; Dempsey, *supra* note 1, at 805 (citing DOT, Request for Comments in Docket OST-98-3717 (Apr. 6, 1998)). The Supreme Court "has said that predation rarely occurs and is even more rarely successful." *Id.* Despite the Court's conclusion, analysts contend that the airline industry by its structure and inherent characteristics tends to "allow unfair exclusionary practices to succeed." *Id.* This characteristic is strikingly evident when the air carriers are compared to enterprises in different industries, because a major air carrier can price-discriminate to a much greater extent, adjust prices much faster, and shift resources between markets much more readily. Through booking and other data generated by computer reservations systems and other sources, air carriers have access to comprehensive, 'real time' information on their competitors' activities and can thus respond to competitive initiatives more precisely and swiftly than firms in other industries. *Id.*

Plaintiffs may pursue predatory pricing claims under section 2 of the Sherman Antitrust Act.¹⁹⁸ Plaintiffs must establish (1) that defendant secured monopoly power in the relevant market; and that (2) this power was used for anti-competitive or exclusionary purposes, as opposed to “growth or development resulting from a superior product, business acumen, or historic accident.”¹⁹⁹ Due to the difficulty in distinguishing between legitimate competition and predatory behavior, courts typically “resolve antitrust claims on a case-by-case basis, focusing on the ‘particular facts disclosed by the record.’”²⁰⁰ Such modes of antitrust enforcement are intended not to protect businesses from unfair competition, but to “protect the public from the failure of the market.”²⁰¹

II. ASSESSING AND MINIMIZING OPPORTUNITIES FOR PREDATORY PRICING IN THE AIRLINE INDUSTRY

A. Spirit Airlines, Inc. v. Northwest Airlines, Inc.: *The Spirit Court’s Analysis Is Flawed*

Plaintiff Spirit Airlines, Inc. (“Spirit”), sued defendant Northwest Airlines, Inc. (“Northwest”), under section 2 of the Sherman Antitrust Act, 15 U.S.C. § 2.²⁰² Spirit alleged that Northwest intended to monopolize the “leisure passenger airline market[]” through the predatory pricing of passenger fares.²⁰³ Spirit specifically alleged that Northwest had the predatory purpose of ousting Spirit from the Detroit-Boston and Detroit-Philadelphia routes.²⁰⁴

The District Court granted Northwest’s motion for summary judgment, accepting its argument that price-cost comparison should consider all passengers along the disputed routes and not just the low-fare ‘leisure’ bracket.²⁰⁵ A price-cost comparison taking into account other routes in addition to Northwest’s ‘leisure’ portion does not support predatory pricing,

Ultimately, this ability to achieve entrenchment enables legacy carriers to drive new entrants from their hub fortresses. *Id.*

¹⁹⁸ See, e.g., *Pac. Bell Tel. Co. v. Linkline Commc’ns, Inc.*, 555 U.S. 438, 451 (2009).

¹⁹⁹ *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 932 (6th Cir. 2005). (quoting *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 595–96 (1985)).

²⁰⁰ *Id.* at 931–32 (citing *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 482–83 (1992) (quoting *United States v. Griffith*, 334 U.S. 100, 107, 68 S. Ct. 941, 92 L.Ed. 1236 (1948)). In *Spirit*, the most pertinent “particular facts” deal with the unique nature of the airline industry, particularly in regards to fare structure and pricing. *Id.* at 931.

²⁰¹ *Spectrum Sports Inc. v. McQuillan*, 506 U.S. 447, 458 (1993).

²⁰² *Spirit*, 431 F.3d at 921. Spirit levied claims of monopolization and attempted monopolization against Northwest under section 2 of the Sherman Antitrust Act. *Id.*

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ *Id.*

because revenues for those routes would not be “irrationally” lower than corresponding costs, thus making the routes unprofitable.²⁰⁶

The Court of Appeals for the Sixth Circuit reversed, reasoning that Northwest’s route monopolization created opportunity for recoupment, thereby preserving Spirit’s price predation claim.²⁰⁷ Further, the circuit court concluded “that a reasonable trier of fact could find that a separate and distinct low-fare or leisure-passenger market existed.”²⁰⁸ However, although the *Spirit* court supported the Ninth Circuit’s partial adoption of the *Areeda/Turner* test, it did not set forth its own version of average variable cost.²⁰⁹

At the time of the suit, Spirit was a low-fare carrier operating out of Detroit.²¹⁰ Spirit’s argument hinged on its depiction of a relevant market consisting of “low fare or leisure passengers.”²¹¹ By contrast, Northwest’s broader definition of the market encompassed both low and high fare segments of the market by incorporating “all passengers on these routes.”²¹²

As of 1995, Northwest achieved status as the fourth-largest domestic airline.²¹³ Northwest had a virtual monopoly over sixty-four of the eighty-six airport gates at the Detroit Metro airport and received business from 78 percent of passengers flying through the airport.²¹⁴ Utilizing the traditional hub-and-spoke model, Northwest developed airport clubs, frequent flyer benefits, advanced seat selection, first class seating, and on-board meals in order to maximize revenue and to “try to sell every seat at its highest possible

²⁰⁶ *Id.* at 957.

²⁰⁷ *Id.* at 921. Spirit supported its recoupment argument with evidence, including “Northwest’s own marketing data, the testimony of its marketing officials, the findings of government regulators and Spirit’s experts.” *Id.* The District Court held that a reasonable trier of fact could conclude that Northwest practiced predatory pricing, because at the time in question, “the market in the two relevant geographic routes was highly concentrated, Northwest possessed overwhelming market share, and the barriers to entry were high.” *Id.*

²⁰⁸ *Id.* The court’s isolation of a low-fare leisure bracket of the market preserved Spirit’s price predation claim, because comparing Northwest’s costs against a smaller pool of revenue from the leisure bracket supports the possibility that Northwest intentionally sustained a period of unprofitability, thereby satisfying prong one of the *Brooke Group* test. *Id.* Prong two addresses the possibility of recoupment. *Brooke*, 509 U.S. at 224.

²⁰⁹ *See Spirit*, 431 F.3d at 938.

²¹⁰ *Id.* at 922.

²¹¹ *Id.* at 921. This portrayal of the market for the purposes of price-cost comparison was essential to Spirit’s ability to prove price predation. Evaluating Northwest’s costs solely against the low-fare segment makes it more likely that an expert would conclude that Northwest’s costs exceeded revenue for that route, and thus that Spirit intentionally engaged in the predatory behavior of engaging in an unprofitable venture in order to secure long term gain.

²¹² *Id.*

²¹³ *Id.* at 923.

²¹⁴ *Id.*

fare.”²¹⁵ Whereas Northwest secured consumer loyalty through name-brand appeal and a business model that relied upon “bells and whistles,” Spirit’s profitability depended solely upon the appeal of its competitively priced passenger fares.²¹⁶

At the time of suit, Northwest controlled 72 percent of the Detroit-Philadelphia route and 89 percent of the Detroit-Boston route.²¹⁷ Northwest sought to preserve its virtual monopoly of these routes by thwarting Spirit’s attempt to expand ticket counter and gate services at the Detroit Metropolitan Airport.²¹⁸ Northwest entrenched itself by means of leases and secondary rights from other airlines.²¹⁹ According to its own analysts, Northwest predicted that low-cost carriers would decrease its revenue by approximately \$250–375 million per year.²²⁰ Northwest identified Spirit as such a low-fare carrier in one of its studies.²²¹

B. The Precarious Standard of Predatory Intent

The *Spirit* court held that a jury may decide that “price-sensitive leisure passengers” constitute the relevant market segment for the purposes of the price-cost comparison, thereby preserving the possibility that Northwest illegally engaged in price predation.²²² Further, the *Spirit* court incorrectly evaluated Northwest’s alleged predatory pricing on the basis of predatory intent, despite concluding that Northwest’s prices exceeded average variable costs on both routes.²²³ The court maintained that Spirit could nevertheless prevail under the test of “what a rational firm would have expected its prices to accomplish.”²²⁴ The danger of the subjective intent-based standard is that it

²¹⁵ *Id.*; see also Bailey, *Deregulation*, *supra* note 30, at 115. Northwest’s inefficient business model, which incurs unnecessary expense in order to secure consumer loyalty, would not be sustainable amidst pressure from low-cost carriers in a perfectly contestable market, or perhaps even a closer approximation to perfect contestability. *Id.* at 118. Northwest’s profitability despite attempted entry by low-cost carriers, such as Spirit, therefore indicates an unhealthy and anti-competitive market in which enterprises may seize opportunities to exercise predatory tactics. *Id.*

²¹⁶ See *Spirit*, 431 F.3d at 922.

²¹⁷ *Id.* at 923.

²¹⁸ *Id.* at 922.

²¹⁹ *Id.* Such strategy constitutes unfair exclusionary practice. This Note contends that the ability for airlines to lawfully monopolize routes under the current regulatory regime is symptomatic of an ailing system and evidences the need for reforms that limit unfair barriers to entry. See *infra* Part II.C.

²²⁰ *Spirit*, 431 F.3d at 929.

²²¹ *Id.*

²²² *Id.* at 958.

²²³ *Id.* at 938.

²²⁴ *Id.* The *Spirit* court’s utilization of an intent based standard is in line with the Ninth Circuit’s standard, which likewise bases predation upon intent, even when prices exceed

provides no reliable means for distinguishing between illegal predatory behavior and legitimate competitive tactics.²²⁵

Due to high barriers of entry to the airline industry, courts could interpret long-term gate leases as evidence of legacy carriers' unlawful intent to secure the probability of a recoupment period following predatory pricing.²²⁶ However, this subjective standard fails to consider a variety of objective variables that influence both the short-term strategy and long-term business models of hub-dominant airline carriers.²²⁷ For instance, regardless of high barriers to entry, air carriers may provide seemingly unprofitable fares due to anticipated decline in costs or the success of consumer loyalty programs.

C. The Way Forward: A Case for Increased Regulation of the Airline Industry

The current legal framework fails to protect competitors—and therefore consumers—from predatory pricing. However, the hesitancy of courts to condemn major carriers for the “discriminatory sharp-shooting” of new entrants may not stem from any shortcoming of the current legal standard.²²⁸ Courts are likely justified in their deference to competition and weariness of condemning lawful, albeit aggressive tactics.

This Note supports the seemingly ‘defendant friendly’ stance of the District Court in *Spirit* that the price-cost comparison test for price predation should derive the appropriate measure of cost from all passengers along the disputed routes.²²⁹ Considering only the limited leisure fair route for the purposes of price comparison as part of the *Brooke Group* test improperly simplifies the fluid and multifaceted relationship between passenger fare and strategies for deriving revenue.²³⁰ Even uniform adoption of the District Court’s assessment of the relevant market for purposes of the price-cost comparison test would fail to sufficiently police price predation. Due to the risk of injustice and harm to competitors that may result from the court’s inability to properly distinguish aggressive yet legitimate competitive behavior from predatory tactics, this Note suggests that the solution lies not in a retroactive

average variable cost. *See* William Inglis v. ITT Cont'l Baking Co., 668 F.2d 1014, 1034 (9th Cir. 1981) (contending that the intent based test arguably favors plaintiffs). *Cf.* Morgan v. Ponder, 892 F.2d 1355, 1359 (8th Cir. 1989) (reasoning that the intent based standard improperly rests upon statements and behaviors influenced by the “heat of competition” in fact “provide[s] no help in deciding whether a defendant has crossed the elusive line separating aggressive competition from unfair competition”).

²²⁵ *See* Robenalt, *supra* note 189, at 668.

²²⁶ *Id.* at 649.

²²⁷ *Id.* at 668.

²²⁸ *See* Dempsey, *supra* note 1, at 736.

²²⁹ *See* Spirit Airlines, Inc. v. Nw. Airlines, Inc., 431 F.3d at 917, 921 (6th Cir. 2005).

²³⁰ *Id.* at 957.

judicial test, but rather in prophylactic measures through regulatory policy. One clear route to such a remedy would be to modify FAA regulations so that opportunities for price predation are thwarted from the onset. In particular, such regulations should focus on decreasing barriers to entry by ensuring fair access to routes and to gate and terminal leases.

The *Spirit* court's reliance on predatory intent and the price-cost comparison test is potentially harmful in its ineffectiveness to identify predatory pricing.²³¹ Further, even if such case-by-case analysis properly sorted out predatory enterprises, any sanctions against defendants would still fail to remedy the fact that the new entrant ousted from the market permanently lost that particular opportunity to secure a share of the market.²³² It is understandable that the *Spirit* court did not highlight market contestability in its discussion of Northwest's alleged price predation. However, though admittedly an "unattainable ideal state[]," the theoretical notion of perfect market contestability nevertheless provides a helpful framework in price predation cases.²³³

Enacting regulations that lower barriers to entry is a clear place to start in order to prevent predatory behavior. Experts acknowledge that "access to gates is critical" to the viability of new entrants.²³⁴ Particularly in regards to the airline industry, entry is not simply determined by developing the best business model, because denying entrants access to gates creates insurmountable barriers to entry.²³⁵ Providing new entrants with the reasonable expectation of securing gate leases would lower barriers to entry and maintain a competitive check on passenger fares offered by dominant airlines. Facilitating market entry would deter carriers from engaging in price predation by obviating the possibility of satisfying the second prong of the *Brooke Group* test.²³⁶

The seemingly irrational practice of sub-competitive pricing is only pursued when the possibility of recoupment exists.²³⁷ However, without the market dominance secured by high barriers to entry, passengers would not

²³¹ See Robenalt, *supra* note 189, at 668.

²³² See Bailey, *Deregulation*, *supra* note 30, at 114. "A contestable market works most effectively if, in response to profit-making opportunity, new firms can enter quickly, earn profits at least temporarily (before incumbents can institute counter measures), and then leave without any loss of investment in sunk capital." *Id.* The fact that a new entrant cannot sustain its enterprise does not by itself indicate price predation. *Id.* Rather, whether a new entrant can abandon its investment without sunk capital tends to indicate whether incumbent competitors were exerting unlawful clout through predatory practices. *Id.*

²³³ *Id.* at 112.

²³⁴ *Spirit*, 431 F.3d at 927.

²³⁵ *Id.*

²³⁶ See Leslie, *supra* note 186, at 1714.

²³⁷ *Id.* at 1698.

pay for higher fares during the legacy carrier's recoupment period due to the prevalence of more competitive options provided by low-cost carriers.²³⁸ Therefore, prosecuting price predation should not hinge upon penalizing the alleged predator after the fact, but should instead rely upon preventative measures. Such strategy would further the intent of antitrust law by promoting healthy competition.

Relying upon the judicial system in order to deter price predation fails to stave off predatory behavior or to remedy high barriers to market entry. Even if courts were able to enact a test that properly identified price predation, successful plaintiffs would still remain in an unprofitable position.²³⁹ Even if such plaintiffs were afforded entry into the market, they would still have permanently lost the opportunity for profit that depended on the prior convergence of favorable factors. Guaranteeing market entry following a suit would be an insufficient remedy, because the new entrant would likely not become profitable following the delay. Therefore, acknowledging the insufficiency of retroactive action, the solution lies in anticipating and regulating circumstances that create high barriers to market entry.

The harm of gate monopolies and the likely effectiveness of prophylactic measures²⁴⁰ is clear from the facts in *Spirit*.²⁴¹ Due to Northwest's control of the Detroit gates, Spirit eventually spent more than \$100,000 to obtain gate access and was forced to pay a 25 percent higher landing fee than legacy carriers, such as Northwest, which had secured long term leases with the Detroit Airport.²⁴²

The ability of entrenched incumbents to establish high barriers to market entry unequivocally highlights the need to regulate opportunities for market entrants. While guaranteeing equal access to all competitors would unnecessarily strain already space-constrained airports and likely diminish the quality of passenger service, at least some reasonable opportunity to enter the market must be available to new enterprises. Once a new airline manages to secure access to a portion of the market, assuming the absence of other exclusionary forces, consumer choice should reward the most efficient and

²³⁸ See Robenalt, *supra* note 189, at 643.

²³⁹ See Leslie, *supra* note 186, at 1738.

²⁴⁰ See Robenalt, *supra* note 189, at 669–70 (2007). One drastic proposal is the “price freeze” approach, which seeks to protect new-entrants by eliminating potentially predatory, supra-competitive pricing. *Id.* at 665. Pursuant to this strategy, legacy carriers would be subject to price freezes for twelve to eighteen months after the entry of a new airline. *Id.* at 669. Although this approach would likely protect new entrants, it would ultimately undermine consumer welfare by preventing airlines from engaging in competitive pricing and by forcing incumbent airlines to recoup by raising prices following the unprofitable price freeze.

²⁴¹ See *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 927 (6th Cir. 2005).

²⁴² *Id.* at 922.

appealing business model. Most critically, ensuring that incumbent airlines share the market with low-cost carriers would provide an essential competitive check on passenger fares. Absent the presence of competition, ticket prices for any route would soar.

Increased regulation as opposed to reliance upon judicial enforcement against predatory pricing is further supported by the inability of the price-cost comparison test to definitively identify price predation. One problem is that the current standard for determining whether a defendant airline engaged in price predation is high, reflecting reticence to sanction airlines for what may be legal competition.²⁴³ Departure from judicial tests in favor of preventative measures is also necessitated by the ambiguities upon which the judicial test is premised. One such unsettled component is a competitor's ability to recoup. Courts look to the existence of high barriers to entry in order to determine whether the defendant airline could engage in a recoupment period.²⁴⁴ A court is willing to find that defendant engaged in price predation when barriers to entry are "sufficiently high so that the predator can rely on a stable period of monopoly returns."²⁴⁵ However, while high barriers to entry accurately indicate the possibility of successful recoupment, they are not dispositive of a defendant's predatory intent or actual predatory behavior.²⁴⁶

The price structure and tactics of hub-dominant legacy carriers further expose the imprecision of the current judicial test. Legacy carriers have a "multi-layered fare structure" that is in itself not predatory, but may be manipulated for a predatory purpose.²⁴⁷ Incumbent airlines combine both low and high fares within a single flight, such that costs cannot be separated according to seat and compared with revenue for the purpose of the price-cost comparison on a flight-by-flight basis.²⁴⁸ This makes it difficult to assess whether passengers on a particular route are paying fares that are above or below average variable cost. Further, it is difficult to determine whether a defendant intentionally sustained a period of unprofitability for those routes.²⁴⁹

Discontent with the current standard arises from the inability of the judicial test to "draw an adequate distinction between predation and vigorous

²⁴³ Robenalt, *supra* note 189, at 649.

²⁴⁴ *Id.* at 642. This recoupment period would satisfy prong two of the *Brooke Group* test. *Id.*

²⁴⁵ *Id.*

²⁴⁶ *Id.* at 645–46.

²⁴⁷ *Id.* at 656.

²⁴⁸ *Id.*

²⁴⁹ Average variable cost is determined by dividing costs by the number of seats for a given route. *Id.* at 659.

competition.”²⁵⁰ Due to this difficulty in separating low-fare from high-fare passenger routes, the *Spirit* court’s decision to isolate the low-fare leisure bracket therefore sets precedent that risks penalizing lawful competitors.²⁵¹

CONCLUSION

The structure of the airline industry heightens antitrust concerns among its competitors. Incumbent legacy airlines have been able to use their clout to erect high barriers of entry for new entrant low-cost carriers. Further, the retaliatory response of legacy carriers to lower prices has been devastating for low-cost carriers, whose business model relies entirely upon attracting passengers with lower fare options. Such aggressive competitive maneuvering among legacy carriers has led to allegations of price predation.

This Note contends that courts are justifiably hesitant to find that a defendant airline engaged in price predation under section 2 of the Sherman Antitrust Act. Many aspects of the judicial test, particularly average variable cost, price-cost comparison, and identifying the relevant market provide imprecise means of calculation for considering whether a defendant actually engaged in predatory pricing. Of great concern is the emphasis placed upon high barriers to entry in evaluating a defendant’s intent. While such barriers indicate the possibility that a defendant engaged in price predation, they do not contribute to the price-cost analysis or in any way confirm a defendant’s predatory purpose.

Even though high barriers to market entry do not provide evidence of a defendant airline’s predatory intent, they nevertheless present an undue obstacle to competition. Instead of inhibiting competition by penalizing defendants, prophylactic measures should be taken to obviate any possibility of price predation by eliminating such barriers in the first place. Regulating market entry so that legacy carriers do not monopolize airport slots and gates would benefit consumers by ensuring that competitively priced airlines prevent legacy carriers from charging exorbitant passenger fares.

²⁵⁰ *Id.* at 665–66. The United States Court of Appeals for the Eighth Circuit has held that standby fares do not constitute predatory pricing. *Id.* at 659. Although priced below average variable cost, standby fare is considered to exceed short-run marginal costs, or “the marginal costs of serving one additional person.” *Id.* The appropriate cost analysis is therefore to compare the standby fare revenue to the incremental cost of providing this service. *Id.* Because this cost is so low, the lower fare does not cause this pricing scheme to approach the predatory zone. *Id.* at 658–59.

²⁵¹ See *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917, 927 (6th Cir. 2005).