Insight

The Turbulent Battle for Spirit Airlines Shows the Nuance of Defining the Relevant Market

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Executive Summary

- Rival suitors JetBlue Airways and Frontier Airlines remain entangled in a battle for Spirit Airlines; to date, this months-long process has included two accepted bids from Frontier, unsolicited and hostile takeover attempts by JetBlue, and four postponed Spirit shareholder votes.
- Whichever company emerges the victor, the combination of either JetBlue/Spirit or Frontier/Spirit would result in the fifth-largest U.S. airline and undoubtedly raise eyebrows among regulators within the Antitrust Division of the Department of Justice (DOJ).
- Defining the relevant market for these airlines will be a major determinant in the merger review process and subsequent ruling; as the Federal Trade Commission and DOJ are currently engaged in a process to "modernize federal merger guidelines," any changes are likely to alter this analysis.

Introduction

On February 7, 2022, Spirit Airlines and Frontier Group Holdings, the parent company of Frontier Airlines, announced a merger agreement that would combine the companies and result in "America's most competitive ultra-low fare airline," according to the company's press release.

Two months later, on April 5, 2022, JetBlue swooped in and made an unsolicited bid to purchase Spirit. Spirit rejected the offer. The rejection prompted JetBlue to launch a hostile takeover bid and sweeten its offer for Spirit, first in May and three more times in June. In response, Frontier raised its original offer and Spirit accepted. As of the market close on July 7, 2022, JetBlue's offer was valued at about $3.7 billion while Frontier's bid was worth roughly $2.6 billion, according to *The Wall Street Journal*.

Despite the 40 percent premium of JetBlue's bid, Spirit rejected the offer on the grounds that the deal was unlikely to receive regulatory approval since JetBlue is already embroiled in an antitrust case of its own involving a partnership with American Airlines. According to *CNBC*, Spirit Board Chair H. McIntyre Gardner wrote a letter to JetBlue Chief Executive Officer Robin Hayes, offering that "[W]e believe a combination of JetBlue and Spirit has a low probability of receiving antitrust clearance so long as JetBlue's Northeast Alliance (NEA) with American Airlines remains in existence."

Throughout the negotiations, Spirit Airlines postponed a series of shareholder votes on its proposed merger with Frontier. Initially scheduled for June 10, the first delay pushed back the vote to June 30, only to be rescheduled a second time for July 8. The third delay moved the vote to July 15, and the most recent postponement deferred the vote to July 27.

Any combined entity will likely face antitrust scrutiny and defining the relevant market—both the line of commerce and geographic location of the business—will be a key component in determining the outcome. This analysis explores different measures of the relevant market pertaining to this case and offers examples of how questionably defined markets can affect the outcome.

A point of caution: This analysis uses information from the most recently revised 2010 Horizontal Merger Guidelines. In January 2022, in response to President Biden's executive order titled "Promoting Competition in the American Economy" (the "Order") issued on July 9, 2021, the Federal Trade Commission (FTC) and the Department of Justice's (DOJ) Antitrust Division initiated a campaign to "modernize federal merger guidelines to better detect and prevent illegal, anticompetitive deals in today's modern markets." The changes will cover both the Horizontal and Vertical Merger Guidelines.[1]

Both the announcement and ensuing request for information from the FTC and DOJ included some of the ideas incorporated in recently proposed antitrust legislation. Changes such as "whether concentration thresholds should be adjusted" will likely have a direct impact on the outcome of any merger review involving Spirit.

Antitrust Background: Relevant Markets

According to the *Horizontal Merger Guidelines*, co-authored by the Federal Trade Commission (FTC) and the U.S. Department of Justice (together the "Agencies"), identifying the relevant market with respect to horizontal mergers serves two roles. First, it helps the Agencies "specify the line of commerce and section of the country in which the competitive concern arises…. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration."

Once the relevant market is defined, the Agencies will calculate the level of market concentration. The Agencies often calculate the Herfindahl-Hirschman Index (HHI) of market concentration. The HHI is the sum of the squared market share of the individual firm. Markets are then categorized into three types:

- Unconcentrated Markets: HHI below 1,500
- Moderately Concentrated Markets: HHI between 1,500 and 2,500
- Highly Concentrated Markets: HHI above 2,500

The Agencies will use this measure and follow general standards (outlined below) when assessing whether to permit or reject a merger:

- Small Change in Concentration: Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- Unconcentrated Markets: Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- Moderately Concentrated Markets: Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- Highly Concentrated Markets: Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

As the standards indicate, this is not a final test, but they do highlight the impact a questionably defined relevant market can have on the outcome.

As noted above, all these thresholds are subject to revision during the Agencies' current review process of the Merger Guidelines.

Examples of Relevant Market Definition Subjectivity

Defining the relevant market is often a point of contention between the antitrust enforcement Agencies and the merging parties because the process is inherently subjective. This poses a major challenge in antitrust litigation. A market can often be defined either too narrowly or too broadly, and it often lies in the eye of the beholder. The Agencies will frequently apply a narrow definition of the market, leading to a higher perceived level of market concentration, while companies will argue for a broader definition to appear as having less market power. Generally, the true relevant market lies somewhere in between.

An example of such a challenge was at the forefront of the FTC complaint against Facebook in 2021. In this case, the FTC defined the relevant market as "personal social networking services" (PSN). The judge dismissed the complaint, saying that, "this case involves no ordinary or intuitive market. Rather, PSN services are free to use, and the exact metes and bounds of what even constitutes a PSN service – *i.e.*, which features of the company's mobile app or website are included in that definition and which are excluded are hardly crystal clear." The Information Technology & Innovation Foundation goes into greater detail of the relevant market definition in this case.

Another example, and presumably less ambiguous than social networks, is retail. But here, too, the relevant market lies in the eye of the beholder. In June 2019, the House Committee on the Judiciary's Subcommittee on Antitrust, Commercial, and Administrative Law launched an investigation into the state of online competition and examined specific companies including Facebook, Google, Amazon, and Apple. The findings were published in a document titled *Investigation of Competition in Digital Markets*.

Part of the investigative process was to define the relevant market. In Amazon's case, the committee limited the relevant market to online retail and stated that Amazon "controls about 65% to 70% of all U.S. online marketplace sales." The committee also noted that the "FTC concluded that a 'relevant market may be divided by channel of sale, resulting in separate markets for brick-and-mortar sales and online sales.'" In response, Amazon contended that the relevant market should be all retail sales and noted that, “[Amazon] accounts for less than 1% of the $25 trillion global retail market and less than 4% of retail in the U.S.” Amazon added that “more than 80 retailers in the U.S. alone earn over $1 billion in annual revenue. Amazon isn’t even the largest U.S. retailer (Walmart’s revenues are more than double those of Amazon).”

Ignoring any other anticompetitive accusations against Amazon and Facebook, it is evident that properly defining the relevant market can yield drastically different outcomes when determining market share and whether a proposed merger will be allowed to close by regulators.

Relevant Markets in Airline Antitrust

Defining the relevant market for airlines is even more convoluted. While the Agencies do not have a set of guidelines specific to the industry, they do have a set of established methods when determining a relevant market.

According to Alexa Naumovich in the *Journal of Air Law and Commerce*, the Antitrust Division “use[s] different ways to define the relevant product and geographic markets, including city-pairs, code-sharing agreements, and run-way slot allocations.”

Naumovich defines the different measures:

- City-pairs: Airline services between departure cities and arrival cities. City-pairs incorporate multiple airports in a large metropolitan area into a single destination (geographic market).
- Code-share Agreements: Allow airlines to extend their own networks by using flights operated by different airlines, increasing the city-pairs that they can serve. The code-share agreements permit an airline to market and sell seats on flights operated by another airline (geographic market).
- Runway Slots: The Federal Aviation Administration (FAA) regulates the allocation of runway slots at certain airports to limit the number of flights going in and out…as a way to manage air traffic at highly congested airports. The FAA allocates more slots to airlines have historically held slots at the airports, creating a barrier for new airlines to enter the slot regulated airport (line of business).

The HHI would be calculated using these methods and the same rules would apply.

Spirit/Frontier Relevant Market: City-pairs

The measures listed in the previous section are better equipped to assess airline competition since airlines do not generally compete at the national level but rather for routes.

An editorial published by *Routes* analyzed the merger using the city-pairs approach. Flight schedule data revealed that Frontier and Spirit have no substantial overlap in routes as Frontier has “heavy exposure in the western U.S., and Spirit largely centered around the east.”

Using flight schedule data for the “upcoming summer season,” the editorial notes that the two carriers “plan to offer almost 650 nonstop routes across their combined networks – and the two will compete directly on fewer than 20% of them…. However, on the routes where the two overlap, they will face competition from one or more carriers on 97% of them.”

The data presented by *Routes* show little evidence that these two companies are direct competitors when it comes to city-pairs.

JetBlue Takeover of Spirit: Relevant Market

The current antitrust litigation involving JetBlue and their "Northeast Alliance" with American Airlines has led Spirit to proceed with caution.

DOJ alleges that the NEA will "not only eliminate important competition in these cities [Boston and New York City] but will also harm air travelers across the country by significantly diminishing JetBlue's incentive to compete with American Airlines elsewhere."

JetBlue concedes that divesting overlapping assets will be necessary to clear the city-pairs regulatory obstacle. *CNBC* noted that JetBlue "would offer a remedy package to address regulatory concerns 'that includes the divestiture of all Spirit assets in New York and Boston so that JetBlue does not increase its presence in the airports covered by the NEA. The package would also include gates and assets at other airports, including Fort Lauderdale.'"

FTC Chair Lina Khan expressed the agency's unwillingness to assist in these "fixes," however. As Khan told Axios, "That is not the work the agency should have to do. That's something that really should be fixed on the front end by parties being on clear notice about what are lawful and unlawful deals." She added that, "We're going to be focusing our resources on litigating, rather than on settling."

DOJ Antitrust Division Chief Jonathan Kanter echoed this sentiment in a speech delivered at the University of Chicago Stigler Center in April 2022. Kanter said, "Our duty is to litigate, not settle, unless a remedy fully prevents or restrains the violation…. Even divestitures may not fully preserve competition across all its dimensions in a market."

Based on the reporting, it appears that Spirit has taken the comments made by Khan and Kanter seriously when assessing and ultimately rejecting the offer from JetBlue. The relevant market, Spirit believes, would be perceived by the Agencies as too concentrated and would fail to gain approval.

Relevant Market: Ultra-Low-Cost-Carriers

The data showed that a merger between Spirit and Frontier would do little to threaten the competition for city-pairs as the airlines serve mostly different geographies. Another potential antitrust problem arises, however, when defining the relevant market: Who is the competition? Are all airlines the same?

They are not. An airline is generally classified in one of three ways: full-service, low-cost-carrier (LCC), and ultra-low-cost-carrier (ULCC). How they operate and generate revenue differs among the various classifications.

The ticket price on a full-service carrier regularly includes, among other things, bags, meals and snacks, drinks, seat-selection, and in-flight entertainment (WiFi, television screens, etc.).

ULCCs charge a ticket price for the seat, plus ancillary fees for any bags, in-flight drinks or snacks, and pre-selecting a seat.

The LCC is a middle ground. Ticket prices for these airlines will include one or a combination of baggage fees, drinks, snacks, pre-selected seats, and even in-flight entertainment.

Spirit and Frontier are both ULCCs. This distinction creates a problem defining the relevant market. If Spirit and Frontier are viewed as simply “airlines,” then the city-pairs classification would be a sufficient measure of concentration. If regulators split the overall market into submarkets, however, as the FTC proposed in the Digital Markets Analysis of Amazon, and make the case that ULCCs compete directly among each other and not with full-service carriers or LCCs, the decision reached in the antitrust litigation could be less predictable.

Spirit seems primed for the latter of these regulatory approaches which was part of their rationale to reject the offer from JetBlue. As Spirit said, “the Justice Department and court ‘will be very concerned that a higher-cost/higher fare airline would be eliminating a lower-cost/lower fare airline in a combination that would remove about half of the ULCC (ultra-low cost carrier) capacity in the United States,’” according to *CNBC*.

The joint statement issued by Spirit and Frontier noted that “The stronger financial profile of the combined company will empower it to accelerate investment in innovation and growth and compete even more aggressively, especially against the dominant ‘Big Four’ airlines, among others.” This statement suggests that Spirit and Frontier may argue that their relevant market is the whole of the airline industry and that the “Big Four” (American Airlines, Delta Airlines, Southwest Airlines, and United Airlines), which controls about 80 percent of the “airline” market, will face steeper competition from the combined firm.

The distinction is important because ULCC customers are usually searching for the lowest price to fly, so a major source of competition is ancillary fees. President Biden specifically mentioned ancillary fees in his executive order that outlined the administration’s goals to protect “[A] fair, open, and competitive marketplace.”

Antitrust regulators could point to this executive order and try to make the case that the merger between two ULCCs will limit competition for the ancillary fee market, which could push up prices.

Response From Lawmakers Concerning the Proposed Spirit/Frontier Merger

When Spirit and Frontier announced their merger, it was immediately met with resistance from Senator Elizabeth Warren (D-Mass) and Representative Mondaire Jones (D-N.Y.). On March 10, 2022, Senator Warren and Representative Jones, accompanied by another two senators and four representatives, sent a letter expressing their concerns about the merger to DOJ Antitrust Division Assistant Attorney General Jonathan Kanter, and U.S. Secretary of Transportation Pete Buttigieg.

The letter read, “[F]or decades, the airline industry has been plagued by increasing consolidation, producing massive airline giants, while leaving consumers and workers behind. Because the proposed Spirit-Frontier merger threatens to exacerbate these trends… we urge the Department of Justice and the Department of Transportation to closely review this mega merger for potential violations ….”

A week later, Warren introduced S.3847, known as the Prohibiting Anticompetitive Mergers Act of 2022. The bill would prohibit mergers in which:

- The HHI would be greater than 1,800 in any relevant market; and
- The increase in the HHI would be more than 100 in the relevant market.
- Deals resulting in market shares are above 33 percent for sellers or 25 percent for employers.

- Deals are valued over $5 billion.

Frontier and Spirit have valued their deal at $6.6 billion (value of the combined entities), well above the $5 billion limit in the Warren bill, and would thus be prohibited, even without violating the three other conditions.

Conclusion

Spirit has made clear its belief that the combination of the current antitrust lawsuit facing JetBlue and a higher-cost carrier eliminating a lower-cost carrier would pose an insurmountable regulatory hurdle. What is less clear is how regulators would rule on a merged Spirit and Frontier venture.

Scrutiny by members of Congress; the executive order concerning competition generally, and airlines and ancillary fees specifically; and comments by FTC Chair Khan and DOJ Antitrust Chief Kanter raise additional barriers for either merger/takeover combination.

At the heart of both cases, and what is likely to be a major point of contention between the regulatory agency and the combined firms, will be the definition of the relevant market.

[1] Vertical Merger Guidelines were issued in 2020. In September 2021, the FTC voted to withdraw its approval while the DOJ has not withdrawn its approval.