PREDATION, COMPETITION & ANTITRUST LAW
TURBULENCE IN THE AIRLINE INDUSTRY
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INTRODUCTION

United Airlines is the largest airline in the world. Beginning in 1982, United launched a plan to monopolize the Denver nonstop and connecting passenger market.

The monopolization of the Denver hub was achieved with several deliberative steps.
Step one was to eliminate the original Frontier Airlines as a competitor, which occurred in 1986.
Step two was to drive Continental Airlines out of Denver as a hub competitor, which occurred in 1994.
Steps three and four were to eliminate Western Pacific Airlines and the new Frontier Airlines as low-cost competitors. Western Pacific was liquidated in 1998.

Until the Departments of Transportation and Justice began to focus on these problems in 1997, the means by which United Airlines accomplished these goals included:
(1) adding seat capacity and flight frequency in competitors' city-pairs in order to drive its competitors' load factors to below break-even levels;
(2) dropping prices to levels at or below those of any competitor which dares to enter its market, even if the price is below United's costs;
(3) refusing any competitor access to its dominant passenger network;
(4) biasing its computer reservations system to dissuade travel agents from selling its competitors' services;
(5) bribing travel agents with commission overrides to steer passenger business toward United; and
(6) entering into exclusive dealing arrangements with corporate purchasers.

After a competitor was eliminated, United's conduct as a monopolist was also consistent-raise prices in its monopoly city-pairs to whatever the market will bear. This gave it the economic resources to repeat the cycle whenever a new entrant attempted to invade its fortress hub.

This section documents the anticompetitive behavior of United Airlines toward its Denver competitors chronologically, beginning shortly after airline deregulation.

THE DEMISE OF THE ORIGINAL FRONTIER AiRLINES

The original Frontier airlines began service as a "local service carrier" in 1946. By the beginning of 1982, Frontier Airlines had more flights at Denver than any other carrier, serving a total of 85 cities from its Denver hub. Frontier had been consistently profitable during the previous ten years. Although the industry as a whole lost money in 1981, Frontier earned $32 million of profit on revenue of $577 million. It was to be Frontier Airlines' last good year.

According to Aviation Daily, in 1982, "United, a major competitor at Denver Stapleton, launched a massive campaign to capture a bigger share of the Denver market and to become the dominant carrier at the airport." The 1981 air traffic controllers' strike had led the FAA to impose a cap on landing slots. In 1982, as it began its buildup at Denver, United was buying slots from anyone who would sell them, moving acres of seats to Denver. United increased its flights out of Denver by a third, predominantly adding capacity in Frontier's markets. In its "United's High On Denver" plan, United Airlines executives explicitly identified Frontier Airlines as its principal target.

From May to July of 1982, United increased its flights from 96 to 133 daily departures, becoming Denver's largest carrier, versus 120 daily departures by Frontier and 110 by Continental. This author's study of the airline industry (published in 1992) discussed this period as follows:

United, the nation's largest airline, was determined to dominate Denver. With a deep pocket that could cross-subsidize losses in competitive markets, a powerful computer reservations system that could discriminate against competitors, and an attractive frequent-flyer program that could lure business travelers (the most lucrative segment of the passenger market), United, the nation's largest airline, began to turn up the heat on Frontier. 1982 marked the first time United Airlines was described by the press as "the 800-pound gorilla."

It is a metaphor that has since been almost universally embraced by observers of the airline industry.

By 1983, United had added over 100,000 seats per week at Denver since deregulation, and increased its frequencies to 174 departures per day at Denver's Stapleton International Airport. Frontier had 138 daily departures and 24.3% of the market, while Continental had 18.5%.' Frontier was being squeezed by a determined United Airlines. That year, despite a significant cost-saving labor agreement, an 11.2% increase in passenger boardings, and an improvement in revenue, Frontier posted a net loss of $13.8 million, the first in more than a decade. By the end of 1983, Continental Airlines collapsed into Chapter 11 bankruptcy.

By 1984, average fares in Denver were the lowest in the United States. In 1985, they dropped another 8.3%. Frontier was forced to begin liquidating assets, and United seized the opportunity. In early 1985, Frontier sold five McDonnell-Douglas aircraft to United Airlines for $95 million, and in May of 1985, was forced to sell half its remaining fleet (25 of 51 of its Boeing 737s) to United for $265 million. By purchasing more than half of Frontier, United was able to gradually downsize its competitor. The rest of Frontier was sold to Newark-based new entrant airline People Express in November 1985.

By 1986, United controlled nearly 40% of the Denver market, followed by Continental at 28% and People Express-owned Frontier at 18%. Fares at Denver fell another 4.6% in that year. Denver was being described as the "fare wars capital of the world," with the lowest unrestricted fares of any major hub in the United States. Yields (the amount of revenue charged per seat) were as low as 5 cents a mile, while Frontier's seat-mile costs were north of 8 cents.

Below-cost pricing began to take its toll on smaller carriers in the Denver market. In May 1986, Pioneer Airlines, a long-time Denver commuter carrier, ceased operations. In addition to below-cost pricing, United launched a program to bribe Denver travel agents with $100 every time they told a customer "it's just as easy and just as cheap to fly United."

In July 1986, with Frontier still losing money, People Express agreed to sell Frontier to United, and transferred many of Frontier's most important assets to United while the deal was pending. United was able to acquire $43.2 million worth of assets from Frontier, including some of its most valuable properties five takeoff and landing slots at Chicago O'Hare, three gates at Dallas/Ft. Worth, contracts to acquire two MD-80 aircraft, and two hangars and six gates at Denver. By now, United had spent more than $400 million directly on Frontier's assets, and hundreds of millions of dollars more in below-cost pricing, in an effort to eliminate Frontier as a competitor at Denver. Continental filed a lawsuit objecting to the monopoly Frontier's acquisition by United would create.

Once it had acquired several of Frontier's prized assets, United began to take a hard line stance in its negotiations over the acquisition of the rest of Frontier. Although United had agreed to purchase Frontier, and agreed to "use its best efforts" to resolve potential labor problems, United balked at consummating the acquisition as its pilots refused to accede to United's insistence that Frontier's pilots be integrated into United's labor force at their existing wage levels (in effect, a "C" scale, with wages 40% below those of United's pilots).

Some speculated that United failed to exercise good faith in the negotiations (for example, United never negotiated with the other union groups), because it knew that Frontier's deteriorating cash position would soon cause it to collapse in bankruptcy. By walking away, United could eliminate Frontier without having to conclude the purchase agreement with People Express.

Meanwhile, People Express continued to lose money, and was forced to shut down Frontier on August 24, 1986. Frontier entered bankruptcy two days later. A United Airlines' publication revealed, "United will benefit from eliminating the instability of Denver's three-carrier hub. This will translate into higher fares and better returns and will ensure that another carrier does not attempt to build a presence in Denver.

But United did not anticipate that Continental would pick up the pieces of a grounded Frontier. Only a month after People put Frontier into bankruptcy, Frank Lorenzo's Texas Air offered to purchase both People Express and Frontier, and by February 1987, they were both folded into Continental (along with New York Air).

After a settlement with United over the transfer of assets from Frontier, Continental came away with most of Frontier's aircraft, in addition to three hangars and two concourses (C and D) at Denver's Stapleton Airport. With the acquisition of Frontier, Continental surpassed United with 236 daily departures compared to United's 218, and briefly held the dominant position at Denver from June 1987 to May 1988. The era of three hubbing airlines in Denver was over.

Subsequently, an antitrust action was filed against United by a large number of former Frontier pilots, flight attendants, and ticket, reservations and station agents against United Airlines. In that case, plaintiffs alleged that United engaged in various anticompetitive activities designed to destroy Frontier. Among the more prominent allegations was that United:

(1) exerted monopoly power in the computer reservations system [CRS] market in Denver and also with respect to its Apollo CRS;

(2) overcharged Frontier for its participation in the Apollo system;

(3) caused Apollo to operate unfairly in ticket sales; and

(4) purposefully did not go forward with the stock purchase agreement it had concluded with Frontier, leaving Frontier so weakened financially that it failed. Unfortunately, the court held that employees lack standing to bring an antitrust claim, and never reached the merits of the complaint.

Another lawsuit brought in 1985 by Continental Airlines objected to the manipulation and display bias, and suppression of competitors' fares and schedules imposed by United and American Airlines in their computer reservations systems. In the mid-1980s, United's Apollo CRS was used by between 70% and 80% of Denver-area travel agencies. A federal district court "found sufficient evidence that United and American committed mail fraud and wire fraud in connection with their CRSs to allow Continental to proceed with a jury trial on its $1 billion RICO (Racketeering Influenced and Corrupt Organizations Act) claim against the carriers," to allow the case to proceed to a jury."'

Continental claimed United had programmed its CRS to favor United's flights over those of its competitors, even whena competitors' flight was more convenient for a customer. Continental also alleged that United overcharged it and other carriers for participation in its CRS. The court found that United and American "had specific intent to defraud" when they "deceitfully concealed material facts concerning the manipulation of the Continental plaintiff's flight information in Sabre and Apollo." After 10 weeks of trial, on the eve of jury deliberations, United settled the suit for about $70 million.

With Frontier and People Express gone, the Denver market became a duopoly for Continental and United. With Frontier out of business, United's market share at Denver climbed to 50%. For a short while it resembled more of a "shared monopoly," as each carrier attempted to recoup some of the losses incurred in the battle with Frontier. Accordingly, airline ticket prices at Denver rose by 17.6% in 1987 and a record 39.2% in 1988. Without Frontier, passenger enplanements at Denver declined sharply, exacerbated by the fare increases.

THE DEMISE OF CONTINENTAL AIRLINES' HUB AT DENVER

Founded as Varney Speed Lines in 1934, Continental Airlines' first route was from El Paso to Denver. From 1937 to 1963, Continental was headquartered in Denver.'65 After Frontier and People Express went out of business, and Frontier's gates and aircraft folded into Continental, for a short while Continental became Denver's leading carrier. In 1987, Continental accounted for 42% of total enplaned passengers at Denver.166 The status was short-lived, however, as United quickly regained the lead in May 1988, a position it never again relinquished. By 1990, Continental was in bankruptcy for the second time in a decade.

Former United Airlines' CEO Stephen Wolf said, "I never fought anything so hard in my life" as the new Denver International Airport [DIA]. Opposition was predicated on cost, and (though never said by United publicly), the possibility that a large new airport might have sufficient capacity to attract new competition. But once Continental jumped on the DIA bandwagon, United had little choice but to jump aboard too.

Among the last things Frank Lorenzo did as CEO of Continental was to sign a lease with the city of Denver in the summer of 1990 for 20 gates at the new Denver International Airport. Because Continental became DIA's first hub carrier, it was able to reserve the closest (and therefore most desirable) concourse (A) to the main terminal building, and the city agreed to build a pedestrian bridge linking the terminal directly to that concourse.

When United subsequently signed up for Concourse B (which had no pedestrian bridge to the main terminal), it insisted the city make the glass on Continental's Concourse A bridge opaque, so that no passenger could see the splendid view of the Colorado Rocky Mountains from it, for United believed the bridge offered Continental a competitive advantage. Mercifully, DIA engineer Ginger Evans refused, and the city breached its contractual agreement. United chose not to press its case, undoubtedly fearing the public relations fallout once the new airport opened.

United took several actions to pressure Continental to depart. For example, United refused to allow DIA to open until its automated baggage system could deliver 225 bags a minute. DIA's chief engineer, Ginger Evans, contended DIA could have opened early in 1994 with the baggage system operating at 40 bags per minute, adequate to allow United to meet its connect times. "Virtually every design and construction professional [who] was involved directly or as a consultant ... believed at that time the project, including the BAE automated baggage system, could have been completed by October 21, 1993 [the originally scheduled opening date] . If an allegedly malfunctioning baggage system was not the fundamental cause of the delay, what was? One plausible and widely accepted explanation has been proffered by former Denver airport director George Doughty in testimony before Congress:

United Airlines did not want to go to DIA. United could have cooperated with the City to work out options for manual bag handling, but they did not.... As to exactly what United's rationale [was] one can only speculate, but a few things are clear. United had no incentive to move in 1994. They had just increased their operations at Denver in order to capture an even greater market share that would eventually force Continental to dismantle its hub. It was to their advantage not to move until that was assured.

In 1992, Continental reached its last high water mark of 285 flights per day (including Continental Express) at Denver. With 38% of the market, Continental was still second to United's 40%. United designated Denver its "major domestic initiative," and increased its capacity by 30% over the next several years in what appeared to be a deliberate move to oust Continental once and for all.

UAL's 1992 Annual Report spoke of "an aggressive plan for expansion" at Denver: "At Denver, United phased in a dramatic increase in departures during the year, moving from 180 flights last spring to 217 during the summer and, by Marchof this year, to 247 departures [plus 105 by United Express carriers]. Its 1993 Annual Report stated, "An aggressive buildup has made a significant contribution to revenue improvement at [the Denver] hub. United ended 1993 with 257 daily departures in Denver, up from 212 a year earlier.... Already the number one carrier in the Mile High City, United had increased its capacity over the last two years by nearly 30 percent. United's aggressive behavior at Denver was clearly targeted at Continental. United pulled away and never looked back as it steadily increased market share, leading to Continental's decision to pull out.

Toward the end, Continental was losing $10 million a month at its Denver hub, and could not face the prospect of continuing hub operations at the more expensive new airport. Denver airport director Jim DeLong described it as a "fierce battle for dominance of the Denver market." Continental's Annual Report revealed that the company had lost $130 million at Denver in 1993, and lost $500 million at Denver from 1990-1993.

According to Continental's CEO Robert Ferguson, "Continental's losses are at unacceptably high levels in Denver, even with our reduced flying. Continental's Annual Report said, "Although the new facilities [at DIA] will be greatly superior to those presently serving Continental's Denver passengers, they also will be much more expensive. It was estimated that increased landing fees required to pay off bonds issued to finance DIA would have added another $50 million to Continental's costs.

The advantages Continental gained from signing the first lease at DIA were never fully realized because Continental ultimately was forced to cry "uncle," in March 1994, and announced its decision to abandon its Denver hub operations and relinquish the market to United. Continental had already downsized its presence in Denver from a high of 285 flights a day in February 1992, to 165 flights in August 1993, to 148 flights in January 1994, to 107 flights in March 1994. Continental's Denver operations dropped to 86 flights in July 1994, 59 in September 1994, and 19 in March 1995. Meanwhile, United increased its flights to 280.

Following Continental's announcement that it was scaling back its Denver hub beginning in the fall of 1993, the withdrawal proceeded throughout the following year. Continental dropped 26 routes through August 1994, and an additional 23 on October 31, 1994. By the time DIA opened, Continental was down to 13 flights a day to three cities.

Passenger traffic, which was increasing since 1990, began to decline after Continental's pullout. In 1995, only 31 million total passengers were flown to, from or through Denver, down from 33 million in 1994. A contributing factor in this decline is the fare increase strategy that United enacted as it realized more monopoly opportunities.

United's goal of becoming the dominant carrier in Denver has been fully realized, as United and its code-sharing affiliates controlled nearly 80% of the total passenger market at Denver. By September 1996, United flew to 55 cities from Denver and Colorado Springs. In 1994, United's CEO, Gerald Greenwald, confessed that United's strategy to dominate the Denver market had paid off in increased market share and profitability.

Outgoing United CEO Stephen Wolf called Denver the "major domestic initiative" for the airline over the preceding two years. According to Greenwald, "United has done a fantastic job of building strength in Denver and we'd like to take advantage of that, if anything, and build it stronger."'

As noted above, United may have purposely delayed opening of DIA in order to encourage Continental to abandon its Denver hub. Along the way, United also cut several additional deals with the city to disadvantage its competitors. United insisted it be allowed to take over the Concourse C automated baggage system loop, so that only United would have a high-speed baggage system. Ironically, the Concourse C automated system was the only one operating well before United occupied it. Other airlines were relegated to traditional tug-and-cart technology.

Further, United insisted that carriers using Concourse A pay a disproportionate share of the costs of that concourse's automated baggage system, though the system has never been functional. (On a per-passenger basis, Continental Airlines pays the highest costs of any carrier at DIA; it absorbs a portion of the additional costs of its two sub-lessees on Concourse A; but because of this agreement, half of Concourse A's domestic gates remain empty.) United's insistence assures that the high cost of Concourse A's gates will dissuade new carrier entry on that concourse for years to come, despite its superior location. Unfortunately, DIA's costs have dissuaded many low-fare airlines (including Southwest Airlines) from entering the market, and driven low-cost airlines (e.g., Midway and Morris Air) from it. Finally, United insisted the city build it a hangar directly north of Concourse C, on land a future concourse is supposed to occupy. No such future concourse can be built without tearing down United's hangar.

In summary, though unable to stop construction of a new airport at Denver, United Airlines was able to ensure its Fortress Hub dominance of DIA by driving up its costs, withholding permission to open DIA until Continental Airlines had succumbed to United's below-cost pricing and fully committed itself to eliminating its Denver hub, by ensuring Concourse C carriers would be deprived use of an automated baggage system and that Concourse A carriers would pay an exorbitant price for its automated baggage system (though a back-up baggage system was welded on top of it, thereby denying Concourse A carriers the automated system whose costs they must pay).

As Continental departed, an airline executive observed, "Denver residents will know the true definition of high fares."'By mid-1995, United enjoyed about 70% of Denver's passenger traffic, and even a higher percentage of DIA's $5 billion travel market. 8 5 Continental Airlines, once an airline as large in Denver as United, accounted for less than 3% of DIA's traffic. Without a major airline to discipline the monopolist, United could extract whatever the market would bear.

United raised fares to monopoly levels in virtually every market Continental abandoned. For example, United Airlines quadrupled its unrestricted coach fare from Denver to San Francisco (from $238 to $954), and tripled its fare from Denver to Los Angeles (from $298 to $892). United would boast that nearly 60% of its seats at DIA are discounted, with approximately 55% discounted up to 35% or more of the full fare.

That makes United sound like a benign monopolist until you compare these statistics with industry-wide data compiled by the Air Transport Association of America [ATA]. According to ATA, more than 90% of passengers fly at a discount, and the average discount is more than 60% of the full fare, and has been for nearly a decade. In 1996, 93% of U.S. travelers were flying on a discounted ticket (compared with 60% on United at Denver), and the average discount was 67.5% off the full fare (compared with only 55% of Denver's United travelers enjoying a 35% discount off the full fare). It is remarkable that United would insist that Denver passengers should be grateful for its pricing when its Denver discounting was so miserly.

In a study of Denver International Airport, the GAO reported to Congress that United Airlines raised prices at Denver 38% from June 1994-95, while the average ticket price nationally increased only 7% over the same period. In August 1995, American Express Travel said its Denver customers were paying 46% more. However, in September 1995, United insisted average fares were only up 16%, but included free frequent-flyer tickets in this calculation.

Moreover, it is unclear whether United was calculating fares for all Denver passengers, or only origin and destination [O&D] passengers (passengers who begin or end their trips in Denver). One would expect that connecting ticket prices would be priced competitively, for a consumer traveling east-to-west (or vice versa) has a multitude of airlines from which to choose and hubs through which to connect, while local O&D passengers are subject to the monopolist's whim on pricing.

United contended it also had to raise prices to cover the $210 million in increased costs attributable to Denver International Airport over the airport it replaced, Stapleton. Earlier, United had estimated that its costs of operations at the new airport would increase by only $100 million. But most of United's fare increases were imposed as Continental downsized its Denver hub, months before DIA opened. With DIA opening, and blaming DIA's high costs, United announced it was adding another $40 round trip to the prices of tickets beginning or ending at Denver.

But because of DIA's efficient runway configuration, terminal spacing, and triple Cat. III simultaneous landing capability, United's operating costs at DIA (excluding airport fees) would be significantly lower than those at Stapleton Airport. Stapleton had been plagued by congestion and delays (particularly during periods of inclement weather), which mutilate efficient aircraft and labor utilization. Thus, DIA's efficiencies offset a portion of United's facility fees and landing costs at DIA.

Because of United's poor credit rating, the city had financed many major facilities for United at DIA - including a hangar with six aircraft maintenance bays, an 18-bay ground equipment maintenance building, an air freight facility, kitchens, and a baggage system-many of which are traditionally tenant-financed facilities, and at other airports would not be included in fees paid to the airport authority.

Moreover, in Congressional testimony, Denver aviation director Jim DeLong identified United Airlines' belated and massive scope changes as the most significant cause of increased construction costs at DIA. "It is clear that your airline is a significant contributor to what you describe as the high cost of DIA, Denver mayor Wellington Webb told United. "It is no secret that when one air carrier becomes dominant in a market, that they develop as a fortress hub, and as a result, fares have always increased." Webb was right. United's massive scope changes negotiated after construction on the main terminal was well under way, coupled with its insistence on delaying the airport opening, contributed to hundreds of millions of dollars in additional construction and interest expenses at DIA. In order to avoid DIA's high costs, other airlines were flying over DIA to reach Colorado ski resorts like Vail and Aspen directly. Lowcost/low-fare carriers like Midway Airlines and Morris Air departed Denver, MarkAir collapsed into bankruptcy, and Southwest Airlines announced DIA's costs made that airport prohibitively expensive to enter.

United's market dominance has also been a significant factor dissuading other new airline entrants at DIA. The city of Denver launched a campaign to try to recruit new entrants to fill the competitive void left by the departure of Continental Airlines.

Denver mayor Wellington Webb observed, "every carrier we have spoken with is concerned with United's dominance of the market." A letter to the editor of the Denver Post put it well: "Since Continental's withdrawal from this market, United's behavior has been that of a monopolist.... The only serious question with regard to United Airlines is why the antitrust regulators have been so quiescent.

While United relishes the role of monopolist at Denver, it objected to a proposed agreement between British Airways and American Airlines on grounds that the alliance would create a monopoly, with the two airlines controlling the majority of routes between the United States and London.

United officials also complained about "predatory pricing" by smaller rivals in Denver and Chicago. United was the only major carrier to support promulgation of the Airline Deregulation Act of 1978, whose principal purposes included the following:

* The availability of a variety of adequate, economic, efficient, and low-priced services without unreasonable discrimination or unfair or deceptive practices.

* Preventing unfair, deceptive, predatory, or anticompetitive practices in air transportation.

* Avoiding unreasonable industry concentration, excessive market domination, monopoly powers, and other conditions that would tend to allow at least one air carrier ... unreasonably to increase prices, reduce services, or exclude competition in air transportation.

* Maintaining a complete and convenient system of continuous scheduled interstate air transportation for small communities and isolated areas.

* Encouraging entry into air transportation markets by new and existing air carriers and the continued strengthening of small air carriers to ensure a more effective and competitive airline industry.

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