

Case Study of JetBlue and Spirit Airlines Merger

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1. Introduction

I read an article about JetBlue-Spirit merger. After months of speculations and negotiations JetBlue decided to acquire Spirit Airlines in a \$3.8bn deal. Spirit airlines were also in negotiation with Frontier, but that deal did not fall through over more money offered by JetBlue. This deal is poised to make America's fifth largest airline.

Upon this deal, JetBlue will result in annual savings in the range of \$600 - \$700 million. It will give them growth with more than 1700 flights to more than 125 destinations and presence in 30 countries. They will combinedly own almost 450 aircrafts and orders of more than 300 Airbus aircrafts which are fuel efficient and equipped with low carbon NEO engines.

The goal is to provide low cost and high quality services at fares below that of the Big four airlines. The big four airlines are United, American, Delta and southwest airlines.

However, in March of this year, The Justice Department filed a civil antitrust lawsuit today to block the JetBlue's proposed acquisition of it's largest and fastest growing ultra-low cost rival Spirit Airlines. The Department of Justice (DOJ) allege that this deal will further concentrate the airline industry with the deal eliminating half of the ultra-low-cost capacity in the US which will lead to higher fares and fewer seats. This eliminates a future competition as wherever Spirit operates airlines have been forced to lower prices and innovate their service.

JetBlue and Spirit have a chance to respond to the complaint and hence need an managerial economist to give them possible changes and point plan which will help in the deal to go through. In this case study I will aim to show both sides arguments and give my opinion of the best outcome.

2. Analysis (Department Of Justice Arguments)

Over the years, various factors have been responsible for elimination of monopolistic competition in the US airline industry. Mergers are largely known to be as competition killers and the current airline industry is an oligopoly which is an imperfect competition. Costs have risen over the years and innovation reduced as consumers face less seats and high charges largely due to 80% of market being controlled by the big four airlines.

From the years 2007 – 2016 there was approximately 8% decrease in flights to major cities, but flights reduced by almost 33% to smaller cities. Deregulation of airline industry took place during Carter's tenure and since then there has been positive growth until recently. The current

Department of Justice is much more progressive than the previous DOJ's and is also blaming their role in not protecting consumers and allowing airline mergers to go through over the years.

All the major airlines have filed for bankruptcy over the years leading to being delisted and upon completing mergers coming back on the indexes. All the major airlines share the same institutional investors in BlackRock, Vanguard and State Street among the top three with all quietly increasing their stakes in the airlines. Common investors lead to anti competition in the market affecting the consumers.

In the most recent merger settlement of US Airways \$11 billion merger with American saw the airline agreeing to divestitures of gates and airport slots in major cities to Low cost carriers which would help in increasing competition across the industry. Antitrust Laws in the United States exist to protect the consumers who are harmed by lack of competition in the market. Airlines have cited high labor costs, operating costs, and lack of trained pilots. Flight delays and cancellations have increased.

JetBlue is headquartered in Long Island City, New York and flew more than 39 million passengers to approximately 107 places around the world. Their revenue was \$9.1bn in 2022. Spirit is headquartered in Miramar, Florida and flew more than 38 million passengers to 92 places and having a revenue of \$5bn in 2022.

Moving to analyze the JetBlue – Spirit deal, DOJ's complaint says that the proposed acquisition will eliminate a low-cost option for many Americans even when they do not fly the no frills airline as wherever Spirit competes other airlines are forced to innovate, provide lower fares and being more consumer friendly. The complaint is under Section 7 of the Clayton Act alleging that Spirit has been a fast growing and has proven disruptive by providing consumers which service

to purchase. This has forced other airlines to introduce unbundled and customizable ticket options making it a healthy model for competition and leading to more Americans travelling. DOJ states that this will lead to direct increase in price to 40 direct routes where both JetBlue and Spirit airlines operate, JetBlue has already said they would look to reduce seats in Spirit aircrafts, JetBlue has partnered with American Airlines through Northeast Alliance which has also been sued by DOJ. JetBlue would increase price on every route Spirit operates and help other airlines in coordinating a price hike and limiting seats due to the acquisition and hence limit future competition.

At first Spirit Inc had decided to merge with Frontier and create the fifth largest airline but the \$2.9bn deal did not go through. At that time Spirit had come out publicly and opposed a merger with JetBlue and those points are pointed out by the DOJ

- Will raise Spirit's ticket prices.
- Eliminates 50% of the ultra-low-cost carriers capacity in the U.S.
- It will merge Spirit with combined JetBlue and American Airlines in the northeast Alliance.
- Already under litigation with DOJ to block the Northeast Alliance transaction.

3. Analysis (What airlines should argue to counter)

When acquisition goes through, JetBlue will be the fifth largest airline but still not close to Southwest the fourth largest. Big Four Airlines have 80% of the market share and upon successful merger JetBlue will have about 10% of the market share.

Yes, there has been talk of JetBlue reducing flights on the same route to increase occupancy and raise rates on Spirit by removing seats. Once there is breakeven on a flight then all the revenues from extra seats go to your gross margin line and this is a great situation of increasing capacity utilization beyond breakeven.

Figure 1

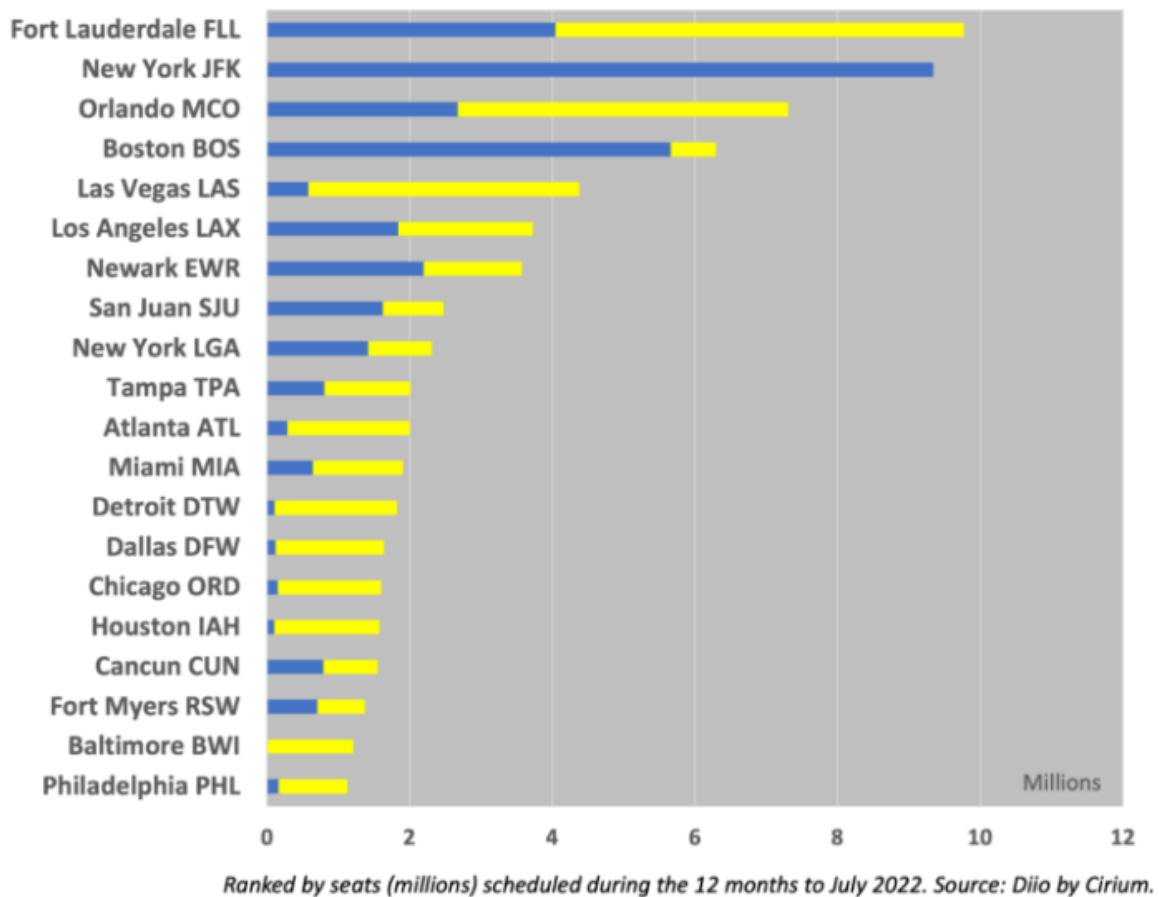


Figure 2

JetBlue-Spirit combined: 20 busiest airports

	Combined	JetBlue	Spirit
1 Fort Lauderdale FLL	9,768,584	4,040,508	5,728,076
2 New York JFK	9,342,226	9,342,226	0
3 Orlando MCO	7,304,963	2,675,766	4,629,197
4 Boston BOS	6,291,986	5,658,365	633,621
5 Las Vegas LAS	4,380,878	581,655	3,799,223
6 Los Angeles LAX	3,726,624	1,839,867	1,886,757
7 Newark EWR	3,568,001	2,196,321	1,371,680
8 San Juan SJU	2,477,226	1,627,254	849,972
9 New York LGA	2,308,441	1,415,970	892,471
10 Tampa TPA	2,006,861	800,916	1,205,945
11 Atlanta ATL	1,997,884	285,976	1,711,908
12 Miami MIA	1,904,795	639,301	1,265,494
13 Detroit DTW	1,822,045	106,766	1,715,279
14 Dallas DFW	1,636,616	116,890	1,519,726
15 Chicago ORD	1,599,911	150,172	1,449,739
16 Houston IAH	1,576,988	98,924	1,478,064
17 Cancun CUN	1,548,802	789,636	759,166
18 Fort Myers RSW	1,371,925	705,870	666,055
19 Baltimore BWI	1,205,947	6,800	1,199,147
20 Philadelphia PHL	1,124,955	164,114	960,841

Ranked by seats scheduled during the 12 months to July 2022. Source: Diio by Cirium.

Figure 1 shows that Florida and the Americas will be a major boost for JetBlue. JetBlue will also gain majorly from Spirit's Las Vegas route. Figure 2 shows the combined seats as of 2022.

JetBlue has also come forward with an agreement with the Florida government which they can showcase to show their plans after completion of the merger. Airline is a very concentrated industry. Flight prices has increased 25% since last year and have outpace consumer inflation in the U.S. This has led to increased operating costs and more lack of pilots for the airlines. JetBlue and Spirit aim to be a large low-cost airline and try and gain a major market share.

To counter the DOJ, divestment will take place massively with more gates and slots to be assigned to Frontier by JetBlue. Frontier would be the only low-cost carrier now according to the DOJ. The merger of US Airways and American was allowed with divestitures taking place on major airports to enhance competition. With government support and recession looming Frontier can look to gains with increased gates, JetBlue and Spirit have argued that they want to democratize pricing and become the largest low fare airline and in turn increasing competition.

Spirit airlines low fares are based upon more seats and costs based upon services offered like luggage, drinks, Wi-Fi, on demand tv and more. JetBlue argues that no everyone gets the low fares that are being marketed and with their award winning service and better customer experience they will provide and merge with TrueBlue reward system to increase efficiency amongst the low-cost carrier. JetBlue have always posted what their flight will actually cost.

Spirit airlines growth though rapid, cannot just depend upon competitive pricing to increase market share and provide healthy competition. Similarly JetBlue cannot grow anymore and is already stretching at the equilibrium of growth. To gain increasing marginal revenue, a merger is very positive for the imperfectly competitive airline industry even though theories suggest that mergers kill competition.

Economist analysis of a merger are as follows to counter to the DOJ

- JetBlue is more effective than Spirit in bringing down competitive fares.
- Customer service will reach more consumers.
- Combination will enhance opportunities and more destinations.
- They compete with other carriers rather than each other.
- Upfront divestitures to ensure low-cost carriers' growth and a massive gain for Frontier.

- JetBlue will look to advance sustainability leadership.

4. Conclusion

The DOJ along with upfront divestitures would also look for JetBlue to cancel their Northeast Alliance with American Airlines. According to me, DOJ does not have a strong case in how declining the merger will keep fair competition in an oligopolistic airline market. Instead DOJ should use this merger to regulate the industry and make agreements on how the merger will adhere to being a low cost airline and increase competition with Frontier getting more gates and slots in part of the deal. When major airlines occupy almost complete market share it is very hard to break them with they having huge stakeholders making money moves for the companies.

In U.S unlike other countries, there are almost no other options for travel for consumers which has led to oligopoly market and which will never be changing. The DOJ should invest and regulate fares and enhance fines for delays and cancellations to enforce healthy competition. Corporate America has a way of getting things done according to their will and if not filing for bankruptcy or going for mergers.

With proper regulation, this merger stands to increase competition and reduce fares rather than doing the opposite due to the nature of the concentrated airline industry.

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