

Predatory Pricing In Airlines

How Southwest Lowered Prices to Squeeze Out Competition in Hawaii

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December 2024



FOR THE YEAR 2023, Hawaiian Airlines lost \$261 million, and by the fourth quarter, the losses rose to more than \$1 million a day.¹ Subsequently, neither the Department of Justice (DOJ)² nor the Department of Transportation (DOT)³ took action to stop a proposed merger between Hawaiian and Alaska Airlines, a merger that will, when completed, leave the already highly concentrated airline sector even more consolidated. News stories suggested if the merger was blocked by either agency, Hawaiian might face a bankruptcy reorganization. As The Wall Street Journal reported, “Analysts have said the merger with Alaska could be a much-needed lifeline for Hawaiian, which has faced a number of challenges and is losing money.”⁴

Less than five years ago, Hawaiian could be described as a reasonably profitable regional airline serving the main five islands of the 50th state,⁵ netting \$233 billion in 2018.⁶ Then, in early 2019, Southwest Airlines entered the market,⁷ flying many of the same routes as Hawaiian but apparently charging consumers below cost, launching a fare war. In this brief, we present evidence showing that Southwest systematically and intentionally lost money to gain market power at the expense of its smaller rival, Hawaiian Airlines.

Charging below cost to monopolize a market is an illegal tactic known as “predatory pricing.” On first glance, it often seems like a good thing. In the short term, prices for consumers are low, but in the medium to long term, markets end up dominated by a few large and unaccountable players who can charge higher prices with less competition. In a worst-case scenario, goods and services stop being provided entirely.

And while Hawaiian’s sudden financial precarity has several causes, predatory pricing almost certainly played a key role. Yet the federal government has all but ceased enforcing predatory pricing laws,⁸ with disastrous results, including the death of small, innovative airlines, and the consolidated system of air travel we have today. Hawaiian is not alone; smaller or ultra-low-cost airlines like Spirit Air are financially precarious right now, and predatory pricing could be a contributing factor.

1 Hawaiian Airlines, “Hawaiian Holdings Reports 2023 Fourth Quarter and Full Year Financial Results,” Newsroom, January 30, 2024, <https://newsroom.hawaiianairlines.com/releases/hawaiian-holdings-reports-2023-fourth-quarter-and-full-year-financial-results>.

2 David Shepardson and Mrinmay Dey, “Alaska Airlines, Hawaiian merger clears US Justice Department review,” Reuters, August 20, 2024, <https://www.reuters.com/markets/deals/alaska-air-hawaiian-merger-moves-forward-us-doj-review-period-ends-2024-08-20/>.

3 U.S. Department of Transportation, “USDOT Requires Alaska and Hawaiian Airlines to Preserve Rewards Value, Critical Flight Service as Merger Moves Forward,” <https://www.transportation.gov/briefing-room/usdot-requires-alaska-and-hawaiian-airlines-preserve-rewards-value-critical-flight>.

4 Alison Sider, “Alaska Air, Hawaiian Airlines Clear Key Antitrust Hurdle,” The Wall Street Journal, August 20, 2024, <https://www.wsj.com/business/airlines/alaska-air-hawaiian-airlines-clear-key-antitrust-hurdle-96c334d8>.

5 Hawaiian Airlines, “Where we fly,” <https://www.hawaiianairlines.com/destinations>.

6 Hawaiian Airlines, “Hawaiian Holdings Reports 2018 Fourth Quarter and Full Year Financial Results,” Newsroom, January 29, 2019, <https://newsroom.hawaiianairlines.com/releases/hawaiian-holdings-reports-2018-fourth-quarter-and-full-year-financial-results>.

7 Southwest Airlines, “Hawaii, Here We Come! Southwest Airlines Service For The Hawaiian Islands Now On Sale,” Investor Relations, March 4, 2019, <https://www.southwestairlinesinvestorrelations.com/news-and-events/news-releases/2019/03-04-2019-160037846>.

8 U.S. Senate Committee on Appropriations, Hearing 105-936, 105th Congress, 1998, “Airline Competition,” 1998, <https://www.govinfo.gov/content/pkg/CHRG-105shrg53117/html/CHRG-105shrg53117.htm>.

The situation with Hawaiian and Southwest is a textbook case. Hawaiian Airlines faced bankruptcy and ultimately gave up its independence to a larger airline, Alaska.⁹ But Southwest hardly emerged unscathed from the financially ruinous fare war it started. Beset with losses nationwide, Southwest is now slashing service (including in Hawaii)¹⁰ and making fundamental changes to its brand and business model under pressure from shareholder Elliott Management, an activist hedge fund.¹¹ Its pricing battle with Hawaiian contributed to those financial woes.

This brief explains how Southwest's seemingly predatory actions ultimately led the federal government to sign off on Hawaiian's merger with Alaska Airlines. It also shows how this pattern of behavior is systemic among the major carriers and explains why we need to reinvigorate the enforcement of predatory pricing law to prohibit it.

BACKGROUND

Hawaiian, one of the oldest airlines in America, launched service in 1929.¹² It operates today in three very distinct markets:

- **High-frequency, short-haul service within the Hawaiian Islands (the Islands);**
- **Long-haul domestic service from the West Coast to Hawaii, competing against larger U.S. airlines, including Alaska; and**
- **Long-haul international service throughout Asia and the Pacific.**¹³

There has been an ongoing pattern of predatory pricing in air service in and around the Hawaiian Islands following the 1978 deregulation of the airline industry. Since that time,

9 Alaska Airlines, "Alaska Airlines completes acquisition of Hawaiian Airlines, expanding benefits and choice for travelers," News Hub, September 11, 2024, <https://news.alaskaair.com/dont-miss/alaska-airlines-completes-acquisition-of-hawaiian-airlines-expanding-benefits-and-choice-for-travelers/>.

10 Alexandra Skores, "Southwest Airlines cutting routes, moving workers from key base amid activist battle," September 25, 2024, Dallas News, <https://www.dallasnews.com/business/airlines/2024/09/25/southwest-airlines-makes-cuts-at-key-base-amid-intense-activist-investor-fight/>; J. Edward Moreno, "Southwest Quits Four Airports in Cost-Cutting Drive," The New York Times, April 25, 2024, <https://www.nytimes.com/2024/04/25/business/southwest-airlines-boeing-airports.html>.

11 Southwest Airlines, "Southwest Airlines Comments on Elliott Management's Special Meeting Request," Investor Relations, October 14, 2024, <https://www.southwestairlinesinvestorrelations.com/news-and-events/news-releases/2024/10-15-2024-003209736>.

12 Hawaiian Airlines, "Our History," <https://www.hawaiianairlines.com/about-us>.

13 Hawaiian Airlines, "Where we fly," <https://www.hawaiianairlines.com/destinations>.

airline competition within Hawaii has been cutthroat.¹⁴ When Aloha Airlines liquidated under Chapter 7 bankruptcy in 2008, ending 62 years of head-to-head competition with Hawaiian, it partially attributed its shutdown to Go!, a startup carrier that undercut pricing before it departed Hawaii in 2014. Similarly, Island Air exited in 2017 after it was unable to effectively compete within the Islands. Its departure left Hawaiian as the primary scheduled airline based in the state, alongside the “island hopper” commuter carrier Mokulele Airlines.¹⁵

Minus significant competition, Hawaiian quickly expanded inter-island service, and fares rose.¹⁶ The situation did not last long. In 2017, Southwest announced it would seek Federal Aviation Administration (FAA) approval for extended overwater operations, using twin-engine Boeing 737s, between the West Coast and Hawaii.¹⁷ It launched nonstop service from the mainland to the Islands on March 17, 2019, with daily service between Oakland and Honolulu. Hawaiian quickly added nonstop flights between Oakland and Maui, and San Jose and Honolulu, as well as inter-island service.¹⁸

Before the first Southwest flight to Hawaii took off, the airline announced a promotion, beginning with a 48-hour sale. Flights within Hawaii were initially priced at \$29 one-way, while service connecting California and the Islands cost from \$49 to \$79. The press release announcing the deal quoted CEO Gary Kelly as saying, “Hawaii, we’re in this for good.” The pattern continued as Southwest announced additional routes. A one-day sale with inter-island fares at \$29 and California-Hawaii fares at \$99 accompanied an announcement of nonstop service between Sacramento and Hawaii as well as more routes within the Islands. Southwest’s 24-hour and 48-hour rock-bottom sales generated buzz, attracted media attention, enticed many first-time flyers to sample Southwest, and put financial pressure on Hawaiian. But Southwest continued offering heavily discounted fares for years after its entry into the market, with one-way inter-island tickets priced at \$39 throughout 2022 and an average fare of \$38 in 2023 on those routes. As recently as October 2024, some

14 Stewart Yerton, “Hawaiian Vs. Southwest: Good News For Travelers, Bad News For The Bottom Line,” Civil Beat, March 9, 2023, <https://www.civilbeat.org/2023/03/hawaiian-vs-southwest-good-news-for-travelers-bad-news-for-the-bottom-line/>; Civil Beat, “Go! Airlines in Hawaii to Close April 1; Q&A for Customers,” March 18, 2024, <https://www.civilbeat.org/2024/03/go-airlines-in-hawaii-to-close-april-1-q-a-for/>; Chris Bradford, “In To Land: Major airline’s owner blasts well-known rival after hundreds of workers suddenly out of jobs following sudden bankruptcy,” The Sun, October 5, 2023, <https://www.the-sun.com/money/9255074/island-air-hawaii-bankruptcy-job-losses/>; Beat of Hawaii, “Why Airlines in Hawaii Are Always One Step from Chaos,” July 26, 2024, <https://beatofhawaii.com/why-airlines-in-hawaii-are-always-one-step-from-chaos/>; Paul Stephen Dempsey, “The Financial Performance of the Airline Industry Post-Deregulation,” Houston Law Review, 2008, https://www.mcgill.ca/iasl/files/iasl/ASPL614_Industry_PostDeregulation-Houston.pdf.

15 Mokulele Airlines, “Hawaii Route Map,” <https://www.mokuleleairlines.com/route-map/>.

16 Hawaiian Airlines, “Hawaiian Airlines Welcomes First A321neo, Readies for U.S. West Coast Expansion,” Newsroom, November 16, 2017, <https://newsroom.hawaiianairlines.com/releases/hawaiian-airlines-welcomes-first-a321neo-readies-for-u-s-west-coast-expansion>.

17 Southwest Airlines, “Southwest Airlines Announces Intention to Serve Hawaii,” Investor Relations, October 11, 2017, <https://www.southwestairlinesinvestorrelations.com/news-and-events/news-releases/2017/10-12-2017-041410405>.

18 Southwest Airlines, “Hawaii, Here We Come! Southwest Airlines Service For The Hawaiian Islands Now On Sale,” Investor Relations, March 4, 2019, <https://www.southwestairlinesinvestorrelations.com/news-and-events/news-releases/2019/03-04-2019-160037846>.

inter-island routes were priced as low as \$60. These fares did not, however, achieve break-even rates, as detailed below.¹⁹

THE SOUTHWEST STRATEGY: CALCULATED LOSSES

In 2022, after three years of losses, Southwest, instead of recalibrating, doubled down on its money-losing Hawaiian strategy and offered \$39 inter-Hawaii fares from July 26 through December 31. News reports soon expressed concern that Southwest’s bargain-basement fares would threaten Hawaiian Airlines’ sustainability. Yet the price-cutting continued into 2023, and it soon became apparent Hawaiian was clearly the worse for the bruising competition, posting a \$260.5 million loss for the year.²⁰

Southwest now flies to Hawaii from eight destinations in California, Arizona, and Nevada. In addition, the airline operates six nonstop routes within the Islands, all of which are under 220 miles one-way. These inter-island flights compete directly with Hawaiian.²¹

Honolulu » Hilo	216 air miles
Honolulu » Maui	101 air miles
Honolulu » Kona	163 air miles
Honolulu » Lihue	102 air miles
Maui » Kona	84 air miles
Maui » Lihue	202 air miles

19 Southwest Airlines, “Hawaii, Here We Come! Southwest Airlines Service For The Hawaiian Islands Now On Sale,” Investor Relations, March 4, 2019, <https://www.southwestairlinesinvestorrelations.com/news-and-events/news-releases/2019/03-04-2019-160037846>; Southwest Airlines, “Hawaii, More Is On The Way! Southwest Airlines Expanded Service For The Hawaiian Islands Now On Sale,” Investor Relations, August 15, 2019, <https://www.southwestairlinesinvestorrelations.com/news-and-events/news-releases/2019/08-15-2019-163027000>.

20 Allison Schaefer, “Southwest Airlines rolls out longest- running \$39 interisland fare,” Yahoo! News, August 5, 2022, <https://www.yahoo.com/news/southwest-airlines-rolls-longest-running-035300315.html?quccounter=1>; Stewart Yerton, “Hawaiian Vs. Southwest: Good News For Travelers, Bad News For The Bottom Line,” Civil Beat, March 9, 2023, <https://www.civilbeat.org/2023/03/hawaiian-vs-southwest-good-news-for-travelers-bad-news-for-the-bottom-line/>; Beat of Hawaii, “Go Big and Predatory: Southwest Hawaii And Costco,” August 20, 2022, <https://beatofhawaii.com/go-big-and-predatory-southwest-hawaii-and-costco/>.

21 Southwest, “Traveling to Hawaii,” <https://www.southwest.com/destinations/hawaii>.

Southwest operates these flights with Boeing 737-800s and 737 MAX 8s, both configured for 175 seats.²² According to Elliott Management, which is mounting a campaign to reorganize Southwest, these inter-island flights had an average load factor of 47% in 2023.²³ That translates to an average of 83 passengers per flight on routes within Hawaii last year.

Elliott calculated that the average fare on these flights was \$38.²⁴ This means Southwest generated revenue of \$3,154 per inter-island flight.

In the airline industry, the most reliable measurement of expenses is cost per available seat mile (CASM), which is the total cost to carry one passenger one air mile. According to Southwest’s financial filings, the carrier’s CASM was 15.16 cents systemwide in 2023.²⁵ Again, there are 175 available seats on each inter-island flight. Here’s how that CASM figure translates on each of the six inter-island routes:

175 seats x total air miles x 15.16 cents:

Honolulu » Hilo	\$5,730.48 (-\$2,576.48)
Honolulu » Maui	\$2,679.53
Honolulu » Kona	\$4,324.39 (-\$1,170.39)
Honolulu » Lihue	\$2,706.06
Maui » Kona	\$2,228.52
Maui » Lihue	\$5,359.06 (-\$2,205.06)

The above calculations show that at least half of Southwest’s six inter-island routes operated at a loss in 2023. In other words, five full years after the airline entered the market, Southwest, even as its own financial pressures mounted, kept inter-island Hawaii fares so low, they actively lost money on these flights. Indeed, on the three money-losing routes, the average cost per flight ranged from \$1,170 to \$2,576 higher than the average revenue per flight of \$3,154. Had Southwest operated legally and raised its fares on these

22 Channing Reid, “The Boeing 737 Max 8 At Southwest Airlines: Everything You Need to Know,” Simple Flying, March 19, 2024, <https://simpleflying.com/boeing-737-max-8-southwest-airlines-guide/>; Southwest Airlines, “Help Center,” <https://support.southwest.com/helpcenter/s/>.

23 Stronger Southwest, Elliott, June 10, 2024, slide 36, <https://www.scribd.com/document/764544171/Stronger-Southwest-06102024>.

24 *Id.*
 25 While the airline’s financial filings do not break down CASM by regions, analysts have asserted that Southwest’s costs in Hawaii are higher than systemwide, due to the FAA’s “ETOPS” overwater certification. Southwest Airlines, “Southwest Airlines Reports Fourth Quarter and Full Year 2023 Results,” Investor Relations, January 25, 2024, <https://www.southwestairlinesinvestorrelations.com/news-and-events/news-releases/2024/01-25-2024-114521040>.

routes, no doubt Hawaiian would have done the same. Instead, both airlines began to bleed financially — and would continue to do so.²⁶

Southwest did not engage in this level of seemingly predatory behavior on its other routes. The Department of Transportation’s quarterly Domestic Airline Consumer Airfare Reports capture the 1,000 busiest domestic city-pair routes in the 48 contiguous states, highlighting both the carrier with the largest market share and the one with the lowest average one-way fare on each route. On routes under 250 air miles, Southwest was both the dominant carrier and the carrier with the lowest fares in multiple cases during all four quarters of 2023. However, on *all* these short routes, Southwest’s average one-way fares were considerably higher than the \$38 average it charged on its Hawaii inter-island routes. The absolute lowest one-way fare it offered on routes of comparable lengths last year in all other U.S. markets was no lower than \$159 — or \$121 more.²⁷

**Routes Under 250 Miles On Which Southwest Provided
The Lowest Average One-Way Fares - 2023**

	LOWEST FARE	HIGHEST FARE
Q1 2023	\$167 (Atlanta-Nashville)	\$201 (Dallas-San Antonio)
Q2 2023	\$163 (Atlanta-Nashville)	\$209 (Houston-San Antonio)
Q3 2023	\$160 (Austin-Dallas)	\$206 (Pittsburgh-Washington)
Q4 2023	\$159 (Reno-San Francisco)	\$201 (Houston-San Antonio)

In fact, during all four quarters of 2023, the lowest average one-way fare offered by any domestic airline on a route under 250 miles was \$85. This was provided in the third quarter on the Las Vegas-Los Angeles route by Spirit Airlines, an ultra-low-cost carrier. However, Spirit’s systemwide CASM in 2023 was 10.52 cents, almost a third lower than Southwest’s CASM of 15.16 cents. Interestingly, Southwest was the dominant airline on this route, with

26 Hawaiian Airlines, “Hawaiian Holdings Reports 2023 Fourth Quarter and Full Year Financial Results,” Newsroom, January 30, 2024, <https://newsroom.hawaiianairlines.com/releases/hawaiian-holdings-reports-2023-fourth-quarter-and-full-year-financial-results>; Southwest Airlines, “Southwest Airlines Reports Fourth Quarter and Full Year 2023 Results,” PR Newswire, January 25, 2024, <https://www.prnewswire.com/news-releases/southwest-airlines-reports-fourth-quarter-and-full-year-2023-results-302044106.html>.

27 U.S. Department of Transportation, Office of Aviation Analysis, “Domestic Airline Fares Consumer Report, First Quarter 2023 Passenger and Fare Information,” August 2023, https://www.transportation.gov/sites/dot.gov/files/2023-08/Domestic%20Airline%20Fares%20Consumer%20Report%202023_Q1.pdf; Id., “Domestic Airline Fares Consumer Report, Second Quarter 2023 Passenger and Fare Information,” October 2023, https://www.transportation.gov/sites/dot.gov/files/2023-10/Domestic%20Airline%20Fares%20Consumer%20Report%202023_Q2.pdf; Id., “Domestic Airline Fares Consumer Report, Third Quarter 2023 Passenger and Fare Information,” February 2024, https://www.transportation.gov/sites/dot.gov/files/2024-02/Domestic%20Airline%20Fares%20Consumer%20Report%202023_Q3.pdf; Id., “Domestic Airline Fares Consumer Report, Fourth Quarter 2023 Passenger and Fare Information,” April 2024, https://www.transportation.gov/sites/dot.gov/files/2024-04/Domestic%20Airline%20Fares%20Consumer%20Report%202023_Q4.pdf.

63% of the market share, but its average one-way fare that quarter was \$133 — \$48 more than Spirit. Southwest has shown it can be profitable without matching every low-cost competitor’s rock-bottom fares, and yet the carrier has not adopted this strategy for inter-island Hawaii flights.²⁸

To be clear, it’s not uncommon to see cut-rate fares when airlines enter new markets. Obviously, they benefit consumers, while allowing unfamiliar carriers to entice first-time flyers. But traditionally, these are limited-time offers. For example, in 2021, Avelo Airlines offered \$19 fares for the first 30 days after the company launched. But when one of the authors of this paper wrote about Avelo’s launch for Conde Nast Traveler three years ago, he asked CEO Andrew Levy about this, and Levy responded, “Enjoy it while you can. That doesn’t pay the bills.”^{29,30}

This is not what has been occurring in the Hawaiian inter-island air travel market since 2019. Southwest was offering \$60 and \$70 one-way fares on these flights in September 2024, five years after entering the market.

Evidence is mounting that Southwest’s strategy in Hawaii is predatory. Its actions caused Hawaiian to lower its fares despite the fact that it would, over time, seriously damage its own bottom line.

SOUTHWEST PRICING SCRUTINY MOUNTS

Southwest’s seemingly predatory behavior didn’t go unnoticed. In late 2020, the Wall Street Journal published an article looking at Southwest’s aggressive expansion efforts across the United States. Southwest CEO Andrew Watterson, who previously worked at Hawaiian Airlines, told reporters the company’s strategy was to go big and offer multiple flights on the targeted routes. Do that, he said, and “the other airlines can’t really touch you.” The head of the Southwest Airlines Pilots Association was quoted as describing the airline’s strategy as “predatory and opportunistic — which we like.”³¹

28 Spirit Airlines, “Spirit Airlines Reports Fourth Quarter and Full Year 2023 Results,” Investor Relations, February 8, 2024, https://s24.q4cdn.com/507316502/files/doc_financials/2023/q4/Earnings-Release-4Q23.pdf.

29 Avelo Airlines, “Meet Avelo: America’s Newest Airline,” PR Newswire, April 8, 2021, <http://www.prnewswire.com/news-releases/meet-avelo-americas-newest-airline-301264717.html>.

30 William J. McGee, “Why Avelo Airlines Is a U.S. Low-Cost Carrier Worth Your Attention,” Conde Nast Traveler, February 22, 2021, <https://www.cntraveler.com/story/why-avelo-airlines-is-a-us-low-cost-carrier-worth-your-attention>

31 Alison Sider, “‘Predatory and Opportunistic’: Southwest Airlines Seizes the Moment as Rivals Struggle,” The Wall Street Journal, November 16, 2020, <https://www.wsj.com/articles/southwest-airlines-covid-expansion-airports-11605296205>.

Local journalists got more specific, calling out Southwest's actions in the Hawaiian market. A local travel blog, The Beat of Hawaii, compared Southwest's strategy to Costco moving in on a mom-and-pop grocery store. More recently, Redditors have taken on the topic, with one commenter, apparently local to the Hawaiian islands, pointing out, "If Hawaiian were to fold, I promise you [Southwest] will be the only game in town and tickets will be \$500 round trip. Same as they did on the mainland. They aren't for the people of Hawaii. ... They don't care one [---] about the people of Hawaii. Just another mainland company here to take profit back to their HQ on the mainland. Don't fall for it."³²

It was also, even more damningly, discussed in the Hawaiian C-suite, something that broke into the open when Hawaiian CEO Peter Ingram noted on an October 2022 quarterly earnings call that Southwest's \$39 fares netted the larger airline just \$26.05 per ticket, something he claimed that even with a 100% passenger load factor would leave the flight operating at a loss. When a Wall Street analyst asked if Southwest was engaging in predatory pricing, Ingram responded, "I'll leave the legal questions to someone else. ... But what I will say is fares of \$26.05 do not cover the total cost of operations, as I said in my prepared remarks." When a second analyst asked Ingram later, he added, "[I]f you look at how the pricing is elsewhere in the country and markets under 250 miles, you won't see pricing in the local market anywhere close to what we're seeing here. So it's highly unusual and I don't think sustainable for the long term."³³

Southwest has said little publicly about its Hawaii inter-island operation in recent years, other than to assert the market is "strong" and "performing very well." But comments by Southwest executives during quarterly earnings calls fill in some gaps.

- **April 2022:** Southwest said it was "restructuring" Hawaii to have "less flying from the mainland to Hawaii and then more flying between the islands."
- **October 2022:** Southwest said, "Our Hawaii inter-island service will take longer to development, and our primary goal at this point is generating awareness among local travelers and incentivize them to try Southwest and experience our product. This is not uncommon with introduction of new service." (Note: This was 3.5 years after entering the market.)
- **July 2023:** Southwest said Hawaii was "under development."

32 Beat of Hawaii, "Go Big and Predatory: Southwest Hawaii and Costco," August 20, 2022, <https://beatofhawaii.com/go-big-and-predatory-southwest-hawaii-and-costco/>; Beat of Hawaii, "Hawaiian Vs. Southwest = Battle of Mom-And-Pop Vs. Costco," January 23, 2023, <https://beatofhawaii.com/hawaiian-vs-southwest-battle-of-mom-and-pop-vs-costco/>; Reddit, "Do you prefer Southwest or Hawaiian for interisland flights?," 2022, https://www.reddit.com/r/Hawaii/comments/11npta4/do_you_prefer_southwest_or_hawaiian_for/.

33 The Motley Fool Transcribing, "Hawaiian Holdings (HA) Q3 2022 Earnings Call Transcript," October 25, 2022, <https://www.fool.com/earnings/call-transcripts/2022/10/25/hawaiian-holdings-ha-q3-2022-earnings-call-transcr/>.

- **October 2023:** Southwest said the investment in Hawaii “has created challenges to our current unit revenue performance.”³⁴

Some aviation experts have offered alternative theories for Southwest’s actions in Hawaii. In August, Gary Leff wrote for the View from the Wing travel blog that Southwest’s strategy with “unprofitable Hawaii flights” is to use the inter-island flying to secure gates for its Hawaii-mainland routes. He also noted that Hawaii is critical to Southwest’s frequent flier and credit card programs, since it is a very popular destination for members.³⁵

But others, who asked AELP for anonymity, were more damning in their assessments. “If it looks like pricing below cost, it probably is. Southwest can’t be making money [in Hawaii] with dirt-cheap fares and half-empty planes,” one prominent aviation expert told AELP. Earlier this year, Elliott Management released a paper entitled “Stronger Southwest,” which found that Southwest’s push into the Hawaiian air market “appears to have driven substantial unnecessary losses.”³⁶

PREDATORY PRICING IS PERVASIVE

In 1993, a landmark DOT report touted the “Southwest Effect” for spreading low fares and generating more traffic. But that same report also provided a remarkably prescient analysis of the Southwest model we see today (as emphasized in **bold**): “Without a competitive discipline, over time Southwest’s fares will increase to cover cost inefficiencies that will creep in, and to extract monopoly profits. **We already see Southwest’s prices beginning to increase where it has forced out its competition and its load factors have attained relatively high levels.** ... In markets dominated by Southwest, more effective low-cost competition is needed to keep fares low and to maintain a competitive level of service.”³⁷ In the Hawaii market, that second phase has not kicked in yet, but the Alaska acquisition of Hawaiian could spur this. It has happened before.

34 The Motley Fool Transcribing, “Southwest Airlines (LUV) Q1 2022 Earnings Call Transcript,” April 29, 2022, <https://www.fool.com/earnings/call-transcripts/2022/04/29/southwest-airlines-luv-q1-2022-earnings-call-trans/>; Id., “Southwest Airlines (LUV) Q3 2022 Earnings Call Transcript,” October 27, 2022, <https://www.fool.com/earnings/call-transcripts/2022/10/27/southwest-airlines-luv-q3-2022-earnings-call-trans/>; Id., “Southwest Airlines (LUV) Q1 2023 Earnings Call Transcript,” April 28, 2023, <https://www.fool.com/earnings/call-transcripts/2023/04/28/southwest-airlines-luv-q1-2023-earnings-call-trans/>; Id., “Southwest Airlines (LUV) Q2 2023 Earnings Call Transcript,” July 27, 2023, <https://www.fool.com/earnings/call-transcripts/2023/07/27/southwest-airlines-luv-q2-2023-earnings-call-trans/>; Id., “Southwest Airlines (LUV) Q3 2023 Earnings Call Transcript,” October 26, 2023, <https://www.fool.com/earnings/call-transcripts/2023/10/26/southwest-airlines-luv-q3-2023-earnings-call-trans/>.

35 Gary Leff, “Southwest Airlines Reveals Strategy: Unprofitable Hawaii Flights Protect Prime Gate Access,” View From The Wing, August 13, 2023, <https://viewfromthewing.com/southwest-airlines-reveals-strategy-unprofitable-hawaii-flights-protect-prime-gate-access/>.

36 Stronger Southwest, Elliott, June 10, 2024, slide 36, <https://www.scribd.com/document/764544171/Stronger-Southwest-06102024>.

37 U.S. Department of Transportation, Office of Aviation Analysis, “The Airline Deregulation Evolution Continues: The Southwest Continues,” 1993, p. 10, <https://apps.dtic.mil/sti/pdfs/ADA299083.pdf>.

Below-cost pricing in an effort to gain market share has been routine in the airline industry since deregulation in 1978, contributing to financial fragility and consolidation. This dynamic gained traction in the 1980s and became rampant by the 1990s. During the U.S. airline industry’s regulated era, from 1938 to 1978, there was little incentive — and few opportunities — for carriers to engage in predatory pricing. That stability ended with the Airline Deregulation Act in 1978. The industry’s profit margin declined 74% in the first decade after deregulation, as consolidation and bankruptcies prevailed.³⁸

In detailed testimony before the Senate in 1998, an executive at Spirit Airlines chronicled how in 1996 rumors started that “Northwest will unload on Spirit.” Soon after, Northwest engaged in fare-cutting and capacity-dumping on the Detroit-Philadelphia route. Spirit estimated that Northwest lost more than \$10 million by matching its \$49 one-way fare and ultimately forced Spirit to cease serving that market. Several months later, Northwest’s fare increased to \$460 for a one-way ticket, a 500% price increase.³⁹

“The major airlines appeared to be on a homicidal mission to destroy the low-fare airlines,” said Paul Stephen Dempsey, director of the Institute of Air & Space Law at McGill University, in 2002. He went on to cite numerous cases of major carriers allegedly putting small competitors “in the crosshairs,” including:⁴⁰

- **American against Sun Jet, Vanguard, and Western Pacific;**
- **Delta against ValuJet;**
- **Northwest against Spirit and Sun Country; and**
- **United against Frontier and Western Pacific.**

By the early 2000s, both the DOT and DOJ had attempted to assert their authority to stop airline predation. In 2002 a federal judge ruled against DOJ in *United States v. AMR Corp.*, which charged American Airlines with predatory pricing against three low-cost carriers in Dallas. The court found that American was meeting the price of its rivals and therefore wasn’t engaged in predation, as well as finding that the DOJ’s cost metrics were unreliable and didn’t prove American was pricing below cost. But in 2005, with a better fact pattern,

38 Airlines for America, “U.S. Airline Mergers and Acquisitions,” September 18, 2024, <https://www.airlines.org/dataset/u-s-airline-mergers-and-acquisitions/>; Airlines for America, “U.S. Airline Bankruptcies,” August 7, 2023, <https://www.airlines.org/dataset/u-s-bankruptcies-and-services-cessations/>; Paul Stephen Dempsey, “The Financial Performance of the Airline Industry Post-Deregulation,” *Houston Law Review*, 2008, https://www.mcgill.ca/iasl/files/iasl/ASPL614_Industry_PostDeregulation-Houston.pdf.

39 U.S. House of Representatives, Committee on the Judiciary, “State of Competition In The Airline Industry,” Hearing, 105th Congress, May 19, 1998, https://commdocs.house.gov/committees/judiciary/hju57743.000/hju57743_of.htm.

40 Paul Stephen Dempsey, “Predation, Competition and Antitrust Law: Turbulence in the Airline Industry,” *Journal of Air Law and Commerce*, 2002, pp. 688, 689, 730-734, <https://scholar.smu.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1627&context=jalc>.

the Sixth Circuit held that Spirit Airlines could pursue a predatory pricing claim against Northwest.⁴¹

For its part, the DOT also looked askance on predatory pricing, and in the late 1990s considered issuing departmental guidelines. Ultimately the DOT abandoned this approach in January 2001, stating, “We have decided not to publish guidelines as originally proposed, since we have concluded that publishing our analyses and developing standards through a case-by-case approach will be a more effective way of proceeding.”⁴²

DOJ and DOT have been quiet on predatory behavior in the airline industry in the decades since. This needs to change.

RECOMMENDATIONS

The issue of predatory pricing within the airline industry and its effects on consumers and competition is larger than what has played out in Hawaii. Clearly more action to put a stop to it is needed. There is regulatory and statutory support for increased federal enforcement. Below is a summary of potential executive and legislative measures to rein in airline predatory pricing.

- **DOJ AND DOT SHOULD REINVIGORATE AND REEXAMINE PREDATORY PRICING LAW.** Engaging in pricing below cost for sustained periods and forcing competitors to suffer financial losses is against the law. Both the DOT and DOJ have the means to examine and bring to light such abuses in the airline market, and Economic Liberties urges them to do so. To be clear, we are not suggesting simply investigating low pricing. We believe investigations should commence when there is evidence a low pricing strategy was undertaken to cause financial losses to competitors.

- **DOT SHOULD UPDATE ITS PREDATORY PRICING GUIDANCE.** The dynamics of a changing airline industry need to be reevaluated as well. Much of the DOJ’s and DOT’s legal research has focused on a market presumption that an “incumbent” airline was a large and powerful major carrier responding to the threat of a “new-entrant” airline that was often a low-cost startup.

41 U.S. v. AMR Corp, 335 F.3d 1109 (10th Cir. 2003), <https://casetext.com/case/us-v-amr-corp/case-summaries>.

42 U.S. Department of Transportation, Bureau of Transportation Statistics, “Enforcement Policy regarding Unfair Exclusionary Conduct in the Air Transport Industry: Findings on the Economic, Policy, and Legal Issues,” January 17, 2001, <https://rosap.ntl.bts.gov/view/dot/34080>.

In 2023, the DOJ updated its “Predatory Pricing: Strategic Theory And Legal Policy” comments on the airline industry by stating, “The entrant will be more dependent on outside funding than the incumbent because the incumbent can generate strong cash flow from the many markets not involved in the price war, while the entrant may face competition in all or most of its markets.”⁴³

However, in the inter-island Hawaii market, this model has been reversed. Incumbent Hawaiian has been under threat from Southwest, a much larger and deeper-pocketed competitor. Thus, these DOJ definitions of “entrant” and “incumbent” should be reversed when examining Southwest and Hawaiian, because the new entrant is causing harm against the incumbent.

• **CONGRESS SHOULD INVESTIGATE AND TAKE ACTION.** Congress possesses the authority to investigate predatory pricing and its harmful effects on consumers and competition. More than three decades ago, Sen. John Danforth (R-MO) introduced the Airline Predatory Pricing Prevention Act of 1993, which called on DOT to investigate any complaints against airlines based on either one of two indicators: (1) pricing below “direct operating costs” and (2) pricing decreases “resulting in widespread losses among all air carriers” on a given route.⁴⁴

Congress could revive similar legislation today by directing DOT to investigate potential abuses and take appropriate action. If DOT finds evidence of either or both indicators, then it can issue a cease-and-desist order against the offending carrier. If the carrier continues, then civil penalties — compounded route by route and day by day — should be imposed. Furthermore, predatory-pricing case law needs to be fixed so there are not unrealistic hurdles to litigation. Congress enacted legislation against predatory pricing, in the words of Lina Khan, “to prohibit large corporations from slashing prices below the cost of production ‘with the intent to destroy and make unprofitable the business of their competitors’ with the aim of ‘acquiring a monopoly in the particular locality or section in which the discriminating price is made.’”⁴⁵ This intent needs to be restored.⁴⁶

Under current Supreme Court precedent, to establish predatory pricing under Section 2 of the Sherman Act, a plaintiff must prove that the defendant both (1) set prices below the

43 Patrick Bolton, Joseph F. Brodley, and Michael H. Riordan, “Predatory Pricing: Strategic Theory and Legal Policy,” U.S. Department of Justice, <https://www.justice.gov/archives/atr/predatory-pricing-strategic-theory-and-legal-policy>.

44 Airline Predatory Pricing Prevent Act of 1993, S.770, 103rd Congress, (1993), <https://www.congress.gov/bill/103rd-congress/senate-bill/770/text>.

45 Lina Khan, “Amazon’s Antitrust Paradox,” Yale Law Journal, Vol. 126, January 31, 2017, <https://ssrn.com/abstract=2911742> (quoting H.R. REP. NO. 63-627, at 8 (1914)).

46 The Institute for Local Self-Reliance argues that “antitrust laws must be updated to make clear that plaintiffs don’t need to show a monopolist raised prices to recoup losses to successfully prove abusive predatory pricing. Rather, sustained below-cost pricing in an industry is sufficient to prove a predatory pricing case.” Ron Knox, “Handcuffed By the Courts: How Judges Broke Our Monopoly Laws and What Congress Must Do to Repair Them,” ISLR, March 2022, p. 6, https://ilsr.org/wp-content/uploads/2022/03/ILSR_Issue-Brief_Handcuffed-By-the-Courts.pdf.

defendant's own costs and (2) has a "dangerous probability" of "recouping its investment in below-cost prices" after reducing competition in the market. To evaluate the probability of recoupment, courts use a two-step analysis. First, courts determine whether the below-cost prices would successfully drive competitors out of the market, taking into account factors such as the extent and duration of the predatory pricing behavior, the defendant's strength, the vulnerability of competitors, and the competitors' drive and incentives to compete.⁴⁷ Second, they consider the likelihood that the defendant will recoup the profits it lost during its below-cost pricing.

In other words, companies that take action to monopolize a business sector are only held liable if there is significant proof of their intent after the fact.⁴⁸ But by then the damage is done and the punishment comes too late to make a difference. Congress could change this, and it should.

Congress should also direct either the Government Accountability Office or Congressional Research Service to thoroughly review airlines' predatory behavior to ensure the proper agencies are taking steps to prevent it.

• **CONGRESS SHOULD REGULATE AIRLINE PRICING.** In Economic Liberties' January 2024 white paper, "How to Fix Flying,"⁴⁹ we called on Congress to regulate the industry with a new approach, one designed to eliminate the instability of constant mergers and bankruptcies, and the complexity of one of the most confusing pricing models on the open market. We believe one way to do this is by legally requiring "fair and transparent pricing." This is a multifaceted approach that would limit the airlines to no more than three fare classes and eliminate the computerized algorithms that constantly change fares based on supply-and-demand factors that are opaque to consumers.⁵⁰

We also believe regulators need to put a stop to price discrimination. Ticket prices should be set at a fixed amount that does not change based on seat location, or increase or decrease over time. Airlines should also not be allowed to engage in dynamic pricing, employing surveillance practices to raise or lower prices based on a consumer's willingness (or unwillingness) to pay a particular fare. This will effectively preclude an airline's ability to make airfares even more opaque by tailoring different ticket prices for passengers based on personal data and online shopping patterns.⁵¹

47 Lina Khan, "Amazon's Antitrust Paradox," Yale Law Journal, Vol. 126, January 31, 2017, pp. 224-226, <https://ssrn.com/abstract=2911742>.

48 Brooke Grp., Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222-24 (1993).

49 William J. McGee and Ganesh Sitaraman, "How to Fix Flying: A New Approach to Regulating the Airline Industry," The American Economic Liberties Project, January 26, 2024, <https://www.economicliberties.us/our-work/how-to-fix-flying/>.

50 *Id.*

51 *Id.*

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