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THE FINANCIAL STATE OF THE AIRLINE INDUSTRY AND THE IMPLICATIONS OF CONSOLIDATION

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

JUNE 17, 2010

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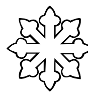

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ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

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THE FINANCIAL STATE OF THE AIRLINE INDUSTRY AND THE IMPLICATIONS OF CONSOLIDATION

THURSDAY, JUNE 17, 2010

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m. in Room SR–253, Russell Senate Office Building, Hon. John D. Rockefeller IV, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

The CHAIRMAN. Good morning, everybody. This hearing is begun. And we have a full quorum, so we will proceed.

Kay Bailey Hutchison is with constituents, and she's on her way. She's a very, very good person to work with.

Let me make my opening statement, then Kay Bailey hopefully will be here by that time, and then we will go to each of you.

We have some time pressure this morning, because we have a— you've already been canceled once, so you're kind of used to this— but, we have a oil spill briefing by Admiral Allen at 10:50. But, what I'll probably be is a little bit late for that so I can stay and ask some questions.

Do you know what? I'm going to put my statement in the record so we can—I mean, it's a brilliant statement, of course.

[Laughter.]

The CHAIRMAN. But, I think it's more important to hear from you. So, if you want, you'll get, you know, to grab a copy of my statement, you can take it home, put it on the wall.

[The prepared statement of Senator Rockefeller follows:]

PREPARED STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

Air transportation is absolutely essential to our economy. I have been working on aviation my entire career, and I have seen just how important it is for our communities to be able to move people and products anywhere in the world in a short time. In West Virginia, air service provides a critical link for many rural communities— giving them the tools to compete, fostering economic activity, connecting families, and providing access to basic services.

Unfortunately, even in the best of economic times, the airline industry struggles to stay healthy. Over the last decade, two recessions, war, and unstable oil prices have created a very fragile industry. Airlines have lost $60 billion, eliminated nearly 150,000 jobs, terminated pensions, seen several major carriers declare bankruptcy, and made deep cuts in service to small communities. We need a strong airline in-

dustry in the United States if we are serious about making certain all of our communities have access to the global marketplace.

Today, the airline industry appears to have weathered the worst of the financial storms, but the core question is whether it has done enough to shore up its bottom-line and survive the next crisis. Will it be able to cope with the next spike in oil prices? Can it survive a recession in Europe?

In an effort to become stronger, United and Continental have announced their intention to merge, creating the world's largest airline—comparable to Delta after its merger with Northwest. If this merger is approved, our passenger aviation system will have one less global network carrier, and I am not sure if this is good or bad, but it is increasingly clear that the current structure is not financially sustainable. I do not want to advocate for higher fares, but the truth is that brutal competition and too many seats have probably led to artificially low fares—the terrible irony is that a weak airline industry can be good for consumers.

Opponents of consolidation argue that it will lead to less competition, higher fares, and lower service levels. There is a lot of concern from passengers lately about the proliferation of small add-on fees—for baggage, food, seat selection, and the latest surcharge, proposed a few weeks ago, for peak travel times. These are legitimate concerns, and I expect the airlines to address them directly and completely.

I also very much recognize that if we want air carriers to survive and grow, to compete with foreign carriers, and continue to offer stable jobs in our communities, they need to maintain their financial health. If consolidation creates the conditions not only to survive, but also to thrive in a competitive global industry—and I hope it does—I will support it.

I do not believe consolidation alone will create a healthy industry. We very much need to pass the FAA reauthorization bill to modernize the air traffic control system. Nothing will kill this nascent recovery quicker than a return to delays, congestion, and gridlock in the skies. It is a delicate balance, but we need to find a way for air carriers to provide service—including service to small communities—in a financially sustainable manner. We have to get this right for air travelers, airline workers and for our national economy.

I want to thank today's witnesses for participating. These are complex issues, and I know your experience and perspective will allow us to begin answering the tough questions ahead.

But, we will start, as people are listed here, the Honorable Susan Kurland, Assistant Secretary for Aviation and International Affairs, U.S. Department of Transportation.

STATEMENT OF HON. SUSAN L. KURLAND, ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION

Ms. KIRKLAND. Thank you, Mr. Chairman.

The CHAIRMAN. And pull that mike right up close, please.

Ms. KIRKLAND. Thank you.

Thank you, Mr. Chairman. Thank you for the opportunity to appear before you this morning in order to discuss the current and future state of the airline industry and the role of the Department of Transportation in the industry's ongoing restructuring.

Let me begin with a brief overview of the state of the airline industry to provide an understanding of the economic environment in which this transaction has been proposed.

Following several consecutive years of losses, from 2001 to 2005, the industry returned to modest profitability in 2006 and 2007, only to confront rapidly increasing fuel costs and then a global recession. 2008 and 2009 were some of the most challenging years in the history of U.S. aviation, primarily because of the global recession that helped push operating revenues for the nine largest U.S. carriers down an unprecedented 17 percent, year over year.

While costs also increased significantly during the first quarter of 2010, airline revenues have also rebounded, in large part on the basis of increased passenger volumes.

For the second quarter of 2010, most analysts are predicting stronger results as passenger and shipper demand, that vanished during the height of the global recession, is returning across all sectors for all carriers. The turnaround from this time last year is encouraging.

We foresee the industry continuing to evolve along several basic trends:

First, carriers, while conscious of costs, are aggressively pursuing new sources of revenue.

Second, over time, low-cost carriers will continue to expand significantly.

Third, legacy carriers are continuing to seek ways to become more efficient producers, including through stronger international alliance relationships.

While I cannot discuss the specifics of the proposed United-Continental merger, or any proposed transaction that is before us for review, I would like to shed some light on DOT's role in the review of an airline merger.

Since 1989, the Department of Justice has had the lead role in reviewing proposed airline mergers. The Department of Transportation, using its special aviation expertise, typically examines the proposed merger, and shares its analysis and views with DOJ's antitrust division. Each transaction that we review is considered on a case-by-case basis, consistent with antitrust principles and practice.

Should DOJ decide not to challenge a particular transaction, on antitrust grounds, DOT would then consider a wide range of follow-on issues that fall within our jurisdiction, including international route transfers, economic fitness, co-chairing, and possible unfair or deceptive practices.

The Department's consideration of aviation economic policy focuses on what is best for a healthy and competitive industry for its workers, for the communities, and consumers that it serves. I can, therefore, assure you that, in conducting our analysis, we are committed to fostering an environment that embraces competition and provides consumers with the price and service benefits that competition brings.

Mr. Chairman, this concludes my testimony, and I would be happy to answer any questions that you may have.

[The prepared statement of Ms. Kurland follows:]

PREPARED STATEMENT OF HON. SUSAN L. KURLAND, ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION

Chairman Rockefeller, Ranking Member Hutchison, and members of the Committee:

Introduction

I appreciate the opportunity to appear before you to discuss the current and future state of the airline industry and the role of the Department of Transportation (DOT) in the industry's ongoing restructuring. This hearing is in response to the proposed United/Continental merger, a potential combination that has understandably captured the interest of this Committee and the American people.

State of the Airline Industry

Let me begin with a brief overview of the state of the airline industry to provide an understanding of the economic environment in which this transaction has been proposed. In the more than 30 years since deregulation, market forces have shaped airline fares and services. During that time, the industry adjusted to a deregulated environment and changing market conditions, facing the expected—fluctuations in supply and demand—but also the unexpected—terrorist attacks, epidemics, and now, with volcanic ash, a natural disaster. Through the various business cycles, carriers have taken steps to cut costs, manage capacity, and cope with volatile fuel prices. Many have adapted well, but not all have succeeded, with an unfortunate number having to file for bankruptcy protection and several exiting the industry altogether.

Following several consecutive years of losses from 2001 to 2005, the industry returned to modest profitability in 2006 and 2007, only to confront rapidly increasing fuel costs and then a global recession. 2008 and 2009 were some of the most challenging years in the history of U.S. aviation, primarily because the global recession helped push operating revenues for the nine largest U.S. airlines down an unprecedented 17 percent year-over-year. While costs also increased significantly during the first quarter of 2010, airline revenues continue to rebound in large part on the basis of increased passenger volumes.

Each one of the nine largest U.S. carriers increased their revenue, year-over-year, despite the fact that all but one of them decreased or held capacity constant. For the first quarter, the nine largest airlines, whose revenue totaled nearly $27 billion, collectively earned a small operating profit of $17 million, excluding special items. While modest, that represented a substantial improvement from the total operating loss of over $1 billion during the first quarter of 2009.

For the second quarter of 2010, most analysts are predicting stronger results, as passenger and shipper demand that vanished during the height of the global recession is returning across all sectors for all carriers. The turn-around from this time last year is encouraging.

Consumers have reaped enormous benefits in the more than 30 years since airline deregulation. During this period, air transportation has been transformed from a luxury that few could afford, to a service that provides average families and small businesses of America with affordable access to destinations across the globe. Adjusted for inflation, air fares have continued to decline throughout the deregulated era, as new carriers, particularly low cost carriers, have entered the market and business models of new entrants and incumbent carriers alike have adapted to meet changing consumer needs and brought innovations and efficiencies to the marketplace. In expanding consumer and business access from local to global, air transportation has become an important driver of economic progress for the citizens and companies of this increasingly mobile Nation.

We foresee the industry continuing to evolve along several basic trends. First, carriers, while conscious of costs, are aggressively pursuing new sources of revenue. Second, over time, low-cost carriers have expanded significantly. Third, legacy carriers are continuing to seek ways to become more efficient producers, including through stronger alliance partnerships.

DOT's Authority to Review Merger Transactions

I am sure you understand that I cannot discuss the specifics of the proposed United/Continental merger, or any proposed transaction that is before us for review. However, I would like to shed some light on DOT's role in the review of an airline merger.

The Department of Justice (DOJ) has the lead role in reviewing proposed airline mergers, given its statutory authority to enforce the antitrust laws. Utilizing its special aviation expertise, DOT typically examines the proposed merger and shares its analysis and views with the Antitrust Division. This practice is consistent with Congress' determination that the deregulated airline industry should generally be subject to the same application of the antitrust laws as other unregulated industries. Each transaction we review is considered on a case-by-case basis consistent with anti-trust principles and practice.

The purpose of our antitrust laws is to ensure that consumers receive the benefits of competition, and this is the prism through which the Department analyzes airline mergers. I can therefore assure you that the Department is committed to fostering an environment that embraces competition and provides consumers with the price and service benefits that competition brings.

We also recognize that the airline industry is very dynamic. Cyclical economic conditions, the competitive environment, infrastructure access and capacity, and in-

dustry innovation all need to be taken into account to allow the industry to adapt to rapidly changing economic conditions.

Should DOJ decide not to challenge a particular transaction on antitrust grounds, DOT would then consider a wide range of follow-on issues that fall within its jurisdiction, including international route transfers, economic fitness, code-sharing, and possible unfair or deceptive practices.

As to international routes, the carriers would be expected to apply for DOT approval of a route transfer to consolidate the international routes they individually hold under one certificate as part of the merger process. By statute (49 U.S.C. 41105), DOT may approve a transfer of such routes only if we find that it is consistent with the public interest. As part of that analysis we must examine the transfer's impact on the viability of each airline party to the transaction, competition in the domestic airline industry, and the trade position of the United States in the international air transportation market.

We would only decide an international route transfer case after we had established a formal record and given all interested persons the opportunity to comment. If DOT determines that the transfer would be contrary to the public interest on competitive grounds or for another reason, DOT could disapprove the transfer in whole or in part. Alternatively, DOT may condition its approval on requirements that would protect the public interest.

Because a proposed merger of major carriers would involve a significant change in the structure of at least one of the existing carriers, DOT would institute a fitness review of airline management, financials and compliance disposition.

While the transfer application is pending, the merging carriers could request that DOT grant them an exemption from the provisions of 49 U.S.C. 41105 to allow them to consummate the merger at their own risk pending DOT's decision on their transfer application. DOT has sometimes approved such exemption requests in the past, conditioned upon the air carriers remaining separate and independently operated entities under common ownership until the transfer application case is decided.

DOT may also review any code-share arrangements concluded between the merging carriers. In DOT's experience, code-share arrangements would likely be necessary during the early phases of integration after the transaction is closed.

Finally, at DOT, we take our responsibility for consumer protection seriously. For example, if carriers in pursuing or implementing a merger were to engage in unfair or deceptive practices, we would not hesitate to act to protect affected consumers based on our 49 U.S.C. 41712 authority.

Conclusion

Airlines are the circulatory system of national and global communities—linking friends and family, suppliers and producers, retailers and manufacturers, facilitating business partnerships, and fostering educational and cultural exchanges of all types. Every American has both a personal and an economic interest in access to safe and affordable air travel. It is therefore easy to understand why so many people take an interest in airline mergers.

Our consideration of aviation economic policy focuses on what is best for a healthy and a competitive industry, for its workers, and for the communities and consumers that it serves. Our goal must be to strike what is often a very difficult balance in the face of a complex and dynamically changing industry. Importantly, in doing so we must also consider the longer term, collective impact on all stakeholders, most importantly America's traveling public.

Mr. Chairman, this concludes my testimony. I would be happy to answer any questions you may have.

The CHAIRMAN. Thank you very much, Susan Kurland.

Glenn Tilton is the Chairman, President, and Chief Executive Officer of United Airlines.

STATEMENT OF GLENN F. TILTON, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, UNITED AIRLINES

Mr. TILTON. Thank you, Mr. Chairman. I appreciate the opportunity to testify today as well.

As I listened to the Assistant Secretary's testimony, I am reminded that the status quo for our industry is clearly unacceptable. It's extraordinary and insightful that this industry has lost some $60 billion and 150,000 jobs in the United States in the last 10

years, delivering the worst financial performance of any major industry, in 186 bankruptcies over the last 30 years.

Both before and after deregulation, this industry has been systemically incapable of earning even a modest profit, let alone a reasonable return, on the large investment that we have made in aircraft, in facilities, and in technology.

It's ironic, then, that this industry, unable to cover its cost of capital, is expected to be, and indeed must be, the Nation's engine for economic recovery.

As leaders, you know the critical role aviation plays, nationally, in the communities that you represent, in driving commerce and tourism, creating jobs, and contributing to the economy. Regardless of our personal perspectives, we can likely all agree, serial bankruptcy and the asset distribution of failed companies is not an acceptable strategy for an industry. We must create economic sustainability through the business cycle. And, to that end, our objective at United Airlines has been consistent: to put our company on a path to sustained profitability.

Without profitability, we cannot provide a stable environment for employees. Without profitability, we cannot maintain service to communities, large and small, or invest in customer service, nor can we create value for shareholders.

To be profitable, we must successfully compete in the global market, as it is today, not as it was 10 years ago, or indeed as it was 30 years ago.

Today, low-cost carriers are very well established, and Southwest Airlines will continue to be the country's largest domestic airline, in terms of number of passengers, after our merger. Today, international competitors have merged, and powerful new entrants continue to gain ground. Today, the world's largest airlines, measured by revenue, are not American or United or Continental, they are Lufthansa and Air France-KLM, with more than half of all transatlantic capacity and more than two-thirds of all transpacific capacity provided by foreign carriers.

United and Continental have taken significant actions to improve our performance, competing across both international and domestic markets and at the same time finding a way to connect small U.S. communities into our respective route networks. In this dynamic, highly competitive environment, these actions have not been enough. Our proposed merger is a logical and essential next step.

Let me be clear. Without this merger, we would not have the 1 to 1.2 billion dollars in synergies to improve product, to improve service for customers, and the financial means to create better career opportunities for our employees. We will not be as successful a competitor as we need to be and to enable continued economic development. Our merger enhances and strengthens service for those who rely on our respective networks in nearly 148 small communities and metropolitan areas, providing business lifelines and collateral economic benefit to those communities that are not traditionally served by low-cost carriers.

Carriers compete vigorously on both price and on service, and our merger won't change that reality. There is significant low-cost carrier competition at every single one of our hubs, including the 15 nonstop routes on which we overlap.

Over the last decade, ticket prices have declined by some 30 percent, when adjusted for inflation, including fares to small communities. Our expected revenue synergies are derived from better service and the expanded network; they're not based on fare increases.

This merger represents excellent value and more destinations for consumers. Consumers will continue to benefit from intense price competition across the industry, due to the prevalence of low-cost carriers, other network carriers, and fare transparency enabled by, today, the Internet.

The competitive landscape has changed. And to be a company that attracts and provides value for customers, shareholders, and employees, United and Continental have to change, as well.

Thank you very much, Mr. Chairman.

[The prepared joint statement of Mr. Tilton and Mr. Smisek follows:]

PREPARED JOINT STATEMENT OF GLENN F. TILTON, CHAIRMAN, PRESIDENT AND CEO, UAL CORP.; AND JEFFERY SMISEK, CHAIRMAN, PRESIDENT AND CEO, CONTINENTAL AIRLINES, INC.

Good morning, Chairman Rockefeller, Ranking Member Hutchison, and members of the Committee.

Thank you for the opportunity to discuss the benefits and answer any questions related to the planned merger of equals between Continental Airlines and United Airlines that we announced on May 3. As we said at the time, this transaction will enable us to provide enhanced long-term career prospects for our more than 87,000 employees and superior service to our customers, especially those in small communities throughout the United States. Our combined company will be well-positioned to succeed in an increasingly competitive global and domestic aviation industry—better positioned than either airline would be standing alone or as alliance partners.

This merger will provide consumers access to 350 destinations in 59 countries around the world. We will offer a comprehensive network in the United States, and we will have strategically located international gateways to Asia, Europe, Latin America, the Middle East and Canada from well-placed domestic hubs throughout the country. We will have 10 hubs, eight in the continental U.S. (Chicago, Cleveland, Denver, Houston, Los Angeles, New York/Newark, San Francisco and Washington Dulles) and two others in Guam and in Tokyo. We will continue to provide service to all of the communities that our companies serve today.

This merger comes at a critical juncture for the U.S. aviation industry, which has confronted extremely difficult business challenges for the last decade. During this time, our industry has lost over 150,000 jobs, and there have been nearly 40 bankruptcies since 2001. U.S. airlines have lost a total of $60 billion since 2001.

While the economy and our industry are beginning to slowly recover from the worldwide recession, we continue to be subject to the volatility of fuel prices and an intensely competitive environment in all of our markets.

As individual companies, we have taken significant steps to respond to these challenges. United went through a bankruptcy restructuring and both airlines have become more efficient and reduced our cost structures. But to survive, we have also been forced to reduce the number of aircraft we fly, the number of destinations we serve and the number of people we employ.

At the same time, we have made significant operational improvements. United now ranks as the leading U.S. global airline in on-time performance as measured by the Department of Transportation, and Continental is regularly recognized in independent surveys for the high quality of its customer service. Through our joint venture and alliance relationships, we have provided enhanced benefits to our customers and achieved substantial synergies.

While we are proud of these recent improvements at our companies, we believe it is clearly in the best interests of our customers, employees, shareholders and the communities we serve to bring our two airlines together in a merger. This merger will provide a platform to build a more financially stable airline that can invest in our product and our people to succeed in a highly competitive environment and be better able to withstand future economic downturns and challenges. The fact is that

sustained profitability is the only way to improve service and reward employees over the long term.

The Merger Will Benefit Customers

By bringing together two of the most complementary route networks of any U.S. carriers, the merger of Continental and United will give travelers expanded access to an unparalleled global network. It combines United's Midwest, West Coast and Pacific routes with Continental's service in New York/New Jersey, the East Coast, the South, Latin America and across the Atlantic.

Customers will have access to 116 new domestic destinations; 40 will be new to United customers, and 76 will be new to Continental customers. The merger will create more than 1,000 new domestic connecting city pairs served by the combined carrier, providing additional convenience to customers.

Our fully-optimized fleets and routes will provide greater flexibility, options, connectivity and convenience for customers. This improved connectivity and direct service options, as well as improved service, are expected to enable the combined airline to generate $800–$900 million in annual revenue synergies—and these synergies are not dependent on fare increases.

Importantly, the combined airline will be better able to enhance the travel experience for our customers through investments in technology, the acquisition of new planes and the implementation of the best practices of both airlines. The new airline will be more cost effective; we expect to realize cost-savings synergies of $200–$300 million per year, mostly through reductions in overhead such as rationalizing our two information technology platforms, combining facilities and corporate functions such as finance, marketing, sales and advertising.

We will have one of the youngest and most fuel-efficient fleets among the major U.S. network carriers, as well as the flexibility to manage our fleet more effectively. With one of the best new aircraft order books in the industry, we will also be able to retire older, less efficient aircraft. This will result not only in greater efficiency but less environmental impact from our fleet.

Once the merger is complete, customers will also participate in the industry's leading frequent flyer program, which will give millions of members more opportunities to earn and redeem miles than ever before. Through Star Alliance, the leading global alliance network, our customers will also continue to benefit from service to more than 1,000 destinations worldwide.

The Merger Provides Job Stability for Employees

The past decade has been a tumultuous time for our employees. They have faced ongoing uncertainty as the industry has been forced to shed tens of thousands of jobs. In fact, in January 2009, the full-time equivalent employees for the U.S. airline industry numbered 390,700—that figure is 151,000—or more than 25 percent—less than the all-time-high airline employment figure of 542,300. Employees have been forced to weather the volatility of oil prices and the challenges of terrorist attacks, increased security, a massive recession and unforeseen events such as SARS, H1N1 and volcanic ash. Through all of this, they have continued to perform at their best, providing our customers with clean, safe and reliable air travel.

We're proud of the work that our employees do every day. The merger will offer our employees improved long-term career opportunities and enhanced job stability by being part of a larger, financially stronger and more geographically diverse carrier that is better able to compete successfully in the global marketplace and withstand the volatility of our industry.

We will continue to serve all of the communities that we serve today and we expect that any necessary reductions in front line employees will come from retirements, normal attrition and voluntary programs. Our plan is to integrate our workforces in a fair and equitable way. Our focus will be on creating cooperative labor relations, including negotiating contracts with our collective bargaining units that are fair to the company and fair to our employees. United has two members of its collective bargaining units on its Board of Directors, and the seats allocated to the collective bargaining units will continue to be part of the Board of the combined company.

The merged company's headquarters will be in Chicago. In Houston, we will continue to have a significant presence and will remain one of Houston's largest private employers. Houston will be our largest hub and will continue to be a premier gateway to Latin America for more travelers than ever before. Some corporate positions will remain in Houston and our CEO will have an office there as well as in Chicago. Over time, as our business grows as a result of the merger, we expect to see a net gain in jobs in Houston.

We expect to adopt the best aspects of each company's culture and practices. People at both companies have come to know, admire and learn from their counterparts in many functions due to our joint venture and Star Alliance relationships, and we are confident that we can integrate our organizations fairly, effectively, and efficiently.

Service to Small Communities Will Be Enhanced

As network carriers, we have a long history of serving small- and medium-sized communities. United is proud to fly passengers from places like Portland, Maine to Honolulu or Charleston, South Carolina to Chicago, while Continental's service to and from Houston has been instrumental to the growth of the 20 Texas communities served.

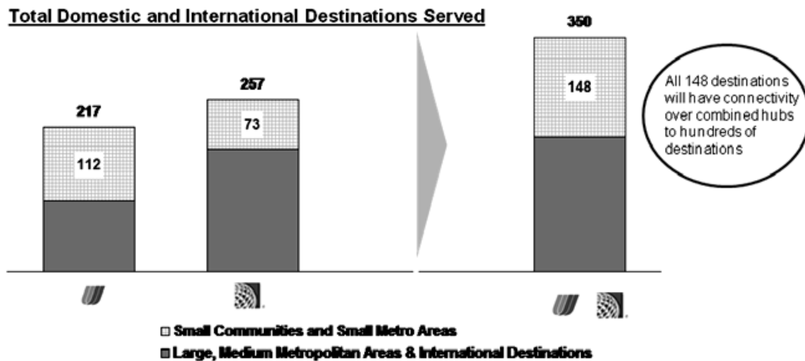
Air travel opens up the world and provides business and leisure opportunities to all Americans, no matter where they live. Airlines are often the lifeblood of small communities, not only because of the economic benefits they provide, but due to their civic and charitable contributions and the volunteer activities of their employees. Both of our companies are committed community partners with robust corporate contributions and responsibility programs and we strongly support our employees' volunteer activities.

The turmoil in our industry has been devastating to many small- and medium-sized communities. Since 2000, more than 100 small communities have lost all network carrier service. Approximately 50 more have seen their service levels cut, losing at least half of their seats.

Low-cost carriers have not filled this void because service to these communities is typically inconsistent with their business model. They are more-often dependent on point-to-point, high-density routes and often have one-size aircraft, which makes it difficult for them to serve these small communities. As a result, approximately 200 of these small communities and metropolitan areas, many of which have fewer than 500 passengers traveling to or from their airports daily, are served only by network carriers.

When we announced our merger, we committed to continuing to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas (*Chart One*). This service enables residents of small communities to connect through our 8 mainland domestic hubs and travel on to hundreds of destinations on thousands of routes worldwide. The combined airline will offer these travelers access to 350 destinations in 59 countries.

CHART ONE
THE MERGER MAKES A MORE EFFICIENT CARRIER, BETTER ABLE TO SERVE SMALL COMMUNITIES



Source: OAG FY 2010.
Notes: Consolidated operations. Domestic destinations with at least one route served 20 times by either United or Continental during at least one month in 2010. International destinations with at least one route served 12 times by either United or Continental during at least one month in 2010. Bristol, UK is excluded for Continental as it will be cancelled in November. Moses Lake, WA and Oxnard, CA are excluded for United as they will be cancelled in June. Airports in the following major metropolitan areas are grouped: New York (JFK, LGA, EWR), Washington (DCA, IAD, BWI), San Francisco (SFO, OAK), Chicago (ORD, MDW), Houston (IAH, HOU), Dallas (DFW, DAL), Los Angeles (LAX, BUR, LGB) Cleveland (CLE, CAK), Tampa (TPA, PIE), Cincinnati (CVG, DAY), and Miami (MIA, FLL). In addition, the following small community airports are also not counted as separate destinations because they are adjacent to a larger airport - Bedford, MA: Carlsbad, CA: Houston/Ellington Field, TX: Mesa, AZ: Seattle/Boeing Field, WA: Wilmington, DE. Airports in major international cities are grouped.

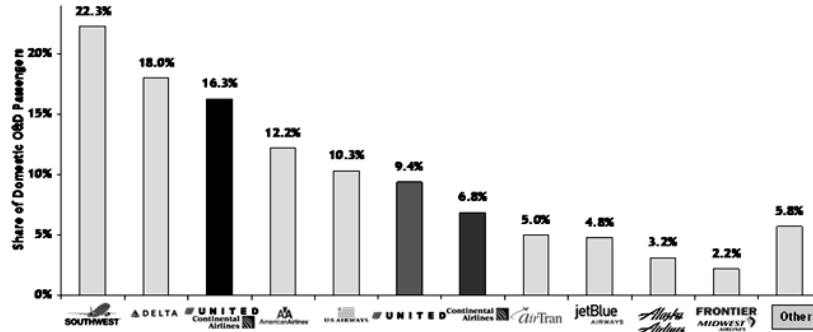
Following the merger, 93 of the 116 destinations that would be new to either Continental or United passengers would be small communities. As a result, a businessperson will be able to fly from Tyler, Texas to Sydney, Australia on a single airline.

The Merger Will Enhance Competition

The potential impact of this merger must be viewed in light of the fundamental changes that have occurred in our industry since 2000. The increased competition from low cost carriers (LCCs) has been dramatic as they have experienced tremendous growth over the past decade. They operate profitably at lower unit revenues than traditional network airlines, generally due to significant cost advantages related to their less costly point-to-point business model. Consequently, their presence limits the ability of their competitors to increase fares.

Industry-wide, LCCs now compete for 80 percent of all domestic travelers. In fact, Southwest has grown to become the largest domestic airline in the U.S., in terms of passengers and will continue in that position after our merger (*Chart Two*). Over 85 percent of passengers traveling nonstop on either Continental or United have an LCC alternative. LCCs compete on domestic city-pairs accounting for 77 percent of United and Continental's combined passengers, and 46 of each of Continental and United's top 50 routes, have LCC competition.

CHART TWO
U.S. DOMESTIC PASSENGER SHARE: MERGED AIRLINE WILL BE ONLY THIRD LARGEST WITH 16%



Source: U.S. DOT O&D Survey YE 2009 Q3.
Note: Frontier includes Midwest. Share of domestic O&D passengers. Largest Other carriers include Hawaiian (1.6%), Allegiant (1.2%), Spirit (1.1%), Virgin America (0.9%), and Sun Country (0.3%).

There once was an assumption that LCCs would have difficulty competing at the hubs of network carriers. This assumption has long since been disproven. LCCs directly compete at all of our hub airports and have very large presences at airports adjacent to our hubs, such as Hobby in Houston, Akron near Cleveland, BWI near Washington and Midway in Chicago. LCCs have market shares in our hub cities ranging from 28 percent in Cleveland to 50 percent in Denver and San Francisco.

LCCs are increasingly being used by business travelers and are targeting those travelers by providing amenities such as preferred seating and boarding access. They are also providing service from the United States to international destinations, including Mexico, the Caribbean, Latin America and Canada.

In addition to the growth of LCCs, competition from international carriers has increased. Mergers between Air France and KLM; Lufthansa, SWISS, bmi, Brussels Airlines and Austrian; British Airways and Iberia; and Cathay Pacific and Hong Kong Dragon Airlines have given these preeminent global carriers international networks and global reach that overshadow those of U.S. network carriers. In 2000, the top two airlines in terms of worldwide revenue, American Airlines and United, were both U.S.-based. Today, the top two are Lufthansa and Air France-KLM (*Chart Three*). In fact, more than half of all transatlantic capacity and more than two-thirds of all transpacific capacity is provided by foreign carriers. The merged carrier

will be able to compete far more effectively with foreign carriers and to maintain competitive domestic service to cities large and small in the U.S.

CHART THREE
U.S. NETWORK CARRIERS HAVE LOST THEIR #1 AND #2 WORLDWIDE REVENUE RANKINGS

Top 10 Carriers Ranked by Revenue

CY2000			CY2009		
Rank	Airline	Operating Revenue ($B)	Rank	Airline	Operating Revenue ($B)
1	American	$19.7	1	Lufthansa	$31.0
2	United	$19.4	2	Air France-KLM	$29.2
3	Delta	$16.7	3	Delta/NW	$28.1
4	JAL	$15.4	4	American	$19.9
5	Lufthansa	$14.0	5	JAL	$16.4
6	British Airways	$13.7	6	United	$16.3
7	ANA	$11.5	7	ANA	$12.9
8	Northwest	$11.4	8	British Airways	$12.6
9	Air France	$11.1	9	Continental	$12.6
10	Continental	$9.9	10	Emirates*	$11.2

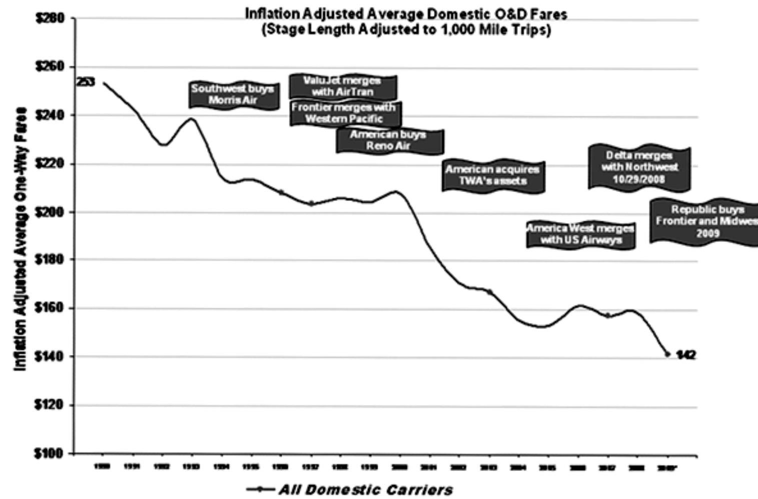
* Emirates 2009 is full year ending June 2009.
Source: For 2000 – Airline Business September 2001. For 2009: Domestic Carriers Company 10-Ks, Foreign Carriers Press releases and Annual Reports.
Notes: 2009 foreign carriers' operating revenues are calculated using the following exchange rates for 2009: 1USD=0.719055EUR; 1USD=0.641035GBP; 1USD=93.59617JPY; 1USD=3.67291AED.

Additionally, well-funded newcomers (such as Emirates and Jet Airways) are making inroads into U.S. international routes from emerging economies in the Middle East and South Asia. This trend will continue, and is a credit to the success of the Open Skies policy as these agreements expose U.S. carriers to more competition than ever before.

Price competition in our industry has also increased due to the ready availability and transparency of fare information to consumers through online sites such as Expedia and Orbitz. Consumers have become more savvy and sophisticated as they search for the fare that meets their needs. "[R]aising airfares isn't like raising the price of milk . . . the Internet can hunt the cheapest fare worldwide in seconds. If one carrier has some empty seats to fill, it will have to cut the price because getting something for that seat is better than flying it empty" (Scott McCartney, "As Airlines Cut Back, Who Gets Grounded," *Wall Street Journal,* 6/5/08). Online sites have expanded their business models and now offer targeted services to corporations and business travelers.

In short, the changing dynamics of the airline industry have resulted in robust competition that maintains significant downward pressure on fares. As a result, airfare prices have declined by more than 30 percent over the last decade on an inflation adjusted basis (*Chart Four*).

CHART FOUR
DESPITE NUMEROUS MERGERS, AVERAGE PRICE* CONTINUES TO DECLINE



Sources: US DOT O&D Survey. CPI from U.S. Bureau of Labor Statistics.
Notes: 2009 Dollars. 2009 FYE Q3.
*Average price per passenger based on average price per mile then adjusted to 1,000 mile trips.

Especially given this landscape and the relative ease with which LCCs can enter into competition with network carriers and other LCCs, this merger will not result in a reduction in competition. There are only 15 overlapping nonstop domestic routes among the hundreds that we fly (and no overlapping international routes). The combined carrier's ability to raise prices on any individual overlapping route is constrained because each has current nonstop competitors. Moreover, extensive competitive connecting service further constrains pricing.

On each of these 15 nonstop overlapping routes, after the merger, travelers would be served by at least one other carrier, but more often two, three, four or five. All but two of the overlapping routes are served by an LCC and six are served by two LCCs (*Chart Five*).

CHART FIVE
NON-STOP OVERLAPS

	City-Pair	Non-Stop Competitors	Current LCC Non-Stop Competitors	UA/CO O&D Passenger Share (%)	LCC O&D Passenger Share (%)
Hubs					
1	**Washington - Houston**	3	Southwest	62.6%	27.0%
2	**Los Angeles - Houston***	3	Southwest	54.6%	35.8%
3	**Houston - San Francisco**	3	Southwest	57.5%	35.4%
4	**Denver - Cleveland**	3	Frontier	46.0%	48.7%
5	**Chicago - Houston**	4	Southwest	53.4%	33.3%
6	**Denver - Houston**	4	Southwest and Frontier	60.4%	38.3%
7	**Chicago - Cleveland**	4	Southwest	40.8%	47.6%
8	**Washington - Cleveland**	4	Southwest	40.4%	53.0%
9	**Denver - New York**	5	Frontier and jetBlue	62.7%	26.1%
10	**Los Angeles - New York**	6	jetBlue and Virgin America	24.3%	36.0%
11	**Chicago - New York**	6	Southwest and jetBlue	42.0%	9.1%**
12	**New York - San Francisco**	6	jetBlue and Virgin America	37.2%	32.5%
13	**Washington - New York**	7	Southwest and jetBlue	18.6%	10.2%
Non-Hub-to-Hub					
14	**Los Angeles - Kahului**	4	—	52.0%	—
15	**Los Angeles - Honolulu**	5	—	29.6%	—

*Reflects recently announced new service by United from LAX–IAH starting Aug 24.
** Does not fully reflect Southwest LGA–MDW service that began June 29, 2009. LCC share for Q3–Q4 2009 is 13.3%.
Source: OAG May 2010: U.S. DOT O&D Survey YE 2009 Q3.
Notes: Consolidated operations. Competitors with at least 5 roundtrips per week. Delta includes Northwest. Frontier includes Midwest. Airports in the following metropolitan areas are grouped: Chicago (ORD, MDW), Cincinnati (CVG, DAY), Cleveland (CLE, CAK), Dallas (DFW, DAL), Houston (HOU, IAH), Los Angeles (LAX, BUR, LGB), Miami (MIA, FLL), New York (LGA, JFK, EWR), San Francisco (SFO, OAK), Washington DC (DCA, IAD, BWI), and Tampa (TPA, PIE).

The Merger Is A Natural Extension of Our Current Relationship

About 2 years ago, our companies began an extensive alliance relationship. We are both members of Star Alliance, the leading global alliance network. Domestically, we have a code-share arrangement, frequent flyer reciprocity and shared lounge access.

We have antitrust immunity for international coordination including our A++ transatlantic joint venture that also includes Air Canada and Lufthansa. We have an immunity application pending with ANA that includes a transpacific joint venture, in connection with the Open Skies agreement initialed and soon to be implemented with Japan.

While these agreements have generated significant synergies and customer benefits, they do not provide the cost savings and employee and customer benefits of a merger. For example, following a merger, we can fully optimize our schedules and integrate our fleets. Our combined mainline fleet of more than 700 aircraft of a broad range of sizes and mission capabilities will enable the most efficient utilization of seat capacity. We will be able to reassign aircraft across the network to better meet demand on different routes, yielding a net increase in annual passengers and improving the business mix of those passengers through the appeal of our broad combined network.

The merger will also enhance our frequent flyer programs. Currently, it is sometimes difficult to obtain reciprocal benefits, elite recognition and awards. A combined program would offer more benefit to customers as they accrue and redeem awards across our combined network on a seamless frequent flyer program.

Our alliance relationship has given each airline the opportunity to know and partially integrate the systems, practices and procedures of the other. As a result, it gives us great confidence that we can successfully integrate our two companies once the merger closes.

Conclusion

Each of our companies has a long and proud history of independence. Continental and United are among the pioneers in the aviation industry and, in fact, have the same founder, Walter T. Varney.

Although our companies have been performing better since the economic recovery began, we analyzed the competitive environment and reflected on the volatility that has plagued our industry. As we looked ahead, we each strongly believed that our combined future was brighter than our standalone future, that this is the right time for a merger, and that we have found the right merger partner.

As we have talked to our customers, our employees and our shareholders, we have felt a great sense of excitement about this merger. By bringing the best of both organizations together, we believe we can not only create a world-class airline with enduring strengths, but also serve our customers and communities better than ever, provide security and stability for our employees and benefit shareholders with a strong financial foundation.

We look forward to continuing to outline the benefits of this merger in Washington, D.C., and throughout the country and the rest of the world. But more importantly, we look forward to our people working together to create the world's leading airline.

The CHAIRMAN. Thank you, Glenn Tilton. That was not exactly an outpouring of optimism. But, when you said you needed to make it perfectly clear, you surely did that.

Mr. TILTON. Thank you very much, Mr. Chairman.

The CHAIRMAN. Yes, sir.

Now Mr. Jeffery Smisek, who is Chairman, President, et cetera, et cetera, of Continental Airlines.

STATEMENT OF JEFFERY A. SMISEK, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, CONTINENTAL AIRLINES, INC.

Mr. SMISEK. Thank you. I'd like to thank the Chairman the Ranking Member, and the members of this Committee for the opportunity to be here today.

I want to make four main points: this merger is good for employees, it's good for communities, it's good for consumers, and it's good for competition.

Let me start with employees. The volatility and the instability of the airline industry have had harsh effects on employment in the airline business. Before 9/11, Continental had over 54,000 employees. Despite being the only network carrier to have grown since 9/11, today, we have less than 41,000 employees, and we've lost over a billion dollars. Before 9/11, United had over 100,000 employees, today they have about 46,000.

After we merge, our employees will be part of a larger, financially stronger, and more geographically diverse carrier. This carrier will be better able to compete in the global marketplace, and better able to withstand the external shocks that hit our industry with disappointing regularity.

Because of how little we overlap, the merger will have minimal effect on the jobs of our front-line employees. We are committed to continuing our cooperative labor relations and integrating our work forces in a fair and equitable manner, negotiating contracts with our unions that are fair to the employees and fair to the company. United has two union members on its board of directors, and those union board seats will continue after this merger.

The merger will enable us to continue to provide service to small communities, communities that many of you represent. But, turmoil in our industry has been devastating to many small and medium-sized communities. As you know, low-cost carriers have not, and will not, serve small communities, as such service is inconsistent with their point-to-point business model that relies largely on local traffic.

As a result, over 200 small communities are served only by network carriers. As a merged carrier, we plan to continue service to

all of the communities we currently serve, including 148 small communities.

The merger will be good for consumers, as well. The combined airline will offer consumers an unparalleled integrated global network and the industry's leading frequent flyer program. It will have the financial wherewithal to invest in technology, acquire new aircraft, invest in its people, and invest in its product. We will have a young and fuel-efficient fleet. And our new aircraft orders will permit us to retire our older, less fuel-efficient aircraft.

Continental brings to the merger its working-together culture of dignity and respect, and direct, open, and honest communication. This working-together culture means people enjoy coming to work every day, and they give great service. United brings to the merger talented employees who are delivering industry-leading, on-time performance.

The merger will also enhance competition. Continental and United have highly complementary route networks. Our networks are so complementary that we have only minimal nonstop overlaps, each of which faces significant competition after this merger. Over 85 percent of our nonstop U.S. passengers have a direct low-cost-carrier alternative. Moreover, low-cost carriers compete at all of our hubs and at airports adjacent to our hubs. As a result of the robust competition in the U.S., airfares have declined by over 30 percent over the past decade, on an inflation-adjusted basis.

We also face significant competition from foreign carriers, which themselves have merged to create attractive global networks, such as Air France-KLM, the Lufthansa group of companies, and British Airways-Iberia. The merged Continental-United will enable us, as a U.S. carrier, to compete effectively against these large foreign airlines.

In sum, the merger will create a strong, financially viable airline that can offer good-paying careers and secure retirements to our coworkers, great customer service, and an unparalleled network to consumers, and reliable service to communities. The merger will provide us with a platform for sustainable profitability, and position us to succeed in the highly competitive domestic and global aviation industry, better positioned than either airline could be, alone, or together in an alliance.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Smisek.

And now, Mr. Robert Roach, who's General Vice President—Transportation, International Association of Machinists and Aerospace Workers.

Please.

STATEMENT OF ROBERT ROACH, JR., GENERAL VICE PRESIDENT, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS

Mr. ROACH. Thank you, Chairman Rockefeller and Ranking Member Hutchison, members of the Committee, for the opportunity to speak to you today.

I am General Vice President Robert Roach, for the International Association of Machinists and Aerospace Workers, the largest airline union in North America. The Machinists Union represents

more than 100,000 airline industry workers and 27,000 that could be impacted by this merger at United, Continental, Air Micronesia, and regional partner ExpressJet. We also are in an alliance with the Japanese Federation of Workers Union. And I speak on behalf, not only of the Machinists Union, but the International Transport Workers Federation, who represents 4.6 million members worldwide.

We believe that we cannot look at the United-Continental transaction in isolation, as the US Airways President has already made known his intention to merge with one of the big three. The airline industry has been in turmoil since the passage of airline deregulation in 1978. Since the airline deregulation, pension terminations have cost taxpayers $10 billion, and participants $5 billion. There have been 162 airline bankruptcies since 1968, and 150 low-cost carriers began operation, but less than a dozen are still providing service today. More than 100 communities have lost all commercial service in the last 10 years. The industry is crying out for some limited, sane reregulation. Maybe we should take a step back and not rush to judgment or consolidation.

Our concern is that we are creating airlines that are too big to succeed. Their failure would mean that one of the big three would have to be bailed out by the taxpayers. If we—it is time we seek a new vision for the future of air transportation. Staying the course will only continue the industry's downward spiral.

Albert Einstein said, "Insanity is doing the same thing over and over again, expecting a different result." We can now close our eyes and believe that repeating the same mistake for 30 years will eventually bring different results, or we can effect real change and have a—an efficient, competitive air transportation industry.

Critics of regulation need only look, in 2007, at the hundreds of billions of dollars that the taxpayer paid to now regulate the financial community, or the 60,000 barrels of oil that is gushing in the Gulf of Mexico, and now we're saying, "Let's regulate. We'll have better oversight."

The airline business plans—the airline business plans today focus on cutting tickets to the bone or putting competitors out of business, making a profitable industry impossible. The long-term costs of underpricing of tickets is too extreme. Pan American, TWA, Eastern, Braniff, Northwest, and Aloha Airlines all survived for more than half a century, but could not endure the insanity of cutting prices to eliminating competition and simultaneously losing billions of dollars.

We have met with both airlines, jointly and separately, since the merger was announced. IAM members still have many questions unanswered and concerned that need to be addressed.

To the carriers' credit, they have set up a line of communication with the Machinists Union, but we still have not received the information that we need to make an informed decision concerning this particular merger.

The merged United-Continental carrier would start out with $13.8 billion in debt. What is the business plan to deal with that debt structure? Will the merged carrier have any choice but to eliminate hubs in order to avoid competing with itself? What happens in Cleveland or Washington-Dulles?

Continental and United represent the latest consolidation of airlines in the same alliance. Continental membership in the Star Alliance essentially started as a merger on an installment plan. Given the prevalence of alliances here at home, what will alliances ultimately mean to the traveling public, particularly if they lead to further consolidation and route frequencies are cut, if not altogether?

Closing of hub initiates a cascade of job loss that begins with airline employees and continues throughout the community. Will the merging carriers and the wholesale reshaping of the industry harm consumers or routes throughout the United States?

We have heard the good intentions of the CEOs. And we certainly believe that they are good intentions. But, I have been through a series of these hearings. I've heard CEOs from America West and US Airways, from Northwest to Delta, make the same claims, only to find tens of thousands of people lose their jobs. I, myself, worked for TWA. And when the alliance—and when the merger went, on a 363 transaction came, I, among tens of thousands of other employees, have lost their jobs, like Janet Calabrese, who was a flight attendant and has no place to go and no health insurance and no pension.

So, I ask that this body look at this merger and give it close scrutiny. And this merger cannot be at the cost of the employees, the flying public, or the Nation that we so all love, and the cities and States that these carriers serve.

Thank you, Mr. Chairman, and we look forward to answering any questions you may have.

[The prepared statement of Mr. Roach follows:]

PREPARED STATEMENT OF ROBERT ROACH, JR., GENERAL VICE PRESIDENT, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS

Thank you, Chairman Rockefeller, Ranking Member Hutchison and members of this Committee for the opportunity to speak to you today. My name is Robert Roach, Jr., General Vice President of the International Association of Machinists and Aerospace Workers (IAM), the largest airline union in North America, which recently entered into an alliance with the Japan Federation of Aviation Workers' Unions (KOHKUREN). In my capacity as a member of the Executive Board and Management Committee of the International Transport Workers' Federation (ITF), I had the ITF review my prepared testimony and they have given their authorization for me to speak on their behalf. My comments today are not only on behalf of the 720,000 members of the Machinists Union, but also reflect the position of 4.6 million ITF members.

The Machinists Union represents United Airlines and/or Continental Airlines workers in the flight attendant; ramp; customer service; reservation agent; fleet technical instructor; maintenance instructor; security guard; and food service employee classifications, plus customer service agents at United's frequent-flier subsidiary, Mileage Plus, Inc. The IAM also represents flight attendants at Continental's wholly-owned subsidiary Continental Micronesia and flight attendants at Continental and United regional partner ExpressJet Airlines. In total, the IAM represents more than 26,000 workers who will be affected by this proposed merger. Our bargaining relationship with each airline spans many decades.

Perpetual Crisis

The airline industry has been in continuous turmoil since the passage of deregulation in 1978. Merger proponents complain about overcapacity as a major reason for industry consolidation, but mergers will not address overcapacity. Braniff, Eastern, PanAm, TWA, Northwest Airlines, People Express, Aloha Airlines and others have all disappeared from the industry landscape, but the problem of overcapacity remains.

We cannot look at the United-Continental transaction in isolation. As the Delta-Northwest merger moves toward its completion, the United-Continental merger takes center stage. Waiting in the wings is a possible third merger, perhaps between US Airways and American Airlines, each a product of recent consolidation with America West and TWA, respectively. We agree with House Transportation and Infrastructure Committee Chairman James Oberstar when he wrote the Department of Justice stating, "This merger will move the country far down the path of an airline system dominated by three mega-carriers . . . If United and Continental merge, another domino in a chain of mergers will fall, and there will be strong pressure for further consolidation."[1]

Does anyone really believe that having only a few major airlines in operation, each with immense market control and offering consumers fewer choices, will benefit the country? If one of these mega-carriers should fail, how would that impact the country?

The Machinists Union has serious concerns not only about the viability of a combined United/Continental carrier, but also for the long-term sustainability of each carrier independently. In fact, our concern is for the entire industry, and we do not believe mergers alone provide the answers. Congress has spent a considerable amount of time debating the issue of entities that are too big to be allowed to fail. Our concern is we are creating airlines that are too big to succeed.

I am not advocating that we maintain the status quo in the airline industry. When there are problems, we must seek solutions. But perhaps we should take a step back and not rush to judgment or consolidation. It is time we seek a new vision for the future of air transportation in the United States.

It was clear to the Machinists Union in 1993 that deregulation had failed. The Clinton Administration recognized the problems facing the air transportation industry and empanelled the National Commission to Ensure a Strong Competitive Airline Industry. One of my predecessors, IAM General Vice President John Peterpaul, served on the Commission. The Commissioners were charged with investigating and devising recommendations that would resolve the crisis in the industry and return it to financial health and stability.

The Committee essentially recommended no substantial regulatory changes and believed that market forces would stabilize the industry. The IAM's representative on the Commission was the only dissenter, arguing that deregulation destabilized the industry and government intervention was necessary.

This country needs the major airlines, or so-called legacy carriers. While low-cost carriers fill an important niche, the air transportation system would collapse without traditional hub-and-spoke carriers. If you want to fly to Europe, Asia, South America or the Middle East you will be flying one of the legacy carriers, or another nation's airline. As John Peterpaul said, "Hubs serve as collection and distribution centers for air traffic, making it possible to serve many more communities than would be feasible with simple linear, point-to point service."[2] It is a mistake to think that as legacy airlines merge and hubs are eliminated that start-ups or low-cost carriers are capable of filling the void.

The Machinists Union's assertion that deregulation had failed to deliver on its promises was ignored in 1993 in favor of supporting airline industry executives who advocated staying the course. Congress now has another chance to make effective changes to this industry.

United and US Airways' pension terminations alone have cost the Pension Benefit Guaranty Board (PBGC) $10 billion and beneficiaries $5 billion.[3] Inflation-adjusted salaries for airline employees have grown less than 5 percent since 1979.[3] There have been 162 airline bankruptcy filings since 1978,[4] with bankruptcies accelerating in the last decade, including the liquidations of Aloha Airlines, ATA and Midway Airlines. Since 1978, 150 low-cost carriers began operations, with less than a dozen still providing service today.[4] More than 100 communities have lost all commercial air service in the last 10 years.[4] The industry has lost more than $60 billion in the last decade, and 163,000 industry jobs have disappeared since 2001.[5]

The so-called low-cost airlines are not immune to the industry's problems and are also looking for additional consolidation to help them survive. For example, US Air-

[1] Chairman James Oberstar's letter to the Department of Justice, May 5, 2010.

[2] *Dissenting Opinion*, by Commissioner John Peterpaul to the Report of the National Commission to Ensure a Strong Competitive Airline Industry, August 19, 1993.

[3] *Airline Deregulation*, U.S. Government Accountability Office Report GAO–06–630, June 2006.

[4] *Flying Blind*, Demos, 2009.

[5] Testimony by ATA President and CEO Jim May Before House Appropriations Subcommittee on Transportation, Housing, Urban Development and Related Agencies on Aviation Stakeholder Priorities for Maintaining a Safe and Viable Aviation System, March 18, 2010.

ways, which became a low-cost carrier after two bankruptcies and a merger with America West Airlines, is now aggressively seeking a merger partner. "Further down the road there's a high probability that US Airways will wind up merging with either United, Delta or American," said US Airways President Scott Kirby.[6]

Even Alfred Kahn, the major architect of deregulation, has said, "I must concede that the industry has demonstrated a more severe and chronic susceptibility to destructive competition than I, along with the other enthusiastic proponents of deregulation, was prepared to concede or predict."[7]

This industry is crying out for limited re-regulation.

Deregulation in this industry—and others—has had disastrous effects. Left completely to their own devices, corporations put their profits first without regard to the impact it has on the Nation.

The 2007 financial and housing meltdown was a result of unregulated corporate greed in the banking and mortgage industries. Instead of only traditional banks offering mortgages, nonbanks were allowed to enter the mortgage market. Predatory lenders aggressively targeted unqualified borrowers. Investment banks sold mortgage packages to Wall Street—all largely unregulated. When the mortgages defaulted—because many should never have been made in the first place—Wall Street collapsed, and took the rest of the economy with it.

One only has to look at the news this evening to see the toxic results of energy industry deregulation suffocating our Gulf shores. Local fishing and tourism industries are being destroyed, not to mention the cataclysmic environmental impact. Oversight and enforcement of BP's operations were woefully inadequate, in spite of a decade of documented safety violations at BP locations across the United States.[8]

Some industries are too critical to the United States to be allowed to regulate themselves. The airline industry needs to be stabilized because it drives $1.4 trillion in economic activity and contributes $692 billion per year to the Gross Domestic Product (GDP).[9] It is too vital to the Nation's commerce to be ignored, taken for granted or left to its own destructive ways.

Today, Congress is considering increased oversight of both the financial and oil industries to provide more regulation. Such action is necessary and long overdue, but it took catastrophes to prompt action. There have been three decades worth of evidence that airline deregulation has failed. At what point do we take another look at this beleaguered airline industry? We need to be forward-thinking before we are asked to bailout the airline industry—again.

It is clear that airline deregulation has failed to deliver on its promises of a stable and profitable industry, and staying the course will continue the industry's downward spiral. Airline bankruptcies will continue, more proud airlines will disappear, employees will continue to suffer and passengers will receive less service. Albert Einstein said, "Insanity is doing the same thing over and over again and expecting a different result." We can close our eyes and believe that repeating the same mistake for thirty years will eventually bring different results, or we can effect real change and have an efficient and competitive air transportation industry.

I do not propose a complete return to the days of the Civil Aeronautics Board and complete re-regulation, but some additional form of government involvement is necessary.

Although I do not agree with everything former American Airlines CEO Robert Crandall says about the airline industry, I share his opinion that, "market-based approaches alone have not and will not produce the aviation system our country needs" and that "some form of government intervention is required."[10]

The IAM believes fares need to be regulated. We must have fare minimums, because if an airline is allowed to charge less for a ticket than it costs to provide the service, we will have more airline bankruptcies and further consolidation until we have only a single airline left in the United States.

Airline business plans today focus on lowering standards, eliminating services and reducing ticket prices to the bone to put competitors out of business, making a profitable industry impossible. The GAO estimates that median ticket prices have dropped nearly 40 percent since 1980, although the costs of aircraft, airport leases

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[6] *US Airways: Merger Probability Is High*, by Ted Reed, TheStreet.com, June 1, 2010. *http://www.thestreet.com/story/10771279/1/us-airways-merger-probability-is-high.html*.

[7] *Change, Challenge, and Competition: A Review of the Airline Commission Report*, by Alfred E. Kahn, 1993.

[8] *Reports at BP Over Years Find History of Problems*, By Abrahm Lustgarten and Ryan Knutson. *Washington Post*, June 8, 2010.

[9] *The World Airline Report*, Air Transport World, June 1, 2009 *http://atwonline.com/eco-aviation/article/world-airline-report–0309.*

[10] *Charge More, Merge Less, Fly Better*, by Robert Crandall, *The New York Times* OP-ED, April 21, 2008.

and fuel have increased dramatically.[11] Employees have been subsidizing the low ticket prices. No business can survive if they sell their product for less than what it costs to deliver their goods.

The long-term cost of under pricing tickets is too extreme. Pan Am, TWA, Eastern, Northwest and Aloha Airlines all survived for more than half a century, but could not endure the insanity of cutting prices to eliminate the competition.

Merger Scrutiny

Although we have met with United and Continental both separately and jointly, information has been slow in coming. The Machinists Union and our 26,000 members at the two airlines do not have enough details about the merger's impact on employees to determine if this merger would be in their best interests. The carriers admit that many of our most important issues, such as pensions, workforce integration, union representation, prevailing wages and working conditions will largely remain unresolved until after the Department of Justice rules on the merger. To the carriers' credit, they have agreed to a communication system through which we can obtain the information to address employee concerns, but that does not answer our questions today.

United Airlines has $8.5 billion in long-term debt,[12] and Continental has $5.3 billion in long-term debt[13]—and they are considered healthy by industry standards. The merged entity would start out $13.8 billion in debt. What is their business plan to deal with the debt structure?

Merging airlines is much more difficult than just painting planes and combining websites. American Airlines' 2001 acquisition of TWA's assets resulted in tremendous job loss, employee integration problems and the closing of a hub in St. Louis, Missouri. The America West-US Airways merger cost the City of Pittsburgh, Pennsylvania its hub, and employee integration problems for some classifications persist 5 years after the merger. The 2008 Delta-Northwest merger is still far from being completed and managements' promises to preserve all front-line jobs in the merger were quickly broken.

With tens of thousands of employees from two different corporate cultures involved, jobs are inevitably lost in mergers and integrating employees groups is never as smooth as management claims. As with any service industry, employees upset with management provide an inferior product. How employees are treated in this merger will ultimately determine its fate. Southwest Airlines founder Herb Kelleher has said, "Happy and pleased employees take care of the customers. And happy customers take care of shareholders by coming back."[14] An airline merger that does not take employees into consideration has the potential to take two viable carriers and create a combined airline destined to fail.

Airline Alliances

Several years ago, the IAM raised concerns with respect to airline alliances. In our opinion, these alliances served as a potential mechanism for allowing airlines a path around antitrust laws. Unfortunately, our concerns have been substantiated. In some cases, they have served as the foundation for airlines to consolidate their operations. Time and time again, consolidations are announced only after both airlines have operated in the same airline alliance structure.

Continental and United Airlines represent the latest consolidation of airlines in the same alliance. Continental's membership in the Star Alliance essentially started a merger on the installment plan. Given the prevalence of alliances here at home, what will alliances ultimately mean for the traveling public, particularly if they lead to further consolidation and route frequencies are cut, if not altogether abandoned?

The implications for worldwide air travel are even more profound, particularly for U.S. consumers. Given the rapid acceleration of outsourcing of most job classifications, will alliances result in the outsourcing of most domestic work on carriers to workers at airlines in other countries? We have already seen thousands of U.S. aviation jobs shifted to countries like China, Singapore, and the Philippines as U.S. air carriers outsource call centers and maintenance work. Given the lack of proper oversight by the FAA, as well as inadequate quality control mechanisms, this develop-

[11] *Airline Deregulation*, U.S. Government Accountability Office Report GAO–06–630, June 2006.

[12] Continental Airlines 10–K filing with the Securities and Exchange Commission, filed 2/17/10.

[13] United Airlines 10–K filing with the Securities and Exchange Commission, filed 2/26/2010.

[14] *From the Corner Office—Herb Kelleher*, by Mary Vinnedge, Retrieved from *success.com* on May 26, 2010, *http://www.successmagazine.com/From-the-Corner-Office-Herb-Kelleher/PARAMS/article/390/channel/19*.

ment should raise alarms for any policymaker that sees domestic job security and consumer interests a priority.

Effects of the Merger on Hubs

The effects of a Continental/United merger would be felt most resoundingly in the upper Midwest and Mid-Atlantic states. The new carrier would most likely eliminate or downsize at least two of its hubs, in Cleveland, OH (CLE) and Washington-Dulles (IAD) in order to remove excess capacity. Closing hubs initiates a cascade of job loss that begins with airline employees and continues throughout the community to firms that provide services to the airline.

In the Midwest, United's leadership position at Chicago-O'Hare (ORD) could mean the elimination of Continental's CLE hub operation. CLE is only 307 miles from ORD. Continental's CLE hub is the smallest of their three hubs and has just recently started to grow again following post-9/11 downsizing. United is Chicago's hometown airline with unparalleled facilities and routes from ORD. CLE and the northern Ohio area have already been suffering greatly from the economic downturn and the mortgage crisis, and eliminating a major local employer would have drastic effects on the local economy.

Such a move would dramatically affect air service for the northern Ohio area, for which CLE serves as the closest major hub. Large corporations with their headquarters in CLE, such as National City Corporation, American Greetings, Eaton, Forest City Enterprises, Sherwin-Williams Paints, Key Bank and Progressive Auto Insurance would lose access to direct domestic and international flights. Communities through Michigan, Kentucky, Tennessee, Ohio, Illinois, Wisconsin, and other states would lose their regional jet service operated by Continental Express, in many cases leaving them only with one airline alternative.

A different situation exists in the Northeast, where United's smaller IAD hub is only 215 miles from Continental's EWR "Global Gateway." EWR is Continental's primary international hub with nonstop service to nearly 100 destinations outside the United States. IAD serves as United's primary gateway to Europe, but its size and scope is nowhere near matching Continental's EWR operation.

Due to the large size of the local Washington, D.C. market, it is presumed that instead of a full-fledged hub closure, IAD would be downsized into a much smaller hub or a large focus city. IAD benefits from the fact that there is a perimeter restriction on flights from nearby Reagan National Airport (DCA) to destinations more than 1,500 miles away, which requires most flights to the West Coast to be operated out of IAD.

A Continental/United combination would also concentrate competition at many nonhub airports. They would be the largest carrier at Boston Logan (BOS), number 3 at New York-LaGuardia (LGA), number 4 at New York-Kennedy (JFK), and the second largest carrier in Honolulu, Hawaii (HNL) after Hawaiian Airlines. At all of these airports it would be necessary to combine personnel and facilities, which would most likely result in layoffs.

We have to ask ourselves if the merging of these carriers and wholesale reshaping of the industry will destroy competition and harm consumers on routes throughout the United States.

As details about the combined carriers' business plan emerge, it must be closely scrutinized to determine if a merger will result in a successful entity or not. We ask Congress to help us determine if this transaction will be good for employees and consumers.

Pensions

The Machinists Union is concerned that employees could lose defined benefit pension plans as a result of the merger. Continental ramp service, stock clerks and public contact employees all participate in a Continental company-sponsored single-employer defined benefit pension plan, while their IAM-represented counterparts at United participate in the multiemployer IAM National Pension Plan (NPP). Continental's IAM-represented flight attendants also participate in one of Continental's defined benefit pension plans and have negotiated the IAM NPP as a contingency plan. United flight attendants do not currently have a defined benefit pension plan, and the Pension Benefit Guaranty Corporation (PBGC) has prohibited United from sponsoring a single-employer pension plan.

The IAM believes that all employees deserve defined benefit pension plans. The carriers acknowledged that harmonizing pensions would be a complex issue, and although they have given it much thought, they did not know how it would be resolved.

In spite of United abandoning its pension obligations in bankruptcy, the IAM fought hard and ensured our members would have a replacement defined benefit

plan. Just as we did in United's bankruptcy, the IAM will not allow our members' retirement security to become a causality of this merger.

Collective Bargaining

The Machinists Union is currently in contract negotiations for all eight classifications where we have members at the two carriers—seven at United plus Continental flight attendants. United negotiations have been ongoing for more than a year, and bargaining with Continental began late in 2009.

Regulatory and shareholder approval are far from certain at this point, and the Machinists Union is committed to negotiating new agreements to cover our members at each airline. It is premature for anyone to talk about combining the carriers' employees, and each airline must recognize their responsibility to continue bargaining in good faith.

Seniority

Seniority integration is always a major concern in mergers. Although airlines often promise fair and equitable integration of seniority, fair and equitable is a very subjective term and should not be left up to the carriers to decide. Some past mergers have resulted in employees losing decades of seniority—I am one of them. My seniority date was changed from 1975 to 2001 after American Airlines purchased TWA's assets in bankruptcy.

Continental Airlines is the product of many past mergers in the wake of deregulation, and in some cases seniority was integrated unilaterally by the then Frank Lorenzo-led carrier. The Machinists will ensure seniority is protected in this merger, but again, this is an issue to be addressed after representation issues are resolved. At the IAM's insistence, both airlines have agreed not to engage in workgroup integration discussions until representation issues are resolved.

History of Sacrifice

United Airlines employees have suffered greatly through the carrier's bankruptcy, the longest and most expensive airline bankruptcy in history.

Immediately after its Chapter 11 filing, United Airlines asked a bankruptcy judge to impose 14 percent "emergency" pay cuts on IAM members. More long-term cuts in pay and benefits cost IAM members $460 million a year (or $2.644 billion over the life of the agreement). United then took steps to cut health benefits for existing retirees and filed a motion in court to ask a judge to impose further cuts if agreements could not be reached with the retirees' representatives.

In the summer of 2004 United ceased funding its pension plans, the first in a series of steps which ultimately led to the termination of its company-sponsored pension plans.

In January 2005, United once again sought and received "emergency" pay cuts from the bankruptcy court—this time it was 11 percent. Six months later IAM members gave up another $176 million a year to save United. Savings attributable to the termination of IAM member's pensions saved United an additional $217 million a year.

In total, IAM members were forced to sacrifice more than *$4.6 billion* for United Airlines. United employees have been subsidizing the airline since 2003, and each day without a new contract that sacrifice continues.

Continental Airlines' employees also sacrificed more the $500 million a year to keep their airline out of bankruptcy during their last round of collective bargaining.

So, employees have the right to question the motives behind this merger and fear they would be forced to subsidize it.

Conclusion

The business plan for the proposed airline must receive close scrutiny. The IAM is concerned that the new entity may be too big to succeed without some form of industry re-regulation, and failure of such a large entity could be disastrous to employees, the industry and the general economy.

As this merger proposal moves forward, the Machinists Union asks regulators to take the merger's impact on employees into consideration. A combined carrier must offer employees more stability and opportunity than are available at the two independent airlines. The merger cannot be at the expense of workers who have already sacrificed to keep their airlines aloft. United and Continental employees did not accept job cuts and wages and benefit changes when their employers restructured just to lose out again in a merger.

The Machinists Union believes that airline mergers should have conditions, including requirements that protect employees, consumers and taxpayers—all of whom have been hurt by this unregulated industry. Employees must have their jobs, wages, benefits and pensions protected. If the architects of a merger can guar-

antee themselves bonuses and lucrative severance packages, then they can do the same for front-line employees. All cities that the airlines currently serve, not just profitable ones, must continue to be served. Pension obligations should be upheld in mergers, and consolidation should not be a vehicle for airlines to dump their pensions on the PBGC.

United and Continental would not be seeking to merge today if employees had not stepped up to save them in the past. United and Continental need to demonstrate how the proposed merger would benefit employees, consumers, and the cities and states the airlines currently serve.

Thank you again for the opportunity to speak with you today. The Machinists Union recognizes it is in the Nation's interest to have a safe, reliable, competitive and profitable air transportation industry. We are committed to working with Congress, the Departments of Justice and Transportation, and the air carriers to achieve that goal.

I look forward to your questions.

The CHAIRMAN. Thank you. And good timing.

Mr. Charlie Leocha, who is the Director of the Consumer Travel Alliance.

Please, sir.

STATEMENT OF CHARLES LEOCHA, DIRECTOR, CONSUMER TRAVEL ALLIANCE

Mr. LEOCHA. Thank you, Chairman Rockefeller and Ranking Member Hutchison, for giving passengers a seat at this table.

My name is Charlie Leocha, and I am the Director of the Consumer Travel Alliance, a nonprofit created to keep the needs of consumers in front of legislators, regulators, and staff here in Washington. Our Alliance is a member of the Consumer Federation of America.

My testimony today focuses, of course, on United and Continental Airlines' proposed merger. According to news reports, these airlines are already forming a steering committee and establishing teams of employees to delve into details of aligning. "Whoa, Nelly," as we say back in my neighborhood, "It ain't a done deal yet."

The Consumer Travel Alliance cannot find any public benefit from this merger. There are no new destinations, no new savings passed on to passengers. We see customer service disruptions and more-restrictive frequent flyer programs. Ultimately, we believe consumers will be faced with less competition and higher prices.

In addition, thousands of small businesses and corporate travelers will face difficult negotiations with a mega-airline larger than any our Nation has ever known before.

The merger plan acknowledges thousands of employee layoffs when our economy is already under stress. Our Nation is now faced with two forms of consolidation: the traditional merger of two airlines, and the development of alliance antitrust immunity that allows multiple airlines to operate as one, internationally. Neither this merger nor antitrust immunity are in the consumer's interest. I don't think that any of us in this room can point to even one single public benefit from the latest airline mergers. Bankruptcy for both airlines has already squeezed costs and capacity out of the system. This merger will only squeeze competition out of the system.

Though Continental and United already work together as alliance partners, they still compete aggressively in many areas. They fight for corporate and leisure travelers. They compete for airline

gates. They compete for frequent flyers, suppliers, travel agency attention, and much more.

The Department of Justice should conclude that the proposed merger is not in the public interest, just as they did a year ago, when reviewing the application from these same two carriers for airline alliance antitrust immunity. DOJ's reasons for denial included consumer harm, higher fares, elimination of competition, and, ultimately, that it was not in the public interest. Nor is this merger.

This union, however, ups the ante. Should this merger be approved, the Nation's system of network carriers will be effectively reduced to three: Delta, United, and American. This trio, even without U.S. Air, which is already rumored to be exploring a merger with American, would control more than 70 percent of the domestic market, if associated regional airlines are included. And their alliances would control 85 percent of international traffic. We are creating yet another industry with companies too big to fail. Have we learned nothing from the past 2 years?

Admittedly, these two airlines have limited overlapping routes. However, their impacts on hubs, long- haul routes, connecting routes, suppliers, and consumers cannot be measured by overlapping routes, alone. The potential impact of this merger should be examined through the long-term prism of our country with only three major network airlines. It will be a consumer nightmare.

Much has been made of the price discipline exercised by low-cost carriers. Maybe so for point-to-point competition. But, flights to smaller airports and to international destinations served by these carriers and their alliances will not face any pricing pressure from low-cost carriers. And that connecting traffic is exactly what these hub-and-spoke carriers are all about.

In summary, this continued consolidation may be helping large airlines survive in the short run, but, when the economy improves, consumers, both leisure and business, will be left at the mercy of a government-approved system of airline oligopoly with less competition and, ultimately, higher airfares.

If airline consolidation is allowed to continue, with mergers in domestic—of domestic carriers and antitrust immunity, the Consumer Travel Alliance predicts that this committee will find itself, within the decade, meeting to find ways to restore competition that is being eliminated today.

America's airline passengers thank you for this opportunity, and I look forward to questions.

[The prepared statement of Mr. Leocha follows:]

PREPARED STATEMENT OF CHARLES LEOCHA, DIRECTOR, CONSUMER TRAVEL ALLIANCE

Thank you, Chairman Rockefeller for giving passengers a seat at this Congressional table and an opportunity to testify about the effects on consumers of today's airline consolidation.

My name is Charles Leocha and I am the Director of the Consumer Travel Alliance, a nonprofit created to keep the needs of consumers in front of legislators, regulators and their staff. Our alliance is a member of the Consumer Federation of America. We are intimately involved with the current conference committee negotiation over the FAA Reauthorization. We are also working with state regulators, the FTC and DOT on privacy issues, travel insurance, pressing consumer issues with online and traditional travel agents and in the area of travel rights.

My testimony today focuses on the effects of the merger of United Airlines and Continental Airlines. I will also address the ongoing effects of consolidation in the airline industry that has been taking place for more than a decade. I am not speaking only for leisure travelers who make up more than 80 percent of airline passengers, but also for business travelers who provide more than 50 percent[1] of airline revenues.

Though these two airlines have many cooperative agreements, they still compete aggressively with each other in many ways—for corporate and leisure travelers, airline gates, frequent fliers, suppliers, travel agency attention and more.

We believe the Department of Justice and Congress should conclude that the proposed merger is not in the public interest, just as they did in June of last year, when reviewing the application from these same two carriers for airline alliance antitrust immunity.[2]

DOJ's reasons for denial included consumer harm, higher fares and elimination of competition, and ultimately that it was not in the public interest. Those same concerns resonate with this corporate marriage, but this union ups the ante—approval would make a third domestic merger almost inevitable.

The Road to Three Big Carriers

Should this merger be approved, the Nation's system of network carriers will be effectively reduced to three major players—Delta, United and, perhaps, a coming mega-carrier formed by the merger of American Airlines with another airline. Even without the American merger with another carrier, this Delta/United/American triumvirate would control more than 50 percent of the U.S. domestic available seat miles (ASMs) and revenue passenger miles (RPMs).[3] Their airline alliances would control 85 percent of international traffic.[4] That kind of consolidation might bode poorly for business travelers as well as leisure travelers and may lead to another industry with its major players considered "too big to fail."

A merged United-Continental initially would have about 90,000 employees and about 700 aircraft, which certainly means higher odds of government bailouts or assistance than if the carriers operated individually. On the other hand, today, if one of these two airlines crumbled, the national air transportation system would shudder, but hardly be crippled.

Are There Benefits for Consumers?

The Consumer Travel Alliance cannot find any tangible consumer benefits of this merger and the ongoing consolidation in the airline industry. There are no new destinations, no new savings passed on to passengers and ultimately consumers are faced with less competition and higher prices. Consolidation to this point has already made airline signaling of airfare changes easier. This merger will make the process of raising airfares even simpler. The continued application of fees and the unbundling of airfares will also accelerate with fewer airlines in competition with each other. The institution of fees for checked baggage, seat reservations, meals and more has been followed by airline after airline like a herd of wildebeests crossing a crocodile-infested river.

To be sure, there are plenty of corporate benefits—reducing the combined work force, certain economies of scale and increasing bargaining power (at the expense of suppliers). But business and leisure travelers don't get anything more than what they have been experiencing through the already coordinated international schedules, shared frequent flier miles and awards and visitation privileges at airport clubs.

Even United and Continental spin-doctors are having trouble finding specific consumer benefits from the merger now under consideration. On their merger website, they have touted supposed consumer benefits that are nothing new. We have all seen the following platitudes they cite for decades[5]—

World's Most Comprehensive Network

In reality, this is no benefit for consumers. At best, the Continental/United network remains identical to the current network operative through the Star Alliance. Potentially, there will be consolidation of overlapping routes. Though few routes

[1] PhocusWright.

[2] Joint application to Amend Order 2007–2–16 under 49 U.S.C. §§ 41308 and 41309 so as to Approve and Confer Antitrust Immunity, Comments of the Department of Justice on the Show Cause Order Docket OST–2008–0234 pg. 42.

[3] AirlineForcasts.com Commentary: United + Continental is a big win for all stakeholders by Paul Mifsud, Carlos Bonilla, Vaughn Cordle, CFA.

[4] Bureau of Transportation Statistics.

[5] *http://www.unitedcontinentalmerger.com/benefits/customers.*

overlap, the final honest assessment is a reduced network and fewer choices for both business and leisure travelers.

Just as Delta swore that it would not abandon its hub at Cincinnati, current Continental statements about the sanctity of their Cleveland operations must be taken with a grain of salt. Everyone in this room realizes that the reduction of flights were made in Cincinnati and that future reductions of flights from Cleveland will be made because of consumer demand, or the lack thereof. However, without the merger of Delta with Northwest and the proposed merger of Continental with United, Cincinnati probably would still be thriving and there would be no discussions about downsizing Continental's Cleveland operations.

World's Leading Airline

When has this been a benefit to consumers? The combination will have the same planes it currently is flying. The merged carrier will have the same frequent flier program that is already aligned through alliance membership.

Competitive Fares

United/Continental claim that 92 percent of their top 50 major city routes have low-cost-carrier competition. That competition will guarantee low airfares. The real change in competition will be in the field of business travel. There, this consolidation will have drastic effects on corporation travel programs that depend on hubs where CO/UA price competition will be eliminated.

When corporate travel departments are faced with both a new paradigm presented by this merger plus the developing might of international alliances that are beginning to negotiate as a single entity rather than as a dozen or more separate airlines, competition will be further degraded.

Award-Winning Customer Service

If past history provides any gauge consumers can expect a decrease in overall customer service when highly rated Continental merges with poorly performing United Airlines. It appears certain the Continental passengers will see degradation in the service levels that they have come to expect.

According to DOT's Airline Quality ratings that measure complaints, misdirected baggage and on-time arrivals, Continental has ranked at the top of the major airlines for the past 3 years (if we take out Northwest that merged with Delta). United Airlines has been mired near the bottom of the rankings for the past 2 years, only excelled in poor customer service by Delta that has not budged from last place even as it absorbed the former customer-service champion, Northwest Airlines.

In fact, customer service will be an unknown as Continental's vaunted service is merged with United's marginal service; a chance of reduced morale among Continental employees as their contracts are reduced to meet United pay levels is expected. From the consumer point of view, this bigger-is-better argument has no basis in reality.

Historically, airline mergers have created a quantum increase in customer service problems. Of course all of these problems can be "worked out," however they subject consumers to additional headaches and travel disruption. One of the most frustrating is the consolidation of passenger data. Every recent merger from the days of the Continental/People Express to the Delta/Northwest mergers has been fraught with IT problems.

Industry-Leading Frequent Flier Program

These programs are already merged from an award-city point of view. The most likely result of this merger will be a shift to more passenger-unfriendly rules such as hefty co-pays for upgrades. Having these frequent flier programs consolidated will allow the Big 3 airlines to more easily make anti-consumer changes. Competition between frequent flier programs is another form of competition that will be eliminated.

The bottom line: If what has happened in the past provides a roadmap to consequences of this pending merger, Consumers will see no benefits and may face degraded service, less competition, more fees and higher prices. Plus, possible changes to current frequent flier rules may raise mileage costs for redemption of miles and reduce free travel opportunities rather than increase them.

Airline Consolidation by Merger

This proposed merger of United Airlines and Continental Airlines is the latest portion in a continuum of airline consolidation that has been slowly taking place over the past decade.

Mergers have been with the airline business for decades, however the size of these mergers is now creating airline behemoths that couldn't even be contemplated only

a decade ago. Continental merged with People Express, Northwest merged with Republic, US Air merged with Allegheny, American merged with Reno Air and then TWA and last year Delta merged with Northwest to create what is the world's largest airline.

Now, Continental and United stand before the Department of Justice and Congress with a merger that will create even a larger airline.

Airline Alliance Consolidation

As domestic airlines have been merging, internationally mergers have also taken place. However, the granting of antitrust immunity that allows certain airlines to do unrestricted business together has changed the economic playing field.

It started with the granting of antitrust immunity for Northwest Airlines and KLM Airlines back in the early 1990s in order to encourage European countries to negotiate Open Skies agreements with the U.S. This initial antitrust immunity grant was issued in the "public interest" for a greater good.

However, airlines discovered that antitrust immunity added significantly to the bottom line and though, today, we have Open Skies agreements with most European countries, the alliance antitrust immunity has continued to grow, not for the public good, but for corporate good.

These antitrust immunity grants have accelerated with the creation of three major airline alliances between the world's largest carriers. Lufthansa, United, US Airways, and Singapore airlines and others form the Star Alliance. American Airlines, British Airways, Iberia, Finnair, Qantas and others make up the OneWorld alliance. Delta, Northwest, Air France, KLM, Korean Air and others have created SkyTeam. Already, DOT has granted SkyTeam and Star Alliance antitrust immunity and the OneWorld alliance has applied for similar antitrust immunity.

This antitrust immunity allows alliance airlines to work together as a joint venture with a separate board of directors. Alliances are already jointly coordinating flights, schedules, route planning, marketing efforts, advertising, sales campaigns, frequent flier programs, catering and maintenance. These alliances are defacto mergers of the alliance's international business.

An Increase in Airfares

This merger needs to be looked at far more expansively than simply overlaying one route structure over another and then congratulating each other at the lack of overlapping routes. I admit that there are few overlapping routes between these airlines. When competition is taken out of the market it affects every route that an airline flies whether it overlaps with its merger partner or not. Investigators also need to examine nonstop flight markets as a separate and distinct market from connecting flights between city pairs.

Consider These Scenarios

First: With one less major network carrier, in an oligopolistic industry, the airline system of trial airfares has one less player. With one less "veto vote" available to reject system-wide fare increases the chances of consumers having to pay more in terms of airfares and airline fees increases exponentially.

Second: The merger also needs to be examined in light of today's airline alliances that already give Continental/United a joint venture for their transatlantic, Latin American and transpacific schedules and route structures. These joint ventures provide this merged carrier a government-approved system to profit from limited international competition and then use that profit to squeeze domestic competitors who do not have such government-assisted antitrust immunity provisions that virtually guarantee profits on international routes.

Effective Business Travel Monopolies at Select Hubs

The effects of the United/Continental merger will have far-reaching negative consequences for business as well as leisure travelers if it leads to a consolidation of the network airlines into three groups. When one of these mega-carriers controls the hub of a corporation, there is no competitive mega-carrier to limit the dominant hub airline's pricing power. Corporate air travel buyers will be forced to capitulate. This situation gets even worse when the dominant hub airline is linked with an international alliance and that alliance demands that corporations bargain with the alliance as a single joint venture rather than playing one airline off against another.

This kind of dominant hub power allows the mega-carrier to control prices for consumers and commissions that they pay travel agents. It affects far more than only business and leisure travelers. It affects new competition as well. Entry into a route that is anchored by a major carrier hub on both ends is extremely difficult for would-be competitors. Suppliers also face the difficulty of bargaining with the domi-

nant mega-carrier from a real position of weakness. The resulting situation is anti-small-business in the hub airport community.

These major carriers also use mergers as a way to consolidate control of airport gates and in some cases take-off and landing slots. These kinds of gate and slot controls can make penetration by low cost carriers very difficult. Washington Reagan only recently has seen new low cost carriers (JetBlue will startup in November) because of limited take-off and landing slots.

At Boston Logan Airport, AirTran's operations were limited for months because they could only secure one gate while Northwest hoarded its gates simply to keep competition out of the airport. As we hold this hearing, Southwest Airlines is attempting to gain slots at both La Guardia and Washington Reagan so that they can compete with entrenched network carriers.

While many analysts and airline CEOs claim that three is the perfect number of large network competing airlines, that perfection in terms of competition only works if all three airlines have relatively equal strength across all markets. When market power is allowed to be concentrated in different hubs, the system is really a divide-and-conquer strategy. This fortress hub system is being played in every city where mega-carriers face minimal competition—Houston, Detroit, Minneapolis, and Dallas. Cities where two competing network carriers have hubs see much healthier competition—New York City, Los Angeles, Chicago.

Low-Cost Carriers, the Competition Antidote

The only real airline pricing discipline is generated by competition from low-cost carriers. The travel industry has documented the "Southwest Effect." This is a three-step effect where first, lower fares increase demand; second, competing airlines match the Southwest fares; and third, sales rise for all airlines in the market.

This kind of competition can only take place if there are available gates at airports and available take-off and landing slots. Both factors must be considered carefully by DOJ while examining this pending merger as well, just as DOT has when considering recently proposed take-off/landing slot swaps between airlines.

On the transatlantic front, Open Skies agreements with the European Union (E.U.) may offer potential avenues for effective low-cost airline penetration when the low-cost airlines decide to expand internationally. Just as low-cost airlines began their move into the domestic market by serving less-popular airports, their expansion into transatlantic flying is dependent on a good Open Skies agreement since major hubs—Heathrow, Frankfurt, Amsterdam, Paris and Madrid—are locked up by the mega-airline alliances.

Conclusions

From a consumer perspective, this continued consolidation may be helping large airlines survive in the short run but when the economy improves, consumers—both leisure and business—will be left at the mercy of a government-approved system of airline oligopoly with less competition and, as a result, according to Department of Justice analysis, ultimately higher airfares.

In the short-term, approval of this merger may not be seen as anti-competitive, but as a form of welfare for struggling airline corporations. In the long term, there is no doubt that effective airline competition will be eliminated and that a market with less competition is less consumer friendly.

If airline consolidation is allowed to continue along its current path with mergers of domestic carriers and antitrust arrangements for groups of international airlines, the Consumer Travel Alliance predicts this committee will find itself, within the decade, meeting to find ways to restore competition to airline system that is being eliminated today.

The CHAIRMAN. Thank you very much.

And now, Mr. Dan McKenzie, who is an industry analyst from Hudson Securities.

STATEMENT OF DANIEL MCKENZIE, SENIOR RESEARCH ANALYST, HUDSON SECURITIES

Mr. MCKENZIE. Good morning. Mr. Chairman and members of the Senate Commerce Committee——

The CHAIRMAN. Can—is your machine on, there?

Mr. MCKENZIE. OK.

Mr. Chairman and members of the Senate Commerce Committee, it's an honor to be here today. So, thank you.

As background, I've been helping investors analyze the airline industry for 10 years, and my firm does not seek investment banking business from the airlines.

As has been widely reported and recognized, the U.S. airline industry, with the exception of low-cost carriers, has been a financial failure. We've seen serial bankruptcies in successive decades. And the point I would like to leave you with is this: While it's natural to think of the industry structure as a monopolistic oligopoly or a few competitors that act like one, it hasn't behaved that way, and there are reasons for why this behavior shouldn't change, looking ahead.

The second point I would like to leave you with today is cost disequilibrium, which reverts to my first point. As long as there are low-cost carriers with a 20- to 30-percent cost advantage, they are going to try and undercut legacy-carrier pricing and take market share. And I don't see this changing, looking ahead.

Or, to put it differently, the day we no longer have a competitive industry is the day every airline has the same cost structure.

However, low-cost carriers, which today enjoy widespread brand acceptance, have been able to sustain sizable cost advantages and, through discounting, drive a shakeout among the legacy carriers, a phenomenon I expect will continue.

The third point I would like to leave you with is that the industry is recovering, financially, but it remains vulnerable to another spike in crude or another economic downtown. My outlook assumes average ticket prices rise 12 percent this year and 5 percent next year, which position the industry to finally begin reporting modest profits. My forecast will, naturally, fluctuate based on the macrobackdrop.

So, what are the factors that have caused the industry to suffer so much? Industry fragmentation is one key. If looking at capacity, the top four airlines, in 2000, controlled 66 percent of the industry capacity. That rose to 70 percent in 2005, and remains the case today. After the announced United and Continental merger, the top four airlines would control 81 percent.

But, perhaps the easiest way to think about the industry's poor health is to think of it in terms of the real estate crisis. People that couldn't afford to buy houses, could. In the case of the airline industry, airlines having a junk credit rating can, nonetheless, easily go out and buy new planes, which, over the past 32 years, has led to brutal competition.

Just as the tech bubble, the telecom bubble, the real estate bubble, and even the commodities bubble have burst, there has been a capacity bubble in the U.S. airline industry which today is beginning to deflate as a consequence of the macrobackdrop volatility. The industry has been undergoing a painful transformation. And I'd say that today we're probably in the seventh inning.

Separately, the macro-backdrop has been extremely volatile. The reality is, fleet and demand—fleet and personnel plans, pardon me, made years ago could not have possibly anticipated the demand shock following the calamity of 9/11, a super spike in crude, the recent financial meltdown, or worldwide health pandemics.

Some may wonder if deregulation was a mistake. Of course it wasn't, with too many benefits to cite. Recall that deregulation in the U.S. has led to deregulation globally. Boeing, Airbus, all of their suppliers, naturally, the banks, aircraft leasing companies, the gaming and lodging industry, and travel management companies have all been very big winners.

So, what does the future look like? The industry is growing about 1 percent today, but there are plane orders for delivery in 2012 and 2013, and, because capacity drives pricing, the additional capacity will impact average ticket prices, further out.

Meanwhile, low-cost carriers will continue to undercut on pricing and take market share, where they can.

And, separately, as long as management teams make promises to labor they can't keep, we'll continue to see Chapter 11 filings. I predict we'll see another Chapter 11 filing sometime in the next 5 years.

But, there is one wildcard here, and that's very volatile fuel prices, which represent the Number 1 threat to the industry. The debate on speculative trading and commodities is not whether it exists, but how best to remedy it. Unfortunately, the airline industry is a highly leveraged, high fixed-cost business that is reeling from 30 percent of its costs getting whipsawed by 50 percent in any given year. And the threat of another super spike has curtailed plane orders by many legacy carriers.

Said differently, speculative trading is perverting capital spending and investment planning, and, as a result, ultimately, perverting economic growth.

I'll conclude by saying there are a lot of factors that have and continue to impact the financial health of the industry. Demand is coming back, and finances are improving, but there remain a number of structural challenges in place that will continue to make the recovery to financial health a slow process.

Mr. Chairman and members of the Commerce Committee, thanks again for the opportunity to be here today.

[The prepared statement of Mr. McKenzie follows:]

PREPARED STATEMENT OF DANIEL MCKENZIE, SENIOR RESEARCH ANALYST, HUDSON SECURITIES

Mr. Chairman and members of the Senate Transportation Committee, it's an honor to be here today, so thank you. As background, I have been helping investors analyze the airline industry for 10 years and my firm does not seek investment banking business from the airlines.

As has been widely reported and recognized, the U.S. airline industry, with the exception of low-cost carriers, has been a financial failure. We've seen serial bankruptcies in successive decades. And the point I would like to leave you with is this: Despite that fact that the industry is structured as a monopolistic oligopoly, it hasn't behaved as one, and there are a number of reasons for why this behavior shouldn't change looking ahead.

The second point I would like to leave you with today is "Cost Disequilibrium," which reverts to my first point. As long as there are low-cost carriers with a 20–30 percent cost advantage, they are going to try and undercut legacy carrier pricing and take market share. And I don't see this changing over my horizon. Or to put it differently, the day we no longer have a competitive industry is the day every airline has the same cost structure. However, low-cost carriers, which today enjoy widespread brand acceptance, have been able to sustain sizable cost advantages and through discounting, drive a shakeout among the legacy carriers, a phenomenon I expect will continue for the next several years.

The third point I would like to leave you with is that the industry is recovering financially, but it remains vulnerable to another spike in crude or another economic downturn. My outlook assumes average ticket prices rise 12 percent this year and 5 percent next year, which position the industry to finally begin reporting modest profits. My forecast will naturally fluctuate based on the macro backdrop.

So what are factors that have caused the industry to suffer so much? Industry fragmentation is one key reason. If looking at capacity, the top 4 airlines in 2000 controlled 66 percent of industry capacity. That rose to 70 percent in 2005 and remains the case today. After the announced United and Continental merger, the top 4 airlines would control 81 percent.

But perhaps the easiest way to think about the industry's poor health is to think of it in terms of the real estate crisis. People that couldn't afford to buy houses could. In the case of the airline industry, airlines having a "junk" credit rating can nonetheless, very easily, go out and buy new planes, which over the past 32 years, has led to brutal competition.

Separately, the macro backdrop has been extremely volatile and has hit the industry hard. The reality is, fleet and personnel plans made years ago could not have possibly anticipated the demand shock following the calamity of 9/11; a super spike in crude to $147; the recent financial meltdown; or worldwide health pandemics. Just as the tech bubble, the telecom bubble, the real estate bubble, and even the commodities bubble have burst, there has been a capacity bubble in the U.S. Airline industry which today, is beginning to deflate as a consequence macro backdrop volatility. The industry has been undergoing a painful transformation and I'd say that today, we're probably in the 7th inning.

Some may wonder if deregulation was a mistake. Of course it wasn't, with too many benefits to cite. Recall that deregulation in the U.S. has led to deregulation globally. Boeing, Airbus, all of their suppliers naturally; the banks; aircraft leasing companies; the gaming and lodging industry; and Travel Management Companies have all been very big winners.

So what does the future look like? The industry is not growing today, but there are plane orders for delivery in 2012 and 2013, and the additional capacity will impact average ticket prices further out. Meanwhile, low cost carriers will continue to undercut on pricing and take market share where they can. And separately, as long as management teams make promises to labor they can't keep, we'll continue to see Ch. 11 filings. I predict we'll see another Ch. 11 filing sometime in the next 5 years.

But there is one wild card here, and that's very volatile fuel prices which represent the Number 1 threat to the financial health of the industry. The debate on speculative trading in commodities is not whether it exists, but how best to remedy it. Unfortunately, the airline industry is a highly-levered, high-fixed cost business that is reeling from 30 percent of its costs getting whipsawed by 50 percent in any given year. And the threat of another super spike has curtailed plane orders by many legacy carriers. Said differently, speculative trading is perverting capital spending and investment plans, and as a result, ultimately perverting economic growth.

I'll conclude by saying that there are a lot of factors that have and continue to impact the financial health of the industry. Demand is coming back and finances are improving, but there remain a number of structural challenges in place that will continue to make the recovery to financial health a slow process.

Mr Chairman and members of the Commerce Committee, thanks again for the opportunity to be here today.

The CHAIRMAN. Thank you very much, Mr. McKenzie.

I'd like to ask, now, if Senator Hutchison has any statement that she'd like to make.

STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Senator HUTCHISON. Well, thank you, Mr. Chairman. Let me just make a short statement, and then I'll turn it back to you for the questions.

This proposed measure is going to have a dramatic impact on my home City of Houston, and certainly on the people who work at Continental.

It's a hard sell in Texas, and I'm disappointed in the decision to merge. And I worked very hard to support alliances so that we could avoid a merger.

I've worked hard, during my Senate term, to promote the long-term viability of the airlines, whether they're based in Texas or anywhere else. And, while I appreciate the fact that Houston will remain the largest hub of the new carrier, and there have been promises that it will have a bright future, I remain concerned about the ramifications to the employees at Continental and, of course, to the Houston hub, that is the main hub now.

Continental is a Texas-born carrier with a strong reputation. It's well managed. And, Mr. Smisek, you've been a part of that management. So, it's a well-run airline.

United has had a different kind of reputation, and its growth and customer service has been more inconsistent.

So, I will like to ask how you are going to merge these two airlines that have different cultures, and how you will also move forward. I do think it's going to pass regulatory muster, but I think it's going to be difficult.

I also believe that government should not get in the way of business decisions, as long as they're within the law.

But, let me just say that I am concerned about the overall health of the industry with these mega-mergers that we are seeing, and if there can continue to be competition. I'm interested in what you have said, Mr. McKenzie, about low-cost carriers with different cost structures being able to compete against the big carriers. But, the big carriers obviously have the efficiencies of scale.

I'm really interested in whether we're going to see fewer of the competitive airlines, beyond the big ones, the big three, which might eventually be four; I don't know. But, I'm just worried about not having competition and a vigorous industry, in the big picture.

So, I will be interested in asking questions. I hate this merger, but I don't think it's my place to step in, unless there are violations that are found, through the Justice Department and Department of Transportation, that will certainly give a fair scrutiny to this merger.

With that, Mr. Chairman, thank you very much, and I'll look forward to asking questions.

[The prepared statement of Senator Hutchison follows:]

PREPARED STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Chairman Rockefeller, thank you for convening today's hearing on the financial state of the Airline Industry. It is important that we understand the impact of the proposed merger between Continental Airlines and United Airlines on consumer air travel, employees, and the commercial aviation industry's future.

This committee has held several hearings on aviation mergers over the years. Regardless of the air carriers involved, each proposal is almost always full of uncertainty, best case scenarios, and promises of better things to come. The Continental/United proposal is no different.

This proposed merger will also have a dramatic impact on the largest city in my home state, Houston, where Continental is headquartered.

Let me be clear: the proposed merger is a very hard sell in Texas. I, for one, am extremely disappointed in this decision to merge.

I have worked hard during my Senate tenure to promote the long-term viability of the airlines, whether they are based in Texas or elsewhere. While I appreciate the fact that Houston will remain the largest hub-airport of the new carrier, and has been promised a bright future in the new carrier's network, I remain concerned

about the ramifications of this decision on the thousands of people who are part of Continental and make the Houston area their home.

Continental is a Texas-born carrier with a strong reputation, as a well managed carrier across many lines of business, including labor relations and consumer relations. Mr. Smisek, you have played an important role in leading Continental and you have been a very effective CEO, but you are now merging with a carrier that has a reputation and history of labor strife and poor customer service. While the merger proposal may look good on paper and will likely pass regulatory muster, you are going to have an extremely difficult task turning the new carrier into an effectively integrated one.

With that said, I also understand the need to make prudent business decisions. I understand how to run a business. I think the fundamental question that has to be asked is, 'What is better for Continental and Houston in the long-term?'

If the Continental/United merger goes through, which I expect it will, can the collateral increases in service, particularly international service, generate enough economic opportunity to create a net benefit for Houston in the years to come? Also, if remaining a stand-alone carrier would have meant Continental would get marginalized over the next decade, then hopefully this business decision is the right one. And one that will allow for a stronger carrier with growth, longevity and roots in Houston for decades to come.

I have long held the belief that Government should not stand in the way of companies and their ability to grow and expand within the parameters of the law. While this proposed merger is difficult for Houston, I fully expect it to receive a thorough and fair review by the Department of Justice and the Department of Transportation.

Thank you, Chairman Rockefeller. I look forward to the testimony.

The CHAIRMAN. Thank you, to my distinguished Vice Chair.

And Senator Dorgan is Chair of the Subcommittee, and I hope my witnesses will be patient, because he always says things that are worth listening to.

With that pressure, you may proceed.

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Well, also mercifully brief, I hope.

Let me say that I agree with much of what the Senator from Texas just said. I—you know, I—there's no question that our economy will not exist the way it is without a robust commercial aviation system. And I understand that. All of us want the airline industry to be healthy, and to work well, and to make money, and to haul people at competitive prices. I mean, that's what all of us want.

I—it's not a secret, I've never been a big fan of mergers. I have never felt that we solve problems in that industry by getting bigger. And it's not just that industry. But, I do think there's always a tension between the interests that the carriers have—in any merger, it's the case, there's always a tension between the specific interests that led parties to want to merge and the public interest. Sometimes they may run parallel, but often not. And when they don't, it seems to me, the public interest has to be preeminent, here.

And I—we have had a lot of hearings here, over these years that I've served on this Committee, of companies that wish to merge. Some have been successful, some have not. In every case, the testimony is that this is almost a perfect fit, hand in glove. In every case, it is, "This will be—this will represent more seamless transportation, having these two companies"—I mean, it has always been the same testimony. But, I think that the yardstick with which we must measure, here, relates to some of the things that

Senator Hutchison said. What about competition? Will there remain competitive forces in that industry that give passengers an—a decent break?

It—I want to just mention two final things.

Mr. McKenzie, you mentioned something, at the end, about "speculative trading is perverting." And I didn't even know what the noun was, but I just agree with it.

[Laughter.]

Senator DORGAN. Excessive speculative trading is perverting everything in this country. And no industry has been hit much harder than the airline industry; they're prodigious users of fuel, and they're the—I mean, they—we all saw the price of oil go to $147 a barrel in day-trading, when demand was down and supply was up. There's a perversion of markets here.

So, I just wanted to mention that. Thanks for being here just to say that, if nothing else.

And the other thing I wanted to say is, if it is the case that this merger, when completed, means that four carriers essentially carry 81 percent of the load, that is, I think, something that augers against more competition, and probably augers toward less competition. And I think that's something that we have to be concerned about and have to think about. And I'm going to ask questions about that, because, while I want our major airlines to succeed, I want startups to be able to startup and succeed, as well. I want low-cost carriers to have competitive juices. And I—you know, so I want the consumer to have a fair break, here.

I come from a State very much like Senator Rockefeller's, and we understand this about deregulation. We understand that, if you're from my State and you want to travel twice as far, you can pay half the price—or if you want to pay—travel half as far, you get to pay twice the price.

For example, if you leave Washington, D.C., and fly to Los Angeles, and then compare the price of leaving Washington, D.C., and flying half as far, to Bismarck, North Dakota, you get to pay twice as much to fly half as far. We understand how all that works, those of us who have come from States where you don't have major hubs and people traveling between the two cities. We also get to pay double passenger facility charges on every flight, because we have to fly to a hub, then get on. So, we pay it twice.

So, I have—as you can see, I have a lot of irritants about things that we need to work on. I shouldn't shower all that on these two companies, necessarily, but I do say that I'm not a big fan of mergers. And I think it is up to the companies to make the case that this will not inhibit competition, and this will—and that this will, in fact, represent the public interest, because I think the public interest, first and foremost, has to be served here.

The CHAIRMAN. Thank you, Senator Dorgan, very much.

Let me just start out. There's a couple of things at play here. There was such a total split in the testimony. Some were—and, Susan Kurland, I'm going to direct this towards you, and then I may also ask you, Mr. McKenzie—in other words, the union and the passengers said, "This is a total disaster," and nothing within their testimony was anything but negative. And the airlines said

that, “We’re under all of these pressures, small startups, low fares,” and what are they to do?

And what I’d like to ask you is—are two questions. One is, we’re in a totally different economy. To me, talking about the past and mergers is a fair point, as Senator Dorgan made. But, today the economics are so unstable, I, myself, can’t guess when the economy is going to rebound to the extent that—will produce healthy American businesses, much less the airline business, which has had a—you know, a long history of troubles, even in very good times.

So, that’s one question, the economy within which this decision is to be made.

The other is the influence of the low-cost carriers. And I don’t think we really talk about that, that much. I mean, I remember when people were leaving Charleston, West Virginia, and they would drive all the way to Cincinnati, which is a long trip, in order to get on Southwest, until what we discovered, if we’d start advertising our airport as being a good place to go, and you don’t have to pay overnight expenses at motels, and all the rest of it. And actually, then, the airport really is strong. We now have six carriers serving the Charleston Airport.

But, could you comment, one, on the economics of mergers? Are they different today than they were before? I mean, I’ve heard—been with Glenn Tilton at a number of hearings, in both this committee and the Finance Committee, and it’s—there has always been trouble. How is it that you can do these things, run an airline, and have so many fewer people working? On the other hand, here are these low-cost airlines. And I have to assume they’re really eating out the underbelly of a lot of these legacy carriers. And I’d like to get your comments on that. Because I don’t think this should be a black-or-white discussion. There are nuances, here. There are facts that are inconvenient, here.

Please.

Ms. KURLAND. Thank you, Mr. Chairman. As you know, our role is to provide advice and counsel to the Department of Justice in reviewing the merger, and we will be taking a look at the full——

The CHAIRMAN. If you can’t answer the question, tell me, and I’ll go——

Ms. KURLAND. No, no. We——

The CHAIRMAN. —to somebody else.

Ms. KURLAND. I’d like to make some comments.

The CHAIRMAN. OK.

Ms. KURLAND. We will be looking at the full range of competition, as it affects the networks, the small communities, passengers, and the workforce. So, we will be looking at all of that.

In terms of the economic situation in which carriers find themselves these days—I think it has been described by several of the speakers—we’ve got so many drivers in their business plans that seem to fluctuate. One is the fluctuation in fuel prices. Second, carriers have gotten much better over the past few years in managing their capacity—they’ve become much more efficient in that. And whether or not they continue on that road also has an impact. Then, also, this is an industry where demand is volatile.

So, these are some of the drivers that we see. And, thus far, each merger, as it comes—before the Government, we have to take a

look at—as you acknowledge, at where it is at a particular point in time.

With respect to the low-cost carriers, what we've seen, even with the mergers that have occurred, is that low-cost carriers have continued to expand significantly. Over the past 12 years, we've seen that they have been able to almost double their domestic passenger share, and in many more markets, they've been able to discipline prices much more than they were ever able to before.

So, I hope that provides some answer to your questions.

The CHAIRMAN. Some. And I will continue, when my round comes up, with you, Mr. McKenzie.

Mr. MCKENZIE. Yes.

Mr. MCKENZIE. Yes, thank you, Mr.——

The CHAIRMAN. Senator Johanns.

STATEMENT OF HON. MIKE JOHANNS, U.S. SENATOR FROM NEBRASKA

Senator JOHANNS. Thank you, Mr. Chairman.

The CHAIRMAN. This is in order of arrival.

Senator JOHANNS. Thank you very much.

Mr. "Smiss-ick," is it?

Mr. SMISEK. "Smy-zick."

Senator JOHANNS. "Smyzick"—and Mr. Tilton—Mr. Smisek, you went through this, kind of, litany, "This is good for employees, this is good for communities," et cetera, et cetera. Can you guarantee this Committee, either one of you, that no employee will lose their job as a result of this merger? Can you just say that to us?

Mr. SMISEK. No.

Senator JOHANNS. OK.

Mr. SMISEK. And the reason for that is, although this will have very minimal effect on our front-line employees, because we have very complementary routes and we overlap a few—only 15 nonstop domestic markets, and no international markets. In any merger, there are redundant jobs in headquarters, and there will be employees in headquarters, in both Chicago and in Houston, who will lose their jobs as a result of this merger.

Senator JOHANNS. Mr. Tilton, is that your assessment, also?

Mr. TILTON. Well, Senator, there's only one CEO, and this witness is not going to be CEO any longer at the conclusion of the merger, so I couldn't offer that to you.

Senator JOHANNS. Well, and I suspect you'll probably be taken care of quite well.

[Laughter.]

Mr. TILTON. To be perfectly candid, sir, that wasn't your question.

Senator JOHANNS. Well, it's not, but I don't equate your position to somebody who has——

Mr. TILTON. Well——

Senator JOHANNS. —given 20 years to the company and is going to lose their pension.

Mr. TILTON. Well, Senator—well, no. Sir, nobody's going to lose their pension as a result of this merger.

Senator JOHANNS. Can you guarantee me that?

Mr. TILTON. Yes. As a result of this merger, no one is going to lose their pension.

Senator JOHANNS. OK. Can you guarantee me that no community will face service cuts as a result of this merger?

Mr. TILTON. We have already stated that no community will lose service as a result of this merger.

Senator JOHANNS. Mr. Smisek, do you agree with that assessment?

Mr. SMISEK. Yes, I do.

Senator JOHANNS. OK. Competition. You also said that this will be good for competition. But, I must admit, I fail to see how this is going to be good for competition. I tend to be very pro-business, but I fail to see how fewer airlines providing services results in a more competitive atmosphere.

Mr. SMISEK. Sure. Let me answer that question. We compete, at Continental, on a global scale. We are a U.S. airline, but a majority of our capacity is offshore. We are principally a business airline. Although we carry leisure travelers, we cater to business travelers. I think we do a very good job, and we've gotten a very good reputation for service and quality of our product.

We are, however, eking out a hand-to-mouth existence. And the reason for that is, our business travelers are being picked off, one by one, by large carriers with better networks than we can offer them. We are strong on the East Coast, and we have good transatlantic service and good service to Latin America. We're very weak on the West Coast, and we're weak in the Pacific. United is strong on the West Coast and strong in the Pacific. It doesn't have a Latin American route network; similarly, it is weak in New York.

Together, we can offer the business traveler, and the leisure traveler, a broad integrated global network. So, what's happening to us are the Lufthansas of the world and the KLMs of the world—Air France-KLMs of the world—the Deltas of the world, are picking off our business travelers, one by one.

And, in this business, we have thin margins in the best of years. And if you start losing a few business travelers, you start losing money consistently. We lost over a billion dollars since 9/11. We lost $282 million last year. All the good things in life come from profitability. And with a better network, we can offer business travelers that network and improve the mix. Nothing in this merger is predicated in fare increases. Nothing at all. This is improving the business mix. More business travelers on the combined airline, which yields a higher average fare onboard the aircraft, because business travelers pay more, because they're getting an inventory we're holding on until the last minute, because they tend to book at the last minute and want to be able to change their flights. It's very expensive to us to take that risk of that inventory spoiling when the plane takes off without someone in that seat.

So, we—for us, we're going to be much more competitive against the large carriers, but—whether they're U.S. carriers or whether they're foreign carriers—and vis-á-vis the low-cost carriers, this merger will drive, also, some cost efficiencies, which will help us, as well. We won't have duplicative advertising budgets, marketing budgets, sales budgets, corporate overhead, things like that—technology—that also drives from efficiencies, which will help us to con-

tinue to compete against the staggeringly successful low-cost carriers, who will continue, and now have 40 percent of the market share in the U.S.

Senator JOHANNS. Mr. Roach, let me just move down the table, here, and I noticed you were a bit animated when I was asking about people losing their jobs and pensions. And I got the impression that you might want to weigh in on that.

Mr. ROACH. Yes.

Senator JOHANNS. So, I'll wrap up today by giving you an opportunity to state your side of this.

Mr. ROACH. Thank you. And——

The CHAIRMAN. In all of 10 seconds.

[Laughter.]

Mr. ROACH. United and Continental, there's a possibility of a lot of people losing their pensions. United Airlines pensions were terminated in 2005, and just about everybody lost their pensions. We were able to put people on a national multiemployer plan. The Continental flight attendants have a single employer plan. United flight attendants have a defined contribution plan. So, we've been talking to the company about, How do you homogenize these plans? They don't have any answers to that question.

You can't take all the United flight attendants and put them in the single employer Continental plan, because it would cost billions of dollars, and the PBGC just wouldn't allow it. So, it's a big question, and people could lose their pensions. And I've never seen a merger that—and I've been in this business 35 years—where people haven't lost their jobs. And they'll say, "It's not a result of the merger," but people are going to lose their jobs.

Senator JOHANNS. Thank you.

Mr. SMISEK. And their health insurance.

The CHAIRMAN. Thank you.

Senator Hutchison is next. This is just in order of arrival, so don't anybody be offended.

Senator HUTCHISON. I would like to follow up on that, because I was aware of the United pension plan that went away with bankruptcy, but I was one on the front lines fighting for Continental to keep their incredibly good legacy pension plan.

So, Mr. Smisek, how are you going to deal with that issue, as the CEO, with such a difference in the level of pension plans between the two employers?

Mr. SMISEK. First, let me say, unequivocally, that no one—no one—will lose their pension plan as a result of this merger. This merger will result between 1 and 1.2 billion dollars of annual synergies, which will permit us to continue to fund the pension plans and continue to provide secure retirements for our co-workers.

Senator HUTCHISON. Are you going to keep the two separate, then? Are you going to keep the legacy plan that Continental has, and keep the United plan, whatever it is?

Mr. SMISEK. Our co-workers at Continental who have a defined benefit plan will keep their defined benefit plan after the merger. Now, as we negotiate, on a workgroup-by-workgroup basis, with the unions, the unions may choose to negotiate an alternate plan. It may be going into, for example, the IAM multiemployer plan. If

the IAM represents, for example, the flight attendants, it may be different if the AFA represents the flight attendants. The unions first have to—the members have to determine which union they're going to pick to represent them.

Some workgroups may choose to freeze their defined benefit plan, and then, going forward, for the future, for future service credit, have a defined contribution plan. For example, our pilots have done that already; they froze their defined benefit pension plan, they kept all the benefits they had under that, and then, going forward, for their service credit, we made contributions to their defined contribution plan.

Last year, Senator, we lost $282 million at Continental, but we put $283 million into our employees' retirement plans.

Senator HUTCHISON. Mr. Smisek, tell me what the future of Houston is going to be in this merger, both the employee base as well as the hub system.

Mr. SMISEK. Senator, I believe that the future of Houston will be brighter with this merger than it would have been had Continental stood alone, because, as I said earlier, we are eking out a hand-to-mouth existence. And the hub is a very potent hub, very strong hub for us, a good hub, good flows into Latin America. The hub will unaffected by this merger; in fact, I believe will be benefited.

You'll notice that we've announced two new nonstop long-haul routes from Houston—Houston-Auckland and Houston-Lagos—in part, from the future benefits that we expect from the traffic flows from this merger; that gave us the confidence to announce those routes on brand new 787 aircraft next year.

Now, it is true that there are going to be some loss of headquarters jobs in Houston, just as there are going to be losses of headquarters jobs in Chicago. But, that's in any merger, and that's unavoidable. You can't have two CFOs, and you can't have, you know, two general counsels, et cetera. You can't have two CEOs. So, that happens in any merger. And, you know, we will treat people with dignity and respect. We always have. We help people find jobs. We pay people severance. We're a very good employer, and I think that our reputation shows that we show everyone at Continental the dignity and respect that they—that they're—that's appropriate, and we're fair to people, and we will do so in connection with any jobs that are lost in this merger.

Senator HUTCHISON. Do you foresee any changes in your very strong hub to Latin America that would switch to other places? For instance, you've got Houston as very strong to Latin America, but do you see changing routes that would then go through Chicago or Florida?

Mr. SMISEK. No, there—I think there are great traffic flows today through Houston. The merger will just enhance it, if you think—just the north-south flows coming down from Chicago enhancing the traffic flows, plus the larger West Coast presence that we will have to flow from West Coast, through Houston, and down. It will also permit us to have nonstop routes we haven't had before, such as Houston-Auckland and Houston-Lagos, that we've announced, which are, you know, very expensive routes for us to do; those are brand new 787, very expensive aircraft. But, with the combined

traffic flows that we anticipate from this merger, we're confident they'll be successful.

Senator HUTCHISON. The last question in this round is for Mr. McKenzie. We have foreign carriers, clearly, that are subsidized, which have made it very difficult for American carriers to compete effectively. I think that has been part of the problems that American airlines have faced, among others. But, what do you see causing your scenario, where the low-cost carriers are more effective because they have lower costs than the big carriers? What do you see changing, other than gasoline prices, within the industry system, that would cause you concern about the ability for other airlines to be competitive in America?

Mr. MCKENZIE. Historically, the number-one barrier to competition from the low-cost-carrier standpoint has been an operating barrier—access to gates, access to facilities. And so, you know, if I put my consumer hat on, it would simply be more access.

The one thing I'll say, though, is, whereas the industry is in the seventh inning of a transformation, I would say Southwest is probably in the fourth or fifth inning of its ultimate end game. Every airline is secretive of their network plans, if this were a card game, my job as an analyst is to peek behind and see what each airline's hand really is.

And as I look at Southwest's hand, it's in the midst of implementing a new revenue-management system, and it's this new revenue-management system that I foresee, in the next 2 to 4 years, that will allow it to go into the smaller communities.

And so, that's really the next competitive change, if you will, domestically, that will impact the industry.

Senator HUTCHISON. I'd like to pursue that later, but my turn is up.

Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Dorgan.

Senator DORGAN. Ms. Kurland, what's your role here?

Ms. KURLAND. Senator, my role here is to give perspective from the Department of Transportation.

In 1989, the Department of Justice was given the role of decider on antitrust merger cases. The role of the Department of Transportation is to provide analysis and advice to DOJ, using our special aviation expertise. We take a look at the competitive landscape, all the issues that go into that kind of analysis. The Department of Justice also will ask us specific questions, looking for our expertise.

Senator DORGAN. Ms. Kurland, has the Department of Justice turned down any proposed mergers in the last decade that you're aware of?

Ms. KURLAND. I would have to look into that, and I would have to get back to you.

Senator DORGAN. But, you're not aware of any.

The CHAIRMAN. You could take a guess.

Ms. KURLAND. Yes, I'm assuming that they have, in the past decade. But, again, I would have to get back to you.

[The information referred to follows:]

Answer. In October 1998, the Antitrust Division filed suit to block Northwest Airlines from buying a controlling stake in Continental Airlines. They were the fourth-

and fifth-largest U.S. airlines, competing on hundreds of routes across the country, and the proposed acquisition would have substantially diminished their incentives to compete against each other. The Division rejected Northwest's plan to put its Continental stock in a "voting trust" for 6 years as insufficient to prevent the competitive harm likely to result from the acquisition. After trial had begun, Northwest announced it was selling Continental the shares that would have given it control, and would retain only a five-percent share. Because the sale of control back to Continental remedied the competitive harm, the Division dropped its lawsuit.

In July 2001, the Division announced its intent to challenge a merger between United Airlines and US Airways, the second- and sixth-largest airlines, after concluding that the merger would reduce competition, raise fares, and harm consumers on airline routes throughout the United States and on a number of international routes, including giving United a monopoly or duopoly on nonstop service on over 30 routes. The Division concluded that United's proposal to divest assets at Reagan National Airport and American Airlines' promise to fly five routes on a nonstop basis were inadequate to replace the competitive pressure that a carrier like US Airways brings to the marketplace, and would have substituted regulation for competition on key routes. After the Division's announcement, the parties abandoned their merger plans.

Senator DORGAN. Let me—thank you—let me ask the two airline CEOs—you propose to create, by merger, the world's largest airline, right? Will this be the world's largest airline?

Mr. TILTON. Measured in some ways, it will be.

Senator DORGAN. Right. Can you just very quickly—and then I'm going to ask a couple of the other witnesses their observations—very quickly, give me the public-interest case for this being done. Not the interest of your company, but what's—what do you think is the public-interest case to have this happen?

Mr. TILTON. The economic predictability and survivability of a national asset, in the best interest of the country, that can provide, for the public interest, a U.S.-based network carrier as an alternative to robust German carriers, French carriers, Asian carriers, that are already consolidating, and provide them with a U.S.-based employer that will be able to generate wealth in small communities that feed into a successful hub in the United States, Senator, such that the future doesn't evolve so that Southwest carries all of the U.S. passengers to the hubs to be carried abroad by Asian carriers, Latin American carriers, and European carriers.

Senator DORGAN. Mr.—is it "Lee-o-cha"?

Mr. LEOCHA. Yes.

Senator DORGAN. Mr. Leocha, your assessment of that?

Mr. LEOCHA. Well, first of all, when he starts off by talking about economic stability, I think they tried that, years ago, at AT&T, and eventually the Government broke it up. They were very stable, but it wasn't good for consumers.

And when he—when they talk about foreign competition, you have all been involved intimately in the debate over antitrust immunity with foreign airlines. These two CEOs are heading an airline, or heading airlines, which have antitrust immunity—broad antitrust immunity—with Lufthansa and their other partners, and they already operate their system with one central board of directors, like a joint venture. And they have the ability to do that.

So, the merger, right now, is——

Senator DORGAN. Yes, but—I'm sorry to interrupt you, but have the alliances—which is what you're referring to—have the alliances, do you think, been beneficial to the traveling public, or to passengers?

Mr. LEOCHA. I think that the window-dressing on alliances looks beneficial, because they allow you to exchange frequent flyer miles, they allow you to go into the other person's presidents' club, they theoretically give you more seamless service. But, in reality, through what is called "interline arrangements"—there are three different levels of the way airlines work together. There's an interline arrangement, where I can fly on American Airlines and then change over to Continental and then change over to Alitalia, and none of those people work together, but they'll still pass my bags along. And then they have what they call the airline alliances, which is a little bit better. And then they've got what they call the merged airline, which the airlines think is better for them.

But, I think that, you know, they've already got this power. And I just can't see any additional public benefit to this merger.

Senator DORGAN. Thank you.

I want to ask a safety question. Given what we've learned from the Colgan flight, that deep tragedy that occurred in the Colgan flight, and the concerns about, quote, "one level of safety," unquote—I don't believe there is one level of safety, regrettably, at this point. I worry a great deal about that—but, I'd like you to tell me whether, in your carriers now, and with a merged carrier, do you believe you can take action, with respect to the regional carriers, that will guarantee the American public that there's going to be one level of safety, no matter what kind of airplane they board?

Mr. TILTON. So, Senator, you and I have had discussions about this on a number of occasions. At our company, we share safety. So, our safety professionals and the team responsible for our relationship, and the decision as to whether or not to use the services of a particular partner carrier, start with safety, just as many of the alliances do. If you can't pass a safety audit, you are not invited into the Star Alliance. If you can't pass a safety audit, you are not invited to be a regional carrier partner for United Airlines.

In the event that you are, you are then subject to periodic reviews, a commitment on your part that you will accept the best practices that we have at United, where we're very proud of our safety record, and you will be an active participant in the safety council that exists between our two companies.

So, to the maximum extent possible, without actually owning the enterprise, we are confident that we have transparency of safety commitment across the various airlines.

Senator DORGAN. I asked that question—I understand it's a little off topic, and yet related to almost everything that we do—and I ask it because what I know about the Colgan crash—and I know a lot about it; I've held several hearings—is frightening. I mean, what we have learned about what went on in that cockpit is frightening. I don't know whether it's a one-time occurrence or something that is much, much more than that, but I think there are very serious issues. And I think, in many ways, the issues relate to size, because the larger the carrier, the more difficult it is to see down here and to supervise that regional carrier to make sure there is one level of safety.

Mr. TILTON. Can I follow up?

Senator DORGAN. Yes.

Mr. TILTON. You know——

The CHAIRMAN. Senator——

Mr. TILTON. —I should have included this in my response, Senator Dorgan. One thing that I should have mentioned that will be in the public interest with robust network carriers that are American-based is a responsiveness to the safety question that you just posed.

The CHAIRMAN. Senator Lautenberg.

Senator LAUTENBERG. Thanks, Mr. Chairman.

STATEMENT OF HON. FRANK R. LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

And, Senator Dorgan, your comment, before, about the mergers, the consolidation, you've seen the success in the banking industry, as they merged and grew. And it would—— so, how can we object to something like this? Something like this includes lifesaving and passenger attention that's different than any other place.

And, Mr. Chairman, because of the limited time, I'd like to know that the record is going to be kept open for a bit, and that the witnesses are expected to respond in very short order to the questions that are submitted.

The CHAIRMAN. That's correct.

Senator LAUTENBERG. Mr. Smisek, we thank you for the wonderful job that Continental has done, the—its contribution to the economy in New Jersey, and its—the base of employees. And are we satisfied—or, can we be assured that there will not be any loss of jobs in the New Jersey region?

Mr. SMISEK. Senator Lautenberg, as I said earlier, because we overlap so little with United, the impact on front-line employees will be negligible. Our hub at Newark Airport is our crown jewel, along with our hub in Houston. We have a fine hub in Cleveland, as well, and a small hub in Guam. But, the New York traffic flows are significant. The local traffic in New York is significant. It is a—it is one of the world's greatest business markets. We are principally a business airline. We were attractive as a merger partner for United for a number of reasons, among those was our Newark hub.

So, I would anticipate, for Newark, bigger, better, and more.

Senator LAUTENBERG. At least where we are, and a greater number of employees likely in the future.

Mr. SMISEK. Well, with Newark, since it is a constrained airport—a slot-constrained airport—what we will be doing is upgauging the aircraft at Newark, taking out smaller airplanes, putting in larger, long-haul airplanes. And those airplanes typically take more employees to handle than smaller aircraft do.

Senator LAUTENBERG. The—there's so much mystery attached to the economic results with the airlines. And as I was looking at the material before this meeting, it was noted that, in the year 2000, there were 546,000 employees in the industry; 2009 was 386,000, a decline of 160,000 employees. Now, were these people just lolling around? Who were they? Were they the mechanics? Were they lesser-trained pilots or—and substitutions that were working longer hours? What happened in there that can explain that?

Mr. TILTON. So, Senator, it's in the aggregate that those numbers exist, and I suspect that many of them were associated with airlines that no longer are with us.

So, if you have 186 bankruptcies over the period since deregulation, airlines come, airlines go. They certainly have since the year 2000. And with them go jobs. So, as they fail, they take jobs with them.

Senator LAUTENBERG. Well, that—as you know, that's a principal concern with us here. What we're really hearing is that, yes, there will be redundancy, there will be overlap, and people will lose their jobs. That's often the mission of a merger; and that is, cut costs by cutting personnel or cutting wages, whatever.

Mr. TILTON. So, Senator, as—although Mr. Roach has suggested that we're going to have a difficult time fulfilling this commitment, we have, nevertheless, said that there is nothing in this merger that suggests that any front-line employees—just as Jeff said relative to Newark a moment ago—are going to lose their jobs as a result of this merger, but there will be vice presidents, there will be senior vice presidents, there will be CFOs, who will lose their jobs, because we don't need two of them. But, the job loss as a result of this merger will only be minimal.

Senator LAUTENBERG. The salary of Captain Sullenberger, who's become famous for his bravery and skill—his salary was cut 40 percent in recent years—I've talked to him—forcing him to take a second job. A recent forum held by the National Transportation Safety Board found that qualified and experienced airline pilots are going to be in extremely short supply in the future.

Now, how can we expect the type of ability, type of talent needed for a healthy and safe aviation industry, with starting salaries just over $20,000 a year? It's unreasonable to expect that people are going to be attracted to the industry. And if they are, do they bring the skill and the personal balance that's required in the cockpit of an airplane?

Mr. TILTON. Well, Senator Lautenberg, I should have answered this when Senator Dorgan asked his question, too, which is that that's another benefit, I believe, to the public good, that if we can stabilize the financing—the finances of—the financial performance of this industry, we will certainly be a better employer, Senator Lautenberg, than we otherwise could be. And professions associated with the industry, if—to Mr. McKenzie's point—if the industry is profitable, it certainly stands to reason, Senator that the industry will be a better employer than it is today, as it is unprofitable.

Senator LAUTENBERG. Is it possible that airlines can be profitable? I mean, we see oil at a relatively low cost. We see a shrinkage in the services available to the passengers. We see other devices for charging more money, baggage, whether it's a mother-in-law or a particular person who accompanies you, there's an extra fee, or whatever it is. There's a charge for everything.

I was on a flight one day, and water was three bucks. Now, you know, if you need water, you should be able to get it and not have to reach into your pocket.

But, all of these things—is the industry a place—and I ran a big company before I came here—a place where we can expect profits

to emerge without really losing the customer base, or without coming back here again and having a merger?

Mr. SMISEK. Senator, there's no question it's—the airline business is an extremely difficult business, and we're subject to, not only significant variations in our input costs, but significant external shocks that affect demand in a material way.

There are carriers that have done—that have been consistently profitable, such as Southwest Airlines. And there are carriers that have—come and go in this business. This merger will provide us with between 1 and 1.2 billion dollars of net annual synergies. The goal of this merger is to restore us to profitability and to permit us to compete more effectively on the global scale. The—that's the global stage in which we do compete today. That is the goal of any enterprise. We've done a poor job at Continental, since 9/11, of being profitable, having lost over a billion dollars. And my goal here, in working together with United and merging the two companies, is to restore our company to profitability so we can have good careers for our employees, solid retirements, and continue with good service. And making the investments, because we invest a great deal of money in our products, with lie-flat seats and audio-video on demand, and DirecTV and in-seat power ports. This is very expensive stuff that we have and that we invest in to make your travel experience a good one.

Senator LAUTENBERG. Mr.——

The CHAIRMAN. Thank you, Senator.

Senator LAUTENBERG. —Chairman, I thank you. I leave, with one expressed hope, that we do not permit cell phones to be operative in airlines.

Thank you.

The CHAIRMAN. Let me ask Mr. Smisek and Mr. Tilton—I was—I had Byron Dorgan's job, as Chairman of the Aviation Subcommittee, for 10 years before he did, and I've watched a lot happen in the airline industry. And I may have a little bit different view than some of my colleagues here about this. And I've watched—when I came here, there were 25 Class A railroads. There are now four. And that's a whole different subject, and a whole different subject of—set of emotions. But, I do think that airlines genuinely struggle. I don't think that they seek to merge just for the fun of it.

So, I'd like to ask you, each of you, and then I'm going to ask the same question of Mr. McKenzie—Do you think, if you cannot merge, that one or the other of you, or both of you, will go under?

Mr. SMISEK. Mr. Chairman, let me speak first to that.

Continental is a very good airline. We have great customer service, we are well respected in the industry, our customers enjoy flying us, our employees enjoy working at Continental. I think we do as fine a job we can with the network we have. And yet, as I've said before, we are eking out a hand-to-mouth existence. And that's not a future that I want for my co-workers, it's not a future I want for the people who fly Continental, it's not a future I want for the communities we serve. It's not good for this Nation.

This is a merger that we need to do at Continental to secure our future, which is why we're doing it. You're right, nobody merges for the fun of it. They're very difficult to accomplish, very difficult to

integrate the two companies, integrate the two cultures. There's a lot of work ahead of us. But, this is something that we need to do at Continental.

The CHAIRMAN. In other words, the——

Mr. TILTON. So——

The CHAIRMAN. Just a second.

Either you said that it's not a good future, and therefore, there isn't a future, or you said it will continue to be a struggle, and we won't want to be—we won't be able to do all we want to do.

Mr. SMISEK. It will continue to be a daily struggle for as far out as I can see, Senator.

Mr. TILTON. So, Senator, I'd go back to Senator Dorgan's question, and merge it with your own. I'm not using the phrase cleverly.

The benefits to the public, of the company that we seek to create, with so few overlaps and so little concern to the public, is a merger of two companies that, if they were not given the opportunity to do so, would certainly continue to do everything that they could to survive and be relevant, against the backdrop of the industry environment that the Assistant Secretary sketched for us. And I think we would.

To Senator Hutchison's point, Continental was in bankruptcy in 1994, 1995, in a very, very difficult period for that company. So, 15 years ago, they went through what the rest of the network carriers have gone through since 9/11. During that period of time, they built the service culture that the Senator referred to, that the rest of us now aspire to. We'll do that, Senator. At United Airlines, if this merger is denied, we will continue to improve United Airlines, and we'll continue to improve United Airlines, just as our colleagues at Continental did after their painful bankruptcy.

Whether or not the next time, Senators, oil goes to 147—we're both prepared to deal with the eventuality of 147, which was actually $170 jet—neither of us can predict. But, what we can tell you, if we are one company, we're going to be much better prepared to deal with whatever the next shock is, because everybody in this room knows one thing is certain: it's coming. We'll be better prepared to deal with it as one company than either one of us would have been prepared to deal with it as two companies.

The CHAIRMAN. Mr. McKenzie, would you comment on my question, and that is—they both seem to indicate that they could survive, but they couldn't survive with enough confidence to meet the future. And I would tend to agree that the future is going to hold some—I mean, I think 9/11s will happen. There are attempts, constantly. And they're not just from overseas, they're also domestic. I think some of those will succeed. The American public is frightened very easily. And so—or the economics—again, where is our economy going? Is it going to take us 10 years to get back to normal, or 5? I don't know. But, how do you answer the question of, Will they survive? And how do you interpret the word "survive," as they describe it, to be, or not be, in the public interest?

Mr. MCKENZIE. Sure. So, last fall I was forecasting a loss of $400 million for all of 2010 for United. Today, I'm forecasting a profit of roughly $400 million. So, the earnings volatility in the airline industry is perhaps unlike any other industry, and that's simply because of the volatility in crude prices. You have 30 percent of the

costs getting whipped around 50 percent, so that does drive a lot of the earnings volatility.

If I look at what these airlines spent back in—when they were last making money—1998, 1999, 2000, 2001—they were spending about $10- to $15 billion a year on new planes and investing in the business. Today, they're spending a third of that, because they simply have to be—they have to be pinching pennies.

So, looking ahead, I am not forecasting either of these two companies—and, by the way, when you talk about failure, there are actually two forms of failure. There's one, which is Chapter 11, which is a restructuring, and there's—and the other form of failure is Chapter 7, which is liquidation. Neither one of these companies would fail in a Chapter 7 situation. If crude were to go to $147 barrel again, or if we go into a double-dip recession, they would probably have to restructure as standalone carriers.

That's not my forecast today, obviously. I think that both of these—I think the industry makes probably about $4 billion this year, and perhaps, $5- to $6 billion next year. So, we are in the path to recovery. But, it is a recovery that is vulnerable and fragile.

The CHAIRMAN. OK. I—I'm over my time, but I'm going to take my inspiration from Senator Lautenberg, here. One more question.

There's—you can survive—I was president of a private college for 4 years, and what we did is, we deferred nonessential maintenance, because we were constantly struggling to make it. We were always, as they describe it, on the edge, trying to survive. And you can survive, as a college. But, then it comes to a point where the deferred maintenance catches up with you and really bites you because you can't defer it anymore, and then you can't afford to do that. Is that what they're talking about? Or are they talking about being able to survive, even with the so-called deferred maintenance, as applied to the aviation industry?

Mr. MCKENZIE. It's really——

The CHAIRMAN. When you say "buying a third fewer airplanes," things that they generally need to keep up, get ahead.

Mr. MCKENZIE. That's correct. When I—I guess when I talk about "survival," I'm really talking about everything. I'm talking about the ability to reinvest in the business and the product, the way the airlines should be investing in the product, in the business; as well as paying their workgroups, you know, what they need to be paid to run the operation; as well as generating a return for shareholders and for, you know, the people that are actually granting and giving capital to this industry.

The CHAIRMAN. I thank you.

Senator Hutchison.

Senator HUTCHISON. I just wanted to go back, Mr. McKenzie, to better understand what your comment was about Southwest and its ability to compete, and looking at managing its revenue system. What do you mean by that?

Mr. MCKENZIE. Sure. So—and I'll just start out by saying this is speculation on my part, simply because the only people that really know what Southwest's network plans are the senior management team of Southwest Airlines.

But, as I try to analyze and anticipate what they're going to do, the one observation is, the smallest city that Southwest served, his-

torically, has had a population of 220,000 people. Their most recent city that they've gone into—Panama City, Florida—has a population of roughly 150,000 people. And I view that as Southwest sticking its toe in the water with respect to service to small communities. And Southwest essentially has been able to plug in four of its cities into Panama City. And I expect this is a peek into the future of Southwest's network planning. And as Southwest retools—Southwest is a very simple company—single fleet type, single engine type, a very simple operating model—as they become more sophisticated, they will, in turn, have the ability to engage in more sophisticated network opportunities, those being more of these smaller cities.

Senator HUTCHISON. Well, they do serve small cities. Lubbock, Texas; Amarillo, Texas—they are in those cities. But, part of their operating competitive difference has been going to different airports—Chicago Midway instead of O'Hare; Love Field instead of DFW. So, is that an effective competitive potential for keeping, not just Southwest, but other airlines that are not the mega-airlines, also competitive and offering different options to consumers?

Mr. MCKENZIE. Southwest loves markets where fares are $500 to $1,000, because they will go in and charge $200, and make money, hand over fist. And if the fares to small communities—again, once Southwest develops the sophistication to really manage its business to go into more of the smaller markets, I think that those smaller markets really do represent an economic opportunity for the carrier, over time.

Senator HUTCHISON. But, what about alternative airports? I mean, is there another potential business model, and also traveling-public model, to build the smaller satellite airports? For instance, you've got Love Field and Midway, but you also have Orange County. Is that something that would create a more robust market that would keep us from worrying about three or four major carriers all doing the same thing, and all of a sudden everybody's prices are $1,000?

Mr. MCKENZIE. Understood. Today, Southwest really has less need for these alternative airports. And the reason why is because it has so much cash. It can afford to go into markets and lose money for a long time before it actually becomes profitable at that airport. And I'll give you an example—Boston to Philadelphia, where the walk-up fares were $900, today have gotten collapsed. But, these small airports really are a rounding error. For Southwest to go into these smaller airports at some point down the road, the results on their financials really would be a rounding error, because they have so much critical mass elsewhere in the United States.

Senator HUTCHISON. OK. But, they've built up a mass, now, so that they're a player in the fairly big leagues—the next tier down, anyway. But, I'm trying to go beyond just Southwest, and beyond just worrying about the big airlines. Is there, then, a market that has been created that would give consumers options from JetBlue, from other smaller airlines that might be able to grow and create a more diverse and exciting airline economy, so that we don't have to worry about "too big to fail," we don't have to worry about just three airlines dominating, but that we'd see something new coming

up? That's what I'm trying to get to—not just Southwest, but moving on.

Mr. MCKENZIE. Got it. So, if I understand your question correctly, it's really a question about new entrants and the possibility of new entrants——

Senator HUTCHISON. Using the original Southwest model, but, if Southwest is moving on, does that create more capability to use these other airports that create a different type of traveling experience, and give more options, that could also grow?

Mr. MCKENZIE. There are a couple of other smaller low-cost carriers that have been successful, that have very strong growth prospects, and a couple of those airlines are Allegiant Air—it's an airline that has been very small, serves the markets that—where other airlines don't like to compete. So, there are a couple of other examples.

As far as new entrants coming into the industry and offering new services, the barriers to entry are actually quite high now, just simply because—in part, regulations; and in part because of the financial strength of the airlines that exist today that compete.

Senator HUTCHISON. Do either of the two CEOs have any comment on that, that would help us, looking at these mergers in a different light?

Mr. TILTON. I do, Senator. And we have particular experience with it. And we had a very thorough discussion of it at the earlier Senate hearing.

In our larger market of Chicago, Milwaukee is an airport that really, I think, is serving an interesting role. Milwaukee could actually be—because it could serve the northern Chicago suburbs, from a commuting perspective, as effectively as O'Hare—could really be another Midway. And what's happening in Milwaukee today is an intense competitive struggle for service provision in that market by some interesting airlines.

AirTran and Southwest are competing vigorously in that market, and have both announced new service to Milwaukee from their disparate places across the U.S. So, AirTran, obviously, from the Southeast; and Southwest from, clearly, the Southwest.

But, there's also a new entrant in Milwaukee that is a hybrid of various forms here of participation in the industry, and that's Republic. And, as you may know, Republic is, historically, a regional carrier, that is a partner carrier of ours, that has acquired Frontier. It also acquired Midwest. So, in acquiring Midwest, based out of Milwaukee, and acquiring Frontier, based in Denver, it amalgamated a series of different models—business models, as you say, and is now competing with those other two low-cost carriers in Milwaukee.

And if you're in Lake Forest, Illinois, and you used to travel to Midway or you used to travel to O'Hare, you now have a third choice, and obviously a very competitive choice, and you're the beneficiary of intense competition for a market that previously served a smaller overall market and today aspires to serve a bigger one.

Senator HUTCHISON. Thank you.

The CHAIRMAN. Senator Dorgan.

Senator DORGAN. Chairman, thank you very much.

Intense competition is a foreign language to those of us that live in some parts of America. We struggle to get a carrier to serve. But, it's good to hear it exists somewhere.

Let me ask about the issue of regional carriers. I've already asked you about one level of safety, but let me ask, What percent of the passengers that you carry in United and Continental are carried on airplanes with your brand and your colors, but are, in fact, regional carriers? Do you know that—what the percent would be now?

Mr. SMISEK. Let me speak for Continental. We have a number of carriers that serve as regional carriers for us—principally, ExpressJet, which has over 200 aircraft. But, those are small aircraft; those are 50-seat and 37-seat aircraft.

For the last 12 months, 36 percent of Continental customers traveled on one of our branded regional partners. Regional partners include ExpressJet, Chautauqua, CommutAir, Colgan/EWR (CPA),* Colgan/IAH (non-CPA), Gulfstream CLE/FLA (non-CPA), and Cape Air GUM (non-CPA).

Mr. TILTON. So, Senator, I'm sure our number is comparable, and it is less than half. For United, approximately 34 percent of our customers travel on United Express over the last 12 months.

Mr. TILTON. That's only in the domestic market. Obviously, it's going to be a smaller number——

Senator DORGAN. That's right.

Mr. TILTON. Right. If you——

Senator DORGAN. I'm interested in the domestic market. And I'm wondering also, then, if this merger occurs and you become the world's largest airline, what percent of your passenger traffic in the United States, domestically, will be transported by regional carriers? Will it increase or decrease?

Mr. TILTON. Well, the first thing—I'm not sure that either one of us knows that answer, but we'll get it to you.

[The information referred to follows:]

Since we are committed to continuing to serve all of the same cities that we serve today as the combined airline, the percentage of passengers we expect to travel on our regional partners should remain in the same range of approximately 33 to 37 percent.

Mr. TILTON. The first thing we will do is take the two fleets, as you and I have discussed, that we will—because you were interested in, How are the synergies created if you're not going to raise fares?—we'll take the two fleets, and we'll make optimal use of the two fleets, which we can't do now, because they're the sole province of each one of us. So, if I have an aircraft that Jeff can use to better economic purpose in Newark, and it's currently in service in Dulles, then we'll, obviously, make that swap.

The extent to which our narrow-body aircraft—our 319s, 320s, Jeff's 737s and the like—can then be put to service in smaller communities. We may actually be able to put larger aircraft into service in communities that are currently, for us anyway, Senator, 70 seats. And that's really the way that it'll work.

What the markets actually allow us to do there, only, frankly, the fellows that Dan McKenzie was talking about a moment ago,

* CPA represents Capacity Purchase Agreement.

the network planners, will know, when the opportunity presents itself.

But, I—let me make sure I say this. Regional partners for United Airlines, in a merger or no-merger scenario, will continue to play a very, very important role in gathering up traffic for us to take abroad or to take on, obviously, longer flights, because we're not going to fly 319s into those very small communities.

Senator DORGAN. I understand that. And the hub-and-spoke system is critical to those areas, such as North Dakota and other similar States, to be able to be transported into a hub so that we are one stop from anywhere. I understand all that.

When I ask about the "one level of safety," it relates to the question of, How much of the traffic is going to migrate to regional carriers, the 50- and the 32-passenger and other kinds of airplanes? And do we have the capability to fix that which I think is now a problem? I—as I indicated, I don't think there is one level of safety, frankly. If I get on an airplane with the experience in the cockpit that is one-tenth the experience that I would get on a plane, on a 757 that's flying from D.C. to Los Angeles, I don't think it's an equivalency. Now, I'm not suggesting that you have to put those same number-hour pilots in every cockpit, but I am saying that we've had substantial evidence in hearings that there's not one level of safety.

And the other question is—and this doesn't relate to the merger, it relates to whether you merge or not—about the issue of whether there is liability assumed by carriers who then hire a regional to put your brand on their tail. At this point, such liability doesn't exist. I believe it should.

Because if you say, Mr. Tilton—and you've told me this before—we're going to insist on one level of safety, we're going to insist on the training that we expect for our people—then I think the liability ought to be assumed by the carrier.

And this all comes about, Mr. Smisek, because of the Colgan crash, and all that we have learned as a result of that. We've learned plenty, and much of it is very frightening.

And my hope is that—with or without a merger—— that we begin, in a very aggressive way, to plug these holes and fix those issues.

Let me make one other point. The question that Senator Rockefeller asked the two of you really doesn't leave room for much of an answer, I think, with the—with an analyst sitting here, because my guess is, you've got to say the following:

If somebody asks, "How're you doing?" you've got to say, "Great," if he's sitting here.

And, "How do you expect to do, if you merge?"

"Fabulous."

"What if you don't merge? Are you still going to do OK?"

"Absolutely. We're in great shape."

I mean, you've got to say that to—I mean, you couldn't come here, with an analyst sitting there, and give us a tale of woe in order to justify a merger, could you? Not that you've got a tale of woe, because the analyst says you're making money now, which is good.

Mr. SMISEK. No, I am—we're not in great shape at Continental.

Senator DORGAN. But, if the merger——

Mr. SMISEK. We've lost a lot of money. We hope to be able to make money on our own, on standalone basis. That's the goal of any enterprise. We—you know, we have invested in our product. We've been borrowing ever more and more money, and borrowing money to pay the money that we owe to other people. And we know that, to provide a future for our employees and for our customers and for the communities, we need to be profitable, and we need to be consistently profitable. And we believe—my board believes, I believe—that a merger with United Airlines maximizes the chances that we will indeed, not only return to profitability, but be able to sustain that profitability.

Senator DORGAN. Well, you're both serious people, and you, as I indicated earlier, come here representing your interest. There is also a public interest. And the question is, Are they parallel? And I—and, you know, that's the issue, it seems to me. And I think I was—I was suggesting, the other morning, in talking about this, that I won't be here, but perhaps someday there'll be a hearing in which American, having merged with Delta, and the new United-Continental having merged with U.S. Air, will be here to talk about a final merger, and the utmost seamlessness in air travel.

I just—the question is, Where is it too much? I mean, what represents that intersection between serving the public interest and making certain that we have commercial airlines that have the ability to make money out there, serving as much of this country as is possible? And—I mean, I don't know the answer to all that, but I think—again, the question is—the first question I asked, Mr. Tilton, you answered as you saw fit—What is the public interest that relates to this proposition so that——

Mr. TILTON. And I think you asked, Senator, the excellent question, and I've really done my best to answer it. And I've answered it a couple of times, even when——

Senator DORGAN. I understand.

Mr. TILTON. —hadn't asked me.

Senator DORGAN. I was listening.

Mr. ROACH. Well, Senator, I believe that you're 100 percent correct, that—where does it stop? And that's why we say there must be some slight form of reregulation, because US Airways is going to merge with one of the big three, and then somebody—American will be bigger, and then United—the new United will have to merge with Delta to become bigger. Where does it stop? And, you know, when you talk about Southwest Airlines making money, they pay the highest wages in the industry, they pay 100 percent medical costs, they do, as Senator Hutchison said, fly into a niche market and places where maybe these guys don't want to go. In addition to that, they compete on service. You see, they compete on service. People get on Southwest Airlines and compete on service. But, they're not going to get on Southwest Airlines to go to Paris. And so, there's a big difference in what happens at Southwest Airlines.

And just one other point. They manage the business. You know, when fuel was $150—when there was—$150 a barrel, they were managing that cost. So, there's a big, significant difference in matching Southwest Airlines with Continental and United, or the

new Continental-United. And, you know, we represent—just so you know, we represent one-third of the employees on Southwest Airlines, so we do have some insight as to what's happening over there, contrary to what others may think.

Senator DORGAN. I thank you very much. Southwest did look like geniuses as that price of oil went way, way up, and then, on the other side of that transaction, they weren't so happy.

But, at any rate, you—look, all of us want the same thing; we want a good commercial air system, in this country, that is able to be financially successful, but that treats people in a way that gives them the competitive pricing and differentiated service, that gives them choices.

So, Mr. Chairman, thank you for your patience.

The CHAIRMAN. No, thank you.

I tend to ask, at hearings of this sort, West Virginia—specifically, Yeager Airport, at Charlestown, is not going to be affected. But, I've discussed that with both of you. And everybody's very satisfied, back at the airport, that it's not going to be affected, so I so stipulate.

I just—I want to end by asking Mr. Roach—let's say the merger is turned down. How does that help the public interest and consumers?

Mr. ROACH. Well, as I indicated in my testimony, Senator—or, Mr. Chairman—is, we are looking for the information to find that out. And I believe somebody said it's up to them to make the case. They haven't made the case to us. And we're not looking at collective bargaining agreements, we're looking about the survivability of the carrier. And so, we've asked for certain information about the survivability of the carrier, the business plan. We want to see both carriers survive, either combined or separate, because, without the carrier, there are no jobs. But, we need information to make that decision.

The CHAIRMAN. Well, that is a point.

Mr. ROACH. Right. And we need information to make that decision, if they're going to survive.

The CHAIRMAN. Well,——

Mr. ROACH. And that's what we've asked for, and there's——

The CHAIRMAN. —you're telling me you're coming here and testifying before a very important hearing and saying that you need information, and you don't have an opinion as to what would happen if they didn't merge——

Mr. ROACH. Well——

The CHAIRMAN. —and stood on their own, and struggled on their own, and whatever would happen to them then, and therefore——

Mr. ROACH. Well——

The CHAIRMAN. —to your employees.

Mr. ROACH. I have a—I have an opinion. First of all, we want to make an informed decision about this particular merger. I was of the opinion—and after discussions with several people, including Secretary LaHood, in a very public discussion—that these alliances, that they were getting antitrust immunity for, was the avenue—and that's what they've previously testified to—that this was the avenue to survivability. And so, now that has changed. Now it's a merger that has survivability. But, last year, and 2 years ago,

when we were challenging the alliances—so these alliances have created a simulated merger. I mean, they've moved together at airports, they have the alliances—they're all in the same Star Alliance. And so, there is a question as to whether or not this is in the best interest of the public, or whether Continental, that has a certain culture and has been doing things a certain way, would be better off by itself. And the same thing—there are two different cultures. This is big stuff, because these are two different cultures that have to be meshed together, and it's going to take 3 to 5 years to at least get that done. And what happens in the interim period, when everybody's trying to do that?

So, I don't want to rush to judgment. And so, that's why we've asked for the information. Because we were going down one track, based on the information we've had previously—alliances, give them antitrust immunity, and this was all good. Now that's changed. And so, my opinion is, we need to make sure that this doesn't become one airline, or two airlines, and there is no competition, and we're still not making any money.

The CHAIRMAN. OK. I'm not sure I understood that. Maybe you, sir, would wish to comment on what would happen——

VOICE. Sure.

The CHAIRMAN. No, no, I'm talking to Mr. Leocha—if the merger were denied. What is the benefit to passengers if they are living hand-to-mouth? And I've been at this a while, and I know pretty well what their struggles are. They've—that's all exacerbated now by the economy and uncertainty, generally, domestically and in the world. But, what's—what would make—why would you be pleased if this merger did not take place?

Mr. LEOCHA. I thank that, in terms of competition, we have an airline system that, right now, operates all of its pricing structure based on signaling to each other. And in the old days, we had six airlines, and there were six chances that one of the airlines would say, "Nope, I'm not going to raise the price," and it would come down.

Now we're down to five airlines, and now we're going to be down to four, soon. And every time you do that, what we end up with, it becomes—it's an order of magnitude of less competition. So, we don't have the competition between the different airlines.

I think that the airlines today—if you look at a big chart, and you take all the airlines, and you lay them out, the smaller the airline, the more money they're making; the bigger the airline, the more money they're losing. And so, it sort of gives you a logical look and say, "Well, maybe big isn't better."

And so, these two airlines can survive. Continental certainly can survive on its own without merging with anyone else. They'll come up with a new method. They may use their Houston hub to become a great international port and serve as a feeder airline for other—you know, other people coming in and out of Houston. These are the things that they can do.

And we need to keep competition in the system. And I'm not saying that—you know, I'm not wishing them to fail because I don't like them, personally. I like—you know, I've met everybody, I like everybody, personally. But, from a consumer point of view—and

it's—the more people that are competing for the consumers' good, the better for the consumer.

But, also, from the other side, when you look at small businesses at the big major hub airlines—or hub airports—they're going to have a much tougher job when they go to negotiate with this big, giant airline, because they're not going to be able to—there's not going to be two or three caterers left. The caterers are going to be stuck having to grow, themselves. They're going to have to remerge to then work with the larger airlines.

The unions have the same problem, because they're trying—they're going to have to pull their people together.

So, we're eliminating competition, not only from the consumer point of view, we're eliminating competition from the small business point of view surrounding the airlines. We're removing competition from the union point of view, in terms of competing for wages. And it goes all the way down the line.

So, competition is what the United States has been built on. And, unfortunately, the Department of Transportation, over the past years, has decided that less competition, in order to make life better for the airlines, is the route that we should take. However, that has been at the expense of the consumers. And right now, yes, there are economic problems. And so, in a short-term solution, we're giving them less competition, but, in the long run, we're going to be hurting the consumers, and we're going to end up with an oligopoly and a small group of people controlling international and the local prices. And where we have low-cost airlines competing with them, that's—in a small part of the market—that will tend to dampen down those prices, but only in specific areas.

So, I'm not wishing them bad just, you know, as a whim, to say, "I don't like it." I think that, historically, it points to nothing good for the consumers in—that we've learned. And when we look at every past airline merger—Republic and Northwest, the—TWA and American, even Delta and Northwest—there are problems. There are major customer service problems right now, to this day. And what I do every day, I write about travel, I study travel. We get letter after letter from people having problems with the larger airlines, as they merge, because there are problems in mergers.

So, it's not all milk and honey. There are real problems, and I think that the consumer is going to end up with the short end of the stick, even though it might sound good, from a money point of view, from the big airlines.

And I'm really happy that you, you know, gave me the opportunity, because I just hear money, money, money, business, business, business, but it's only at one side. One you drop down to the small business level, the small business guy is taking it in the shorts, and the consumer is going to take it in the pocketbook.

The CHAIRMAN. Just quickly, Senator Hutchison, do you have a question? Because I'm just going to ask——

Senator HUTCHISON. No.

The CHAIRMAN. —I'm going to ask the two chief executives to——

Mr. TILTON. So, I——

The CHAIRMAN. —respond to what you've heard.

Mr. TILTON.—I think one thing that everybody in the industry knows is that everybody that is a part of the collateral economy of

this industry makes money. Jeff and I covet the margins of all of our suppliers, all of our providers, all of our airports, all of the retailers on the concourses. They all do very well. They all know that they do very well. All of the avionics companies.

The entity that doesn't do well in this business is the entity that we're talking about right now. I've done my best to address the questions, which have been excellent, with respect to why I think this is in the public good. And the short answer here is, bankruptcies are not in the public interest.

The CHAIRMAN. Mr. Smisek?

Mr. SMISEK. Senator, I don't even know where to begin, but I'll keep it short.

This is a brutally competitive industry. This industry is competitive today. It will be brutally competitive after we merge. We will have substantial and significant competition on all of our overlap routes after this merger. We have substantial competition on our routes today, that are nonoverlap routes.

We have—this is—there are—actually, I would disagree with Mr. McKenzie—there are low barriers to entry in this business, and there are high barriers to exit. They—we tend to restructure, we don't tend to go out of business.

And, as a result, there is a constant overcapacity, which leads to lower and lower fares, which is very good for consumers, without question, but, for us charging in amounts for our business that are below our costs, it's not a good way to make money, over the long run.

This—we do not set prices; the market sets prices. We can't set prices before this merger, we won't be able to set prices after this merger. This is clearly a competitive—it has only gotten more competitive over time, as low-cost carriers have entered into hubs. We have low-cost competition in all of our hubs, as does United Airlines. And those carriers continue to grow and be successful, because they have new employees, they have lower wages, they have brand new equipment, they have no pensions, or low pension costs, they have low healthcare costs, because they have young employees. And we have to compete against those lower costs.

This is an opportunity for us to be able to save costs through efficiencies, to generate additional revenues from the complementarity of our routes and the greater network that we can offer business travelers, and have a chance to make money.

And that, I think, is good for competition. It's good for us to be able to invest in our product and provide good, high-quality services, to provide improved wages and benefits for our employees.

So, I very much believe that this merger is in the public good, and I very much believe this does not lessen competition.

The CHAIRMAN. I thank you for that. I, again, just say that I tend to agree with you, perhaps departing from some of my colleagues' views on this.

One thing I wanted to do before closing this hearing, Mr. McKenzie, is to restore your reputation. It's good with me, but Senator Dorgan, who's one of the best members of this Committee and a superb Senator, indicated that the two chief executives couldn't answer because you were there. And I think—maybe I actually

want to bring your reputation down a little bit—I don't think you're that terrifying——

[Laughter.]

The CHAIRMAN. —and that the word "analyst," I don't think they were quivering at your being here. So, I just want to put that in perspective, because I found that awkward, somehow.

Mr. SMISEK. Mr. Chairman, excuse me, could I make one technical thing? We've provided the Committee with letters of support from around the country, and also from Texas, and I would ask, with your permission, they be entered into the record.

The CHAIRMAN. Everything.

Mr. SMISEK. Thank you.

[The information referred to follows:]

Letters from the following communities and organizations in support of the United-Continental merger are retained in Committee files:

State of West Virginia
Raleigh County (WV) Memorial Airport
City of Beckley, WV
Beckley-Raleigh County (WV) Chamber of Commerce
City of Fort Walton Beach, FL
City of Key West, FL
Greater Miami Chamber of Commerce
City of Orlando, FL
City of Pensacola, FL
City of Waco, TX
City of Victoria, TX
City of Tyler, TX
Tyler, Texas Area Chamber of Commerce
City of Midland, TX
City of Lubbock, TX
City of Laredo, TX
Greater Killeen (TX) Chamber of Commerce
City of Corpus Christi, TX
City of College Station, TX
Brownsville (TX) Chamber of Commerce
City of Amarillo, TX
Amarillo (TX) Chamber of Commerce
City of Minot, ND
Minot International Airport

The CHAIRMAN. The hearing is adjourned, and I thank all of you for your patience on this important matter.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. JOHN THUNE, U.S. SENATOR FROM SOUTH DAKOTA

Thank you, Mr. Chairman. And I want to thank you for holding this hearing. I think this is an important discussion to have not only with respect to the merger in front of us, which is awfully important to those of us who represent States that are going to be most impacted by this, but I think generally speaking the entire aviation industry.

As I noted when this Committee held a hearing regarding the Delta/Northwest merger roughly 2 years ago, I suspected that we would see more mergers. That being said, in light of the current economic environment, I can understand why United and Continental want to do this. It, in many respects, becomes a matter of survival in the airline business today. But there are many of us who are very concerned about the future of the industry, the impacts of this merger and potential mergers in the future—particularly when it comes to the rural states that many of us represent.

But I guess my greatest concern has to do with service and cost issues, particularly with regard to smaller communities in the network. I have witnessed first-hand the changes that have occurred as a result of the Northwest/Delta merger and I can tell my colleagues that despite assurances to continue to provide "service" to rural states—that doesn't mean that frequencies will stay the same or that aircraft won't be downsized, or that the same level of customer service will exist. Ultimately these scheduling and aircraft changes result in higher costs and less options for the leisure and business travelers that fly to and from South Dakota and other cities across the country.

So, I certainly understand why United and Continental want to merge from a business standpoint. I understand the necessity of trying to find some synergies and that many of United and Continental's routes don't overlap, but expand or create opportunities for consumers to have access to new destinations—both domestic and overseas.

However, less competition is never good from a consumer's perspective and I have concerns both in the short-term and also looking long-term about what additional merges mean to the strength of our domestic aviation sector, and our economy as a whole.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF SUSAN FLEMING, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to provide a statement for the record on the potential implications of the merger proposal recently announced by United Air Lines (United) and Continental Airlines (Continental). Earlier this month, these two airlines announced plans for United to merge with Continental through a stock swap the airlines valued at $8 billion. This follows the acquisition of Northwest Airlines (Northwest) by Delta Air Lines (Delta) in 2008, which propelled Delta to become the largest airline in the United States. The United-Continental merger, if not challenged by the Department of Justice (DOJ), would surpass Delta's in scope to create the largest passenger airline in terms of capacity in the United States. However, as with any proposed merger of this magnitude, this one will be carefully examined by DOJ to determine if its potential benefits for consumers outweigh the potential negative effects.

Extensive research and the experience of millions of Americans underscore the benefits that have flowed to most consumers from the 1978 deregulation of the airline industry, including dramatic reductions in fares and expansion of service. These benefits are largely attributable to increased competition from the entry of new airlines into the industry and established airlines into new markets. At the same time,

however, airline deregulation has not benefited everyone; some communities—especially smaller communities—have suffered from relatively high airfares and a loss of service. We have been analyzing aviation competition issues since the enactment of the Airline Deregulation Act of 1978.[1] Our work over the last decade has focused on the challenges to competition and industry performance, including the financial health of the airline industry, the growth of low-cost airlines, changing business models of airlines, and prior mergers.[2] In the airline context, DOJ has the primary responsibility to evaluate most mergers in order to carry out its antitrust responsibilities.[3] In its review, DOJ considers a number of factors, including increases in market concentration; potential adverse effects on competition; the likelihood of new entry in affected markets and possible counteraction of anticompetitive effects that the merger may have posed; verified "merger specific" efficiencies or other competitive benefits; and whether, absent the merger, one of the airlines is likely to fail and its assets exit the market.

This statement presents: (1) an overview of the factors that are driving mergers in the airline industry, (2) the role of Federal authorities in reviewing merger proposals, and (3) key issues associated with the proposed merger of United and Continental. This statement is based on two previously issued reports—our 2008 report for this Committee on airline mergers and our 2009 report on the financial condition of the airline industry and the various effects of the industry's contraction on passengers and communities[4]—as well as our other past work on aviation issues. In addition, we conducted some analysis of the proposed United and Continental merger, including analysis of the airlines' financial, labor, fleet, and market conditions.

To identify the factors that help drive mergers in the airline industry, we relied on information developed for our 2008 and 2009 reports on the airline industry, updated as necessary. To describe the role of Federal authorities, in particular DOJ and the Department of Transportation (DOT), in reviewing airline merger proposals we relied on information developed for our 2008 report, also updated as necessary.[5] To identify the key issues associated with the proposed merger of United and Continental, we reviewed airline merger documents and financial analyst reports and analyzed data submitted by the airlines to DOT (Bureau of Transportation Statistics financial Form 41, origin and destination ticket, and operations data). We also analyzed airline schedule data. We assessed the reliability of these data by: (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report. We conducted this audit work in May 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

On May 3, 2010, United and Continental announced an agreement to merge the two airlines. The new airline would retain the United name and headquarters in Chicago while the current Continental Chief Executive Officer would keep that title with the new airline. The proposed merger will be financed exclusively through an all-stock transaction with a combined equity value of $8 billion split roughly with 55 percent ownership to United shareholders and 45 percent to Continental shareholders. The airlines have not announced specific plans for changes in their networks or operations that would occur if the proposed merger is not challenged by DOJ.

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[1] Pub. L. No. 95–504, 92 Stat. 1705.

[2] A list of related GAO products is attached to this statement.

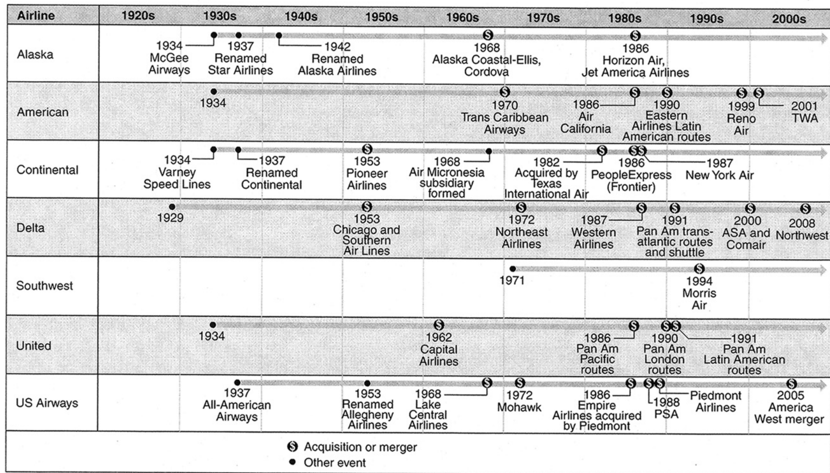
[3] Under the Hart-Scott-Rodino Act, an acquisition of voting securities and/or assets above a set monetary amount must be reported to DOJ (or the Federal Trade Commission for certain industries) so the department can determine whether the merger or acquisition poses any antitrust concerns. 15 U.S.C. § 18a(d)(1). Both DOJ and the Federal Trade Commission have antitrust enforcement authority, including reviewing proposed mergers and acquisitions. DOJ is the antitrust enforcement authority charged with reviewing proposed mergers and acquisitions in the airline industry.

[4] GAO, *Airline Industry: Potential Mergers and Acquisitions Driven by Financial and Competitive Pressures*, GAO–08–845 (Washington, D.C.: July 31, 2008); and *Commercial Aviation: Airline Industry Contraction Due to Volatile Fuel Prices and Falling Demand Affects Airports, Passengers, and Federal Government Revenues*, GAO–09–393 (Washington, D.C.: Apr. 21, 2009).

[5] GAO–08–845.

The airline industry has experienced considerable merger and acquisition activity since its early years, especially immediately following deregulation in 1978 (fig. 1 provides a timeline of mergers and acquisitions for the seven largest surviving airlines). A flurry of mergers and acquisitions during the 1980s, when Delta Air Lines and Western Airlines merged, United Airlines acquired Pan Am's Pacific routes, Northwest acquired Republic Airlines, and American Airlines and Air California merged. In 1988, merger and acquisition review authority was transferred from the Department of Transportation (DOT) to DOJ. Since 1998, despite tumultuous financial periods, fewer mergers and acquisitions have occurred. In 2001, American Airlines acquired the bankrupt airline TWA, in 2005 America West acquired US Airways while the latter was in bankruptcy, and, in October 2008, Delta acquired Northwest. Certain other attempts at merging in the last decade failed because of opposition from DOJ or from employees and creditors. For example, in 2000, an agreement was reached that allowed Northwest to acquire a 50 percent stake in Continental (with limited voting power) to resolve the antitrust suit brought by DOJ against Northwest's proposed acquisition of a controlling interest in Continental.[6] A proposed merger of United Airlines and US Airways in 2000 also resulted in opposition from DOJ, which found that, in its view, the merger would violate antitrust laws by reducing competition, increasing air fares, and harming consumers on airline routes throughout the United States. Although DOJ expressed its intent to sue to block the transaction, the parties abandoned the transaction before a suit was filed. More recently, the 2006 proposed merger of US Airways and Delta fell apart because of opposition from Delta's pilots and some of its creditors, as well as its senior management.

Figure 1: Highlights of Domestic Airline Mergers and Acquisitions



Sources: Cathay Financial and airline company documents.

Since deregulation in 1978, the financial stability of the airline industry has become a considerable concern for the Federal Government owing, in part, to the level of financial assistance it has provided to the industry by assuming terminated pension plans and other forms of assistance. Between 1978 and 2008, there have been over 160 airline bankruptcies. While most of these bankruptcies affected small airlines that were eventually liquidated, 4 of the more recent bankruptcies (Delta, Northwest, United, and US Airways) are among the largest corporate bankruptcies ever, excluding financial services firms. During these bankruptcies, United and US Airways terminated their pension plans and $9.7 billion in claims was shifted to the Pension Benefit Guarantee Corporation (PGBC).[7] Furthermore, to respond to the

[6] GAO, *Aviation Competition: Issues Related to the Proposed United Airlines-US Airways Merger*, GAO–01–212 (Washington, D.C.: Dec. 15, 2000) p. 10, footnote 6.

[7] PBGC was established under the Employee Retirement Income Security Act of 1974 (ERISA) and set forth standards and requirements that apply to defined benefit plans. PBGC was established to encourage the continuation and maintenance of voluntary private pension plans and

Continued

shock to the industry from the September 11, 2001, terrorist attacks, the Federal Government provided airlines with $7.4 billion in direct assistance and authorized $1.6 billion (of $10 billion available) in loan guarantees to six airlines.[8]

Although the airline industry has experienced numerous mergers and bankruptcies since deregulation, growth of existing airlines and the entry of new airlines have contributed to a steady increase in capacity, as measured by available seat miles. Previously, we reported that although one airline may reduce capacity or leave the market, capacity returns relatively quickly.[9] Likewise, while past mergers and acquisitions have, at least in part, sought to reduce capacity, any resulting declines in industry capacity have been short-lived, as existing airlines have expanded or new airlines have expanded. Capacity growth has slowed or declined just before and during recessions, but not as a result of large airline liquidations.

Airline Mergers Are Driven by Financial and Competitive Pressures, but Challenges Exist

Volatile earnings and structural changes in the industry have spurred some airlines to explore mergers as a way to increase their profitability and financial viability. Over the last decade, the U.S. passenger airline industry has incurred more than $15 billion in operating losses. Several major airlines went through bankruptcy to reduce their costs and restructure their operations, while others ceased to operate or were acquired. Most recently, U.S. airlines responded to volatile fuel prices and then a weakening economy by cutting their capacity, reducing their fleets and work forces, and instituting new fees, but even with these actions, the airlines experienced over $5 billion in operating losses in 2008 before posting an operating profit of about $1 billion in 2009.[10] Furthermore, over the last decade, airfares have generally declined (in real terms), owing largely to the increased presence of low-cost airlines, such as Southwest Airlines, in more markets and the shrinking dominance of a single airline in many markets.

One of the primary financial benefits that airlines consider when merging with another airline is the cost reduction that may result from combining complementary assets, eliminating duplicative activities, and reducing capacity. A merger or acquisition could enable the combined airline to reduce or eliminate duplicative operating costs, such as duplicative service, labor, and operations costs—including inefficient (or redundant) hubs or routes—or to achieve operational efficiencies by integrating computer systems and similar airline fleets. Other cost savings may stem from facility consolidation, procurement savings, and working capital and balance sheet restructuring, such as renegotiating aircraft leases. Airlines may also pursue mergers or acquisitions to more efficiently manage capacity—both to reduce operating costs and to generate revenue—in their networks. Given recent economic pressures, particularly increased fuel costs, the opportunity to lower costs by reducing redundant capacity may be especially appealing to airlines seeking to merge. Experts have said that industry mergers and acquisitions could lay the foundation for more rational capacity reductions in highly competitive domestic markets and could help mitigate the significant impact that economic cycles have historically had on airline cashflow.

The other primary financial benefit that airlines consider with mergers and acquisitions is the potential for increased revenues through additional demand, which may be achieved by more seamless travel to more destinations and increased market share and higher fares on some routes.

- *Increased demand from an expanded network*: An airline may seek to merge with or acquire an airline as a way to generate greater revenues from an expanded network, which serves more city-pair markets and better serves pas-

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to insure the benefits of workers and retirees in defined benefit plans should plan sponsors fail to pay benefits. PGBC operations are financed, for example, by insurance premiums paid by sponsors of defined benefit plans, investment income, assets from pension plans trusted by PBGC, and recoveries from the companies formerly responsible for the plans.

[8] The six airlines receiving loan guarantees were Aloha, World, Frontier, US Airways, ATA, and America West.

[9] GAO, *Commercial Aviation: Bankruptcy and Pensions Problems Are Symptoms of Underlying Structural Issues*, GAO–05–945 (Washington, D.C.: Sept. 30, 2005).

[10] Collectively, U.S. airlines reduced domestic capacity, as measured by the number of seats flown, by about 12 percent from the fourth quarter of 2007 to the fourth quarter of 2009. As we reported in April 2009, to reduce capacity, airlines reduced the overall number of active aircraft in their fleets by eliminating mostly older, less fuel-efficient, and smaller (50 or fewer seats) aircraft. Airlines also collectively reduced their work forces by about 38,000 full-time-equivalent positions, or about 9 percent, from the first quarter of 2008 to the first quarter of 2010. In addition to reducing capacity, most airlines instituted new fees, such as those for checked baggage, which resulted in $3.9 billion in added revenue during 2008 and 2009.

sengers. Mergers and acquisitions may generate additional demand by providing consumers more domestic and international city-pair destinations. Airlines with expansive domestic and international networks and frequent flier benefits particularly appeal to business traffic, especially corporate accounts. Results from a recent Business Traveler Coalition (BTC) survey indicate that about 53 percent of the respondents were likely to choose a particular airline based on the extent of its route network.[11] Therefore, airlines may use a merger or acquisition to enhance their networks and gain complementary routes, potentially giving the combined airline a stronger platform from which to compete in highly profitable markets.

- *Increased market share and higher fares on some routes*: Capacity reductions in certain markets after a merger could also serve to generate additional revenue through increased fares on some routes. Some studies of airline mergers and acquisitions during the 1980s showed that prices were higher on some routes from the airline's hubs soon after the combination was completed.[12] Several studies have also shown that increased airline dominance at an airport results in increased fare premiums, in part because of competitive barriers to entry.[13] At the same time, though, even if the combined airline is able to increase prices in some markets, the increase may be transitory if other airlines enter the markets with sufficient presence to counteract the price increase. In an empirical study of airline mergers and acquisitions up to 1992, Winston and Morrison suggest that being able to raise prices or stifle competition does not play a large role in airlines' merger and acquisition decisions.[14]

Cost reductions and the opportunity to obtain increased revenue could bolster a merged airline's financial condition, enabling the airline to better compete in a highly competitive international environment. Many industry experts believe that the United States will need larger, more economically stable airlines to be able to compete with the merging and larger foreign airlines that are emerging in the global economy. The airline industry is becoming increasingly global; for example, the Open Skies agreement between the United States and the European Union became effective in March 2008.[15]

Despite these benefits, there are several potential barriers to successfully consummating a merger. The most significant operational challenges involve the integration of work forces, aircraft fleets, and information technology systems and processes, which can be difficult, disruptive, and costly as the airlines integrate.[16]

- *Workforce integration*: Workforce integration is often particularly challenging and expensive and involves negotiation of new labor contracts. Labor groups—including pilots, flight attendants, and mechanics—may be able to demand concessions from the merging airlines during these negotiations, several experts explained, because labor support would likely be required for a merger or acquisition to be successful. Some experts also note that labor has often opposed mergers, fearing employment or salary reductions. Obtaining agreement from each airline's pilots' union on an integrated pilot seniority list—which determines pi-

[11] Respondents were travel managers responsible for negotiating and managing their firms' corporate accounts.

[12] See Severin Borenstein, "Airline Mergers, Airport Dominance, and Market Power," *American Economic Review*, Vol. 80, May 1990, and Steven A. Morrison, "Airline Mergers: A Longer View," *Journal of Transport Economics and Policy*, September 1996; and Gregory J. Werden, Andrew J. Joskow, and Richard L. Johnson, "The Effects of Mergers on Price and Output: Two Case Studies from the Airline Industry," *Managerial and Decision Economics*, Vol. 12, October 1991.

[13] See Severin Borenstein, 1989, "Hubs and High Fares: Dominance and Market Power in the U.S. Airline Industry," *RAND Journal of Economics*, 20, 344–365; GAO, *Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Markets*, GAO/RCED–97–4 (Washington, D.C.: Oct. 18, 1996); GAO, *Airline Competition: Effects of Airline and Market Concentration and Barriers to Entry on Airfares*, GAO/RCED–91–101 (Washington, D.C.: Apr. 16, 1991).

[14] See Steven A. Morrison, and Clifford Winston, "The Remaining Role for Government Policy in the Deregulated Airline Industry." *Deregulation of Network Industries: What's Next?* Sam Peltzman and Clifford Winston, eds. Washington, D.C., Brookings Institution Press, 2000 pp. 1–40.

[15] Open Skies seeks to enable greater access of U.S. airlines to Europe, including expanded rights to pick up traffic in one country in Europe and carry it to another European or third country (referred to as fifth freedom rights). Additionally, the United States will expand EU airlines' rights to carry traffic from the United States to other countries.

[16] Airlines also face potential challenges to mergers and acquisitions from DOJ's antitrust review, which is discussed in the next section.

lots' salaries, as well as what equipment they can fly—may be particularly difficult. According to some experts, as a result of these labor integration issues and the challenges of merging two work cultures, airline mergers have generally been unsuccessful. For example, although the 2005 America West-US Airways merger has been termed a successful merger by many industry observers, labor disagreements over employee seniority, and especially pilot seniority, are not fully resolved. More recently, labor integration issues derailed merger talks—albeit temporarily—between Northwest and Delta in early 2008, when the airlines' labor unions were unable to agree on pilot seniority list integration. Furthermore, the existence of distinct corporate cultures can influence whether two firms will be able to merge their operations successfully. For example, merger discussions between United and US Airways broke down in 1995 because the employee-owners of United feared that the airlines' corporate cultures would clash.

- *Fleet integration*: The integration of two disparate aircraft fleets may also be costly. Combining two fleets may increase costs associated with pilot training, maintenance, and spare parts. These costs may, however, be reduced after the merger by phasing out certain types of aircraft from the fleet mix. Pioneered by Southwest Airlines and copied by other low-cost airlines, simplified fleets have enabled airlines to lower costs by streamlining maintenance operations and reducing training times. If an airline can establish a simplified fleet, or "fleet commonality"—particularly by achieving an efficient scale in a particular aircraft—then many of the cost efficiencies of a merger or acquisition may be set in motion by facilitating pilot training, crew scheduling, maintenance integration, and inventory rationalization.
- *Information technology integration*: Finally, integrating information technology processes and systems can also be problematic and time-consuming after a merger. For example, officials at US Airways told us that while some cost reductions were achieved within 3 to 6 months of its merger with America West, the integration of information technology processes took nearly 2½ years. Systems integration issues are increasingly daunting as airlines attempt to integrate a complex mix of modern in-house systems, dated mainframe systems, and outsourced information technology. The US Airways-America West merger highlighted the potential challenges associated with combining reservation systems, as there were initial integration problems.

The Department of Justice's Antitrust Review Is a Critical Step in the Airline Merger and Acquisition Process

DOJ's review of airline mergers and acquisitions is a key step for airlines hoping to consummate a merger. For airlines, as with other industries, DOJ uses an analytical framework set forth in the *Horizontal Merger Guidelines* (the Guidelines) to evaluate merger proposals.[17] In addition, DOT plays an advisory role for DOJ and, if the combination is consummated, may conduct financial and safety reviews of the combined entity under its regulatory authority.

Most proposed airline mergers or acquisitions must be reviewed by DOJ as required by the Hart-Scott-Rodino Act. In particular, under the act, an acquisition of voting securities or assets above a set monetary amount must be reported to DOJ (or the Federal Trade Commission (FTC) for certain industries) so the department can determine whether the merger or acquisition poses any antitrust concerns.[18] To analyze whether a proposed merger or acquisition raises antitrust concerns—wheth-

[17] The Guidelines were jointly developed by DOJ's Antitrust Division and the Federal Trade Commission and describe the inquiry process the two agencies follow in analyzing proposed mergers. The most current version of the Guidelines was issued in 1992; Section 4, relating to efficiencies, was revised in 1997. DOJ has proposed some changes in the Guidelines to better reflect its merger review process and the public comment period on these changes has been extended to June 4, 2010.

[18] See 15 U.S.C. § 18a(d)(1). Both DOJ and FTC have antitrust enforcement authority, including reviewing proposed mergers and acquisitions. DOJ is the antitrust enforcement authority charged with reviewing proposed mergers and acquisitions in the airline industry. Additionally, under the Hart-Scott-Rodino Act, DOJ has 30 days after the initial filing to notify companies that intend to merge whether DOJ requires additional information for its review. If DOJ does not request additional information, the firms can close their deal (15 U.S.C. § 18a(b)). If more information is required, however, the initial 30-day waiting period is followed by a second 30-day period, which starts to run after both companies have provided the requested information. Companies often attempt to resolve DOJ competitive concerns, if possible, before the second waiting period expires. Any restructuring of a transaction—*e.g.,* through a divestiture—is included in a consent decree entered by a court, unless the competitive problem is unilaterally fixed by the parties before the waiting period expires (called a "fix-it first").

er the proposal will create or enhance market power or facilitate its exercise[19]—DOJ follows an integrated five-part analytical process set forth in the Guidelines.[20] First, DOJ defines the relevant product and geographic markets in which the companies operate and determines whether the merger is likely to significantly increase concentration in those markets. Second, DOJ examines potential adverse competitive effects of the merger, such as whether the merged entity will be able to charge higher prices or restrict output for the product or service it sells. Third, DOJ considers whether other competitors are likely to enter the affected markets and whether they would counteract any potential anticompetitive effects that the merger might have posed. Fourth, DOJ examines the verified "merger specific" efficiencies or other competitive benefits that may be generated by the merger and that cannot be obtained through any other means. Fifth, DOJ considers whether, absent the merger or acquisition, one of the firms is likely to fail, causing its assets to exit the market. The commentary to the Guidelines makes clear that DOJ does not apply the Guidelines as a step-by-step progression, but rather as an integrated approach in deciding whether the proposed merger or acquisition would create antitrust concerns.

In deciding whether the proposed merger is likely anticompetitive DOJ considers the particular circumstances of the merger as it relates to the Guidelines' five-part inquiry. The greater the potential anticompetitive effects, the greater must be the offsetting verifiable efficiencies for DOJ to clear a merger. However, according to the Guidelines, efficiencies almost never justify a merger if it would create a monopoly or near monopoly. If DOJ concludes that a merged airline threatens to deprive consumers of the benefits of competitive air service, then it will seek injunctive relief in a court proceeding to block the merger from being consummated. In some cases, the parties may agree to modify the proposal to address anticompetitive concerns identified by DOJ—for example, selling airport assets or giving up slots at congested airports—in which case DOJ ordinarily files a complaint with the court along with a consent decree that embodies the agreed-upon changes.

DOT conducts its own analyses of airline mergers and acquisitions. While DOJ is responsible for upholding antitrust laws, DOT conducts its own competitive analysis and provide it to DOJ in an advisory capacity. DOT reviews the merits of any airline merger or acquisition and submits its views and relevant information in its possession to DOJ. DOT also provides some essential data that DOJ uses in its review. In addition, presuming the merger moves forward after DOJ review, DOT can undertake several other reviews if the situation warrants. Before commencing operations, any new, acquired, or merged airlines must obtain separate authorizations from DOT—"economic" authority from the Office of the Secretary and "safety" authority from the Federal Aviation Administration (FAA). The Office of the Secretary is responsible for deciding whether applicants are fit, willing, and able to perform the service or provide transportation. To make this decision, the Secretary assesses whether the applicants have the managerial competence, disposition to comply with regulations, and financial resources necessary to operate a new airline. FAA is responsible for certifying that the aircraft and operations conform to the safety standards prescribed by the Administrator—for instance, that the applicants' manuals, aircraft, facilities, and personnel meet Federal safety standards. Also, if a merger or other corporate transaction involves the transfer of international route authority, DOT is responsible for assessing and approving all transfers to ensure that they are consistent with the public interest.[21]

In Creating the Largest U.S. Passenger Airline, a United-Continental Merger May Face Integration Challenges and Analysis of Some Overlapping Markets

If not challenged by DOJ, the merged United-Continental would surpass Delta as the largest U.S. passenger airline. As table 1 indicates, combining United and Continental Airlines would create the largest U.S. airline based on 2009 capacity as measured by available seat miles, and a close second based on total assets and operating revenue. The combined airline would also have the largest workforce among U.S. airlines based on March 2010 employment statistics, with a combined 76,900 employees as measured by full-time-equivalent employees (table 2). The airlines'

[19] Market power is the ability to maintain prices profitably above competitive levels for a significant period of time.

[20] United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (Washington, D.C., rev. Apr. 8, 1997).

[21] 49 U.S.C. § 41105. DOT must specifically consider the transfer of certificate authority's impact on the financial viability of the parties to the transaction and on the trade position of the United States in the international air transportation market, as well as on competition in the domestic airline industry.

work forces are represented by various unions, and in some cases the same union represents similar employee groups, such as the union for the pilots (table 3). Finally, the combined airline would need to integrate 692 aircraft (table 4). The two airlines share some of the same aircraft types, which could make integration easier.

Table 1.—Total Assets, Operating Revenue, and Capacity of Major U.S. Airlines (2009)

	Capacity as measured by available seat miles (thousands)	Total assets	Total operating revenue
United-Continental	217,166,074	$125,742,402	$28,720,624
Delta	197,701,800	195,546,148	28,909,882
American	151,772,113	89,629,364	19,898,245
Southwest	98,170,797	55,190,553	10,350,338
US Airways	70,721,007	28,901,241	10,780,838
AirTran	23,304,612	8,649,482	2,341,442
Alaska	23,148,960	18,045,385	3,005,999

Source: GAO analysis of Bureau of Transportation Statistics Form 41 data.

Table 2.—Full-Time-Equivalent Employees of Top U.S. Airlines (March 2010)

Rank	Airline	Total full-time-equivalent employees (thousands)
1	Delta	74.7
2	American[a]	75.2
3	United	43.7
4	Southwest	34.6
5	Continental	33.2
6	US Airways	29.5
7	JetBlue	11.2
8	Alaska	9.2

Source: GAO analysis of Bureau of Transportation Statistics data.
[a] Includes American Eagle.

Table 3.—Union Representation for Various Employee Groups

		Employee groups			
	Pilots	Flight attendants	Mechanics	Public contact, ramp and stores, and other workers	Dispatchers
United	Air Line Pilots Association (ALPA)	Association of Flight Attendants (AFA)	International Brotherhood of Teamsters (IBT)	International Association of Machinists (IAM)	Professional Airline Flight Control Association (PAFCA)

	Pilots	Flight attendants	Mechanics	Fleet service	Ticket agents	Dispatchers
Continental	ALPA	IAM	IBT	IBT	Nonunion	Transport Workers Union (TWU)

Source: United Air Lines and Continental Airlines.
Note: In addition, The International Federation of Professional and Technical Engineers (IFPTE) represent more than 260 United engineers and related employees.

Table 4.—United and Continental Aircraft Fleet

Aircraft	United	Continental	Merged
Boeing 737		226	226
Boeing 747	24		24
Boeing 757	96	61	157
Boeing 767	35	26	61
Boeing 777	52	20	72
Airbus 319/320	152		152
Total	*359*	*333*	*692*

Source: United Air Lines.

If not challenged by DOJ, the airlines would attempt to combine two distinct networks, United with major hubs, where the airline connects traffic feeding from smaller airports, in San Francisco (SFO), Los Angeles (LAX), Denver (DEN), Chicago O'Hare (ORD), and Washington DC Dulles (IAD) and Continental with hubs in Houston Intercontinental (IAH), Cleveland (CLE), Guam (GUM), and New York Newark (EWR), as shown in figure 2.

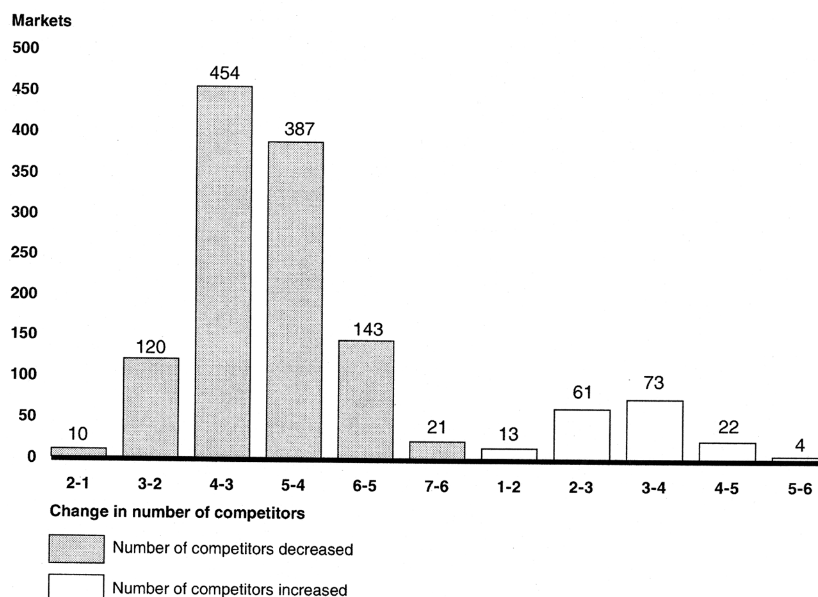
Figure 2: United and Continental Domestic Route Maps (May 2010)

Source: agpDat, Diio LLC.

The amount of overlap in airport-pair combinations between the two airlines' networks is considerable if considering all connecting traffic; however, for most of the overlapping airport-pair markets there is at least one other competitor. Based on 2009 ticket sample data, for 13,515 airport pairs with at least 520 passengers per

year, there would be a loss of one effective competitor in 1,135 airport-pair markets[22] affecting almost 35 million passengers by merging these airlines (see fig. 3).[23] However, only 10 of these airport-pair markets would not have any other competitors in it after a merger. In addition, any effect on fares would be dampened by the presence of a low-cost airline in 431 of the 1,135 airport pairs losing a competitor.[24] The combination of the two airlines would also create a new effective competitor in 173 airport-pair markets affecting almost 9.5 million passengers.

Figure 3: Change in Effective Competition from United-Continental Combination (2009)



Source: GAO Analysis of DOT Origin and Destination Ticket Data.
Note: All origin and destination airport pairs with at least 520 passengers. A competitor holds at least 5 percent of market share.

In examining nonstop overlapping airport pairs between United and Continental, the extent of overlap is less than for connecting traffic. However, the loss of a competitor in these nonstop markets is also more significant because nonstop service is typically preferred by some passengers. For example, based on January 2010 traffic data, the two airlines overlap on 12 nonstop airport-pair routes, which are listed in figure 4.[25] For 7 of these 12 nonstop overlapping airport-pair routes (generally between a United hub and a Continental hub), there are currently no other competitors. However, of these 7 airport-pair markets, all but the Cleveland-Denver market may have relevant competition between other airports in at least one of the endpoint cities. For example, passengers traveling from San Francisco (SFO) to Newark

[22] It is generally preferable, time permitting, to assess city-pair, rather than airport-pair, changes in competition. Some larger U.S. cities (New York, Chicago, Los Angeles, Washington, D.C.) have more than one commercial airport that can compete for passenger traffic. DOJ generally considers the relevant market to be a city-pair combination.

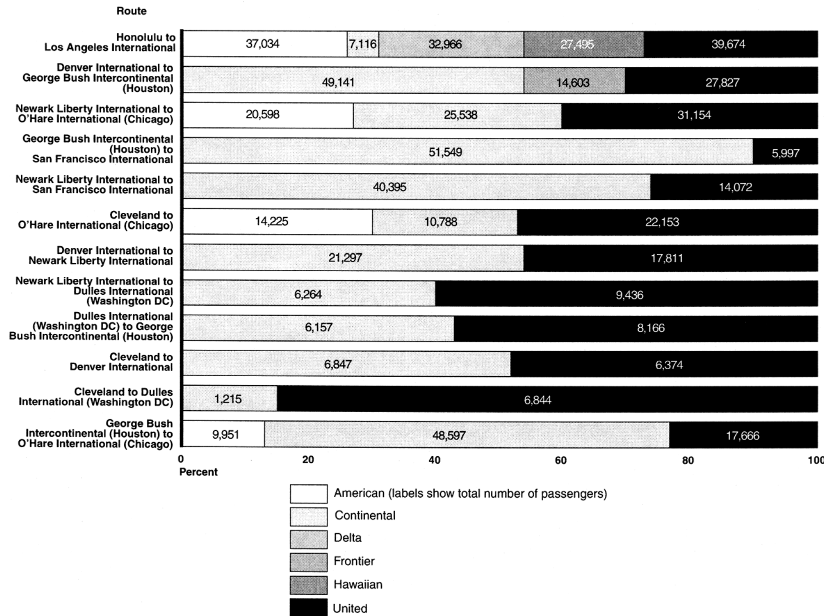
[23] For this airport-pair analysis, we considered any airport-pair market with less than 520 annual passengers to be too small to ensure accuracy. We defined an effective competitor as having at least 5 percent of total airport-pair traffic. This is the same minimum market share that we have previously applied to assess whether an airline has sufficient presence in a market to affect competition. See GAO–08–845, p. 21 and 42.

[24] We defined low-cost airlines as JetBlue, Frontier/Midwest, AirTran, Allegiant, Spirit, Sun Country, and Southwest.

[25] In March 2010, Continental initiated nonstop service between Los Angeles (LAX) and Kahului Airport (OGG) in Hawaii, which is also served by United. This compares to 12 nonstop overlaps (7 highly concentrated) in the Delta-Northwest merger.

(EWR) could consider airlines serving other airports at both endpoints—Oakland or San Jose instead of SFO and John F. Kennedy (JFK) or LaGuardia instead of EWR.

Figure 4: Total Passengers on Overlapping Nonstop Airport Pairs (January 2010)



Source: DOT T–100 data.

If not challenged by DOJ, the combined airline could be expected to rationalize its network over time, including where it maintains hubs. Currently, the two airlines do not have much market share that overlaps at their respective hubs (see table 5). However, it is uncertain whether the combined airline would retain eight domestic hubs. There is considerable overlap between markets served by United out of Chicago (ORD) and Continental out of Cleveland (CLE). For example, 52 out of 62 domestic airports served by Continental from Cleveland are also served by United from Chicago (ORD).

Table 5.—Passenger Market Share at Hub Airports (2009)

Continental hub airports	Continental share (%)	United hub airports	United share (%)	Total (%)
Houston (IAH)	72		5	77
Newark (EWR)	68		5	73
Cleveland (CLE)	53		6	59
	1	Washington Dulles (IAD)	51	52
	4	Chicago (ORD)	38	42
	6	San Francisco (SFO)	33	39
	4	Denver (DEN)	29	33
	6	Los Angeles (LAX)	17	23

Source: GAO analysis of DOT Origin and Destination ticket data.

Both United and Continental have extensive worldwide networks and serve many international destinations. Between the two airlines, over 100 international cities are served from the United States. The two airlines do not directly compete on a city-to-city route basis for any international destinations. Nevertheless, for inter-

national routes, airlines aggregate traffic from many domestic locations at a hub airport where passengers transfer onto international flights. In other words, at Newark, where Continental has a large hub, passengers traveling from many locations across the United States onto Continental's international flights. Likewise, United aggregates domestic traffic at its Washington Dulles hub for many of its international flights. Hence, a passenger traveling from, for example Nashville, may view these alternative routes to a location in Europe as substitutable. Continental and United serve many of the same international destinations in Europe and the Americas from their Newark and Dulles hubs, respectively. These destinations include Amsterdam, Brussels, Frankfort, London, Montreal, Paris, Rome, Sao Paulo, and Toronto. Similarly, both airlines also serve many international destinations from their Midwest hubs—most notably United's hub at Chicago and Continental's hub at Houston. Such destinations include: Amsterdam, Cancun, Edmonton, London, Paris, San Jose Cabo, Tokyo, and Vancouver. In total, according to current schedules, they serve 30 common international destinations, representing 65 percent of their total international seat capacity. Whether service to international destinations from different domestic hubs will be viewed as a competitive concern will likely depend on a host of factors, such as the two airlines' market share of traffic to that destination and whether there are any barriers to new airlines entering or existing airlines expanding service at the international destination airports.

To compete internationally, both Continental and United are part of the Star Alliance, one of the three major international airline alliances.[26] In 2009, Continental left the SkyTeam Alliance and joined the Star Alliance. As part of joining this alliance, the Star Alliance members, including Continental, applied for antitrust immunity, which allows the member airlines to coordinate schedules, capacity, and pricing in selected markets. DOT has authority to approve these antitrust immunity applications,[27] but DOJ may also comment if it has antitrust concerns. On June 26, DOJ filed comments that objected to immunity for the alliance in some markets and requested some conditions, called carve-outs, in which the immunity would not be granted. On July 10, 2009, DOT approved the Star Alliance application for antitrust immunity but with special conditions, including carve-outs.[28] Among the markets not granted immunity were New York-Copenhagen, New York-Lisbon, New York-Geneva, New York-Stockholm, Cleveland-Toronto, Houston-Calgary, Houston-Toronto, New York-Ottawa, and U.S.-Beijing.[29]

Related GAO Products

Airline Industry: Airline Industry Contraction Due to Volatile Fuel Prices and Falling Demand Affects Airports, Passengers, and Federal Government Revenues. GAO–09–393. Washington, D.C.: April 21, 2009.

Airline Industry: Potential Mergers and Acquisitions Driven by Financial Competitive Pressures. GAO–08–845. Washington, D.C.: July 31, 2008.

Commercial Aviation: Bankruptcy and Pension Problems Are Symptoms of Underlying Structural Issues. GAO–05–945. Washington, D.C.: September 30, 2005.

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Commercial Aviation: Legacy Airlines Must Further Reduce Costs to Restore Profitability. GAO–04–836. Washington, D.C.: August 11, 2004.

Transatlantic Aviation: Effects of Easing Restrictions on U.S.-European Markets. GAO–04–835. Washington, D.C.: July 21, 2004.

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[26] An airline alliance is an agreement between two or more airlines to cooperate on a substantial level. The three largest passenger airline alliances are the *Star Alliance*, *SkyTeam* and *Oneworld*. Alliances provide a network of connectivity and convenience for international passengers. Alliances also provide a marketing brand to passengers making interairline code-share connections within countries.

[27] 49 U.S.C. §§ 41308, 41309.

[28] Department of Transportation, Joint Application of Air Canada, *et al.,* Final Order, to Amend Order 2007–2–16 under 49 U.S.C. §§ 41308, 41309, DOT–OST–2008–0234 (July 10, 2009).

[29] In addition, the order modified and placed conditions on pre-existing carve outs for this alliance.

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PREPARED STATEMENT OF DAVID CUSH, PRESIDENT AND CEO, VIRGIN AMERICA INC.

Thank you, Chairman Rockefeller, Ranking Member Hutchison, and other distinguished members of the Committee, for the opportunity to present this written testimony. My name is David Cush and I am the President and CEO of Virgin America Inc., a new, California-based low-fare airline which began operations in August 2007. Currently, Virgin America serves San Francisco (SFO), Los Angeles (LAX), New York (JFK), Washington, D.C. (IAD), Seattle (SEA), Las Vegas (LAS), San Diego (SAN), Boston (BOS) and Fort Lauderdale (FLL). On June 23, 2010, we will inaugurate service to Toronto Canada (YYZ) and, in the fourth quarter of 2010, Orlando (MCO).

Virgin America employs more than 1,500 full-time aviation professionals throughout the United States, and presently operates a fuel efficient fleet of 28 Airbus A320 family aircraft, with plans to operate a fleet of up to 44 aircraft by next year. In less than 4 years since its launch, Virgin America has captured a host of travel industry best-in-class awards, including "Best Domestic Airline" by *Condé Nast Traveler* for two consecutive years and "Best Domestic Airline" in *Travel & Leisure World's Best Awards* for two consecutive years.

The proposed merger between United and Continental would create the world's largest airline by most measures. This combination presents several important public policy issues including, most particularly, its effect on competition. How consumers ultimately fare after such a merger will largely depend on the ability of those airlines remaining in the marketplace to compete effectively with the merged entity. Among the issues that will determine whether other airlines will be able to provide an effective competitive alternative are access to: (1) those airports where the combined entity will have a significant presence and (2) corporate travelers who the merged airline, with significantly increased capacity and an enhanced route network, will pursue more aggressively through corporate discount agreements.

Airport Access

Turning initially to airport access, market entry by low-fare airlines is an essential component for airline competition and the key to sustained growth in the industry. Beginning with the Department of Transportation's (DOT) groundbreaking 1993 report on the "Southwest Effect,"[1] several studies have documented the power of low-fare airlines to stimulate aggressive price competition and dramatically increase total passenger enplanements after entering a market. Moreover, low-fare airlines have a proven track record of creating jobs while their legacy network peers have shed positions. According to the latest DOT data, the number of full-time employees at low-fare airlines grew by more than 14 percent between 2006 and 2010, while the number of full-time employees at network legacy airlines shrank by more than 4 percent.[2]

Nevertheless, the competitive benefits of low-fare market entry are limited at a number of airports because of slot controls and difficulties securing gates. Although lack of access to airport terminal facilities may prove difficult, it can usually be overcome. The inability to secure scarce slots and gates, on the other hand, acts as an absolute barrier to entry that prevents low-fare airlines from providing more choices and lower prices to consumers. This is especially the case at several New York area airports and, in Virgin America's own experience, Chicago's O'Hare International Airport.

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[1] U.S. Department of Transportation, *The Airline Deregulation Evolution Continues: The Southwest Effect* (1993), available at *http://ostpxweb.dot.gov/aviation/domesticaffairs.htm*.

[2] U.S. Department of Transportation, Bureau of Transportation Statistics, *March 2010 Passenger Airline Employment Down 3.8 Percent from March 2009* (May 18, 2010), available at *http://www.bts.gov/press_releases/2010/bts024_10/pdf/bts024_10.pdf*.

By way of background, the Federal Aviation Administration (FAA) has long utilized a system of slots to manage congestion and delays at airports where demand at peak travel times significantly exceeds airport capacity. However, as set forth in the High Density Rule (the mechanism by which the FAA historically allocated and administered slots), it was well settled that "slots do not represent a property right but represent an operating privilege subject to absolute FAA control . . ." 14 CFR § 93.223(a).

The High Density Rule used to be in effect but was eventually rescinded at each of the three major New York area airports—JFK, Newark and LaGuardia. Between 2006 and 2008 however, following overscheduling by airlines and extensive delays, the DOT/FAA issued a number of orders re-imposing a system of caps and slots at each of these airports, limiting the number of hourly operations and preventing airlines from adding new flights during peak periods. These controls continue in place today, even though they were imposed as a short-term solution to mitigate delays and congestion, with the initial allocation of slots based on historic operations at each airport. Consequently, the incumbent airlines at these airports have had their large slot bases "grandfathered," while new entrants and limited incumbents are now limited to whatever relatively low capacity levels they were providing during the base period used for the initial allocation of slots. Market shares at New York area airports are, therefore, concentrated among only a handful of airlines.

For example, at Newark, one airline—Continental—accounts for more than 70 percent of all passenger enplanements and controls most of the terminal space and gates at that airport.[3] Similarly, at JFK, three airlines—Delta, JetBlue, and American—account for nearly 66 percent of all passenger enplanements;[4] and at nearby LaGuardia, three airlines—Delta, American, and US Airways—control about 70 percent of all passenger enplanements.[5] This concentration of a few airlines dominating the U.S.'s largest airline market is a direct result of the system of slot controls.

Even before the DOT/FAA imposed the current system of slot controls at New York area airports, one airline, JetBlue, received—at no cost—75 slot exemptions for use at JFK during the controlled period (3 p.m.–8 p.m.) when the High Density Rule was in effect at that airport. It was only after receiving these slot exemptions in 1999 that JetBlue was able to very quickly buildup its JFK operations. Although the High Density Rule was eventually terminated at JFK, the slots that were "grandfathered" to JetBlue at JFK in 2008 included JetBlue's historic operation of these 75 slot exemptions. More recently, JetBlue reached a deal to trade 12 slots to American in return for slots at Washington's Reagan National—effectively monetizing the windfall that JetBlue was awarded in 1999 and controlling its competition at JFK. In a similar fashion, Continental last year acquired all 10 of AirTran's slots at Newark (where Continental was and continues to be the dominant airline) in return for four slots at LaGuardia and six slots at Reagan National. As with the example of JetBlue at JFK, the Newark slots that AirTran traded to Continental did not have any value to the participants until the Federal Government recently created them. However, given that slots are a scarce commodity allocated free-of-charge by the Federal Government, an airline that did not incur any costs when it initially received the underlying slots in the first instance, such as JetBlue at JFK and AirTran at Newark, should not now be permitted to trade the slots in order to receive a financial benefit, *i.e.,* "free" access to airports such as Reagan National, which continues to be subject to the High Density Rule and where access is generally only available through purchases made under the Buy/Sell rule[6] or Congressionally-created exemptions from slot controls.

Meanwhile, at Chicago's O'Hare International Airport, only two airlines—American and United—now account for nearly 80 percent of passenger enplanements.[7] Although slot controls at that airport were lifted in 2008 following the opening of a new runway, new entrants have effectively been shut out of the airport because of the shortage of gates. This barrier has been exacerbated by the unwillingness of American and United to relinquish gates to competitors. Indeed, Virgin America's long-standing interest in starting service at Chicago's O'Hare International Airport has been repeatedly blocked by our inability to obtain access to gates at the airport.

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[3] Port Authority of New York & New Jersey, *Newark March 2010 Traffic Report,* available at *http://www.panynj.gov/airports/general-information.html*.

[4] Port Authority of New York & New Jersey, *JFK March 2010 Traffic Report,* available at *http://www.panynj.gov/airports/general-information.html*.

[5] Port Authority of New York & New Jersey, *LaGuardia March 2010 Traffic Report,* available at *http://www.panynj.gov/airports/general-information.html*.

[6] The Buy/Sell Rule is codified at 14 CFR § 91.221.

[7] U.S. Department of Transportation, Bureau of Transportation Statistics, *Airport Snapshots,* February 2010, available at *http://www.transtats.bts.gov/airports.asp*.

By holding long term leases to valuable gates, the incumbents have reduced the supply of O'Hare gates, and are thereby able to pick and choose their competition.

Unfortunately, given existing slot controls in the New York area, Virgin America has not been able to grow its New York service above the level provided when the airline launched operations there in 2007. Similarly, Virgin America has effectively been shut out of Chicago's O'Hare International Airport for the reasons discussed above.

Airport access is further hampered by scheduling practices by large incumbents. As the FAA Administrator, J. Randolph Babbitt, recently noted,[8] the Federal Government has been forced to resort to the use of "blunt tools" such as operational caps, restrictions, and rules to counter delays caused by aggressive industry overscheduling, whereby airlines compress an unrealistically large number of flights into a relatively short time window. In particular, Administrator Babbitt identified Atlanta, Chicago, and San Francisco as cities where airline scheduling behavior has increased delays. The large incumbent airlines that individually operate hundreds of daily flights at these airports should, quite properly, be required to adjust their schedules before the situation becomes so dire that the Federal Government is left with no other choice than to impose operational limitations. Indeed, this was precisely the behavior that prompted the DOT/FAA to reintroduce caps and slots at the New York area airports between 2006 and 2008—a capacity management system which grandfathered the majority of slots to large incumbents that were already entrenched at those airports while simultaneously erecting an insurmountable barrier of entry to new service by low-fare airlines—all to the detriment of consumers.

Where Virgin America has launched service, the consumer benefits have been measurable and dramatic. For example, JFK—San Francisco, JFK—LAX, and Washington Dulles—San Francisco average fares have all fallen by nearly one-third since Virgin America entered those markets. Moreover, LAX-Boston fares have dropped 29 percent since Virgin America entered the market. Similarly, Washington Dulles—LAX and San Francisco—Boston average fares have both fallen 23 percent since Virgin America began competing in those markets.[9]

As the Congress considers U.S. airline consolidation and the overall state of competition in the industry, great care must be taken to ensure that low-fare carriers are provided meaningful opportunities to compete with entrenched legacy airlines at capacity-controlled airports. Moreover, the Federal Government, acting through the Transportation and Justice Departments, needs to continue to keep pressure on the airports to assure that new entrants and smaller incumbents can provide competition to the well-entrenched incumbents which, in a very real sense, can effectively restrict access to these airports through their control of gates.

At bottom, the Federal Government not only has the authority, but the responsibility, to take steps to enhance the level of competition at airports subject to operating limitations or gate shortages. Many studies have been completed since the 1980s detailing the serious competitive problems that exist at slot-controlled airports in the United States. The findings of these studies are still true today, in particular the fact that the secondary market at slot-controlled airport is so limited that it has not resulted in any significant market entry by new entrants or expansion by limited incumbents. Indeed, as the Government Accountability Office, the investigative arm of the Congress, warned as far back as 1996, "[C]ontrol of slots by a few airlines greatly deters entry at key airports in . . . New York and Washington."[10] Policies that cultivate and enhance low-fare competition are necessary to ensure that the objectives of the Airline Deregulation Act of 1978 are realized, particularly as the industry becomes increasingly consolidated. That statute requires, among other things, that the Federal Government consider, as being in the public interest, policies that place maximum reliance on airline competition as well as provide opportunities for new entrant airlines.

Given the increased market consolidation that will result from the proposed merger, the Federal Government must begin to address the serious access problems at the New York area airports and Chicago's O'Hare International Airport. The Federal Government must now begin to develop, through a carefully constructed rulemaking, a new pro-competitive allocation system that will be used going forward at these and other airports where demand for access significantly exceeds capacity. The current stop-gap measures employed thus far—the short-term administrative allocation of slots based on historic airport operations—have not fostered new com-

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[8] Remarks of J. Randolph Babbitt, "NextGen is Happening," Aviation Week and Space Technology NextGen Forum (May 20, 2010).

[9] U.S. Origin and Destination Survey via APGDat, *www.apgdat.com*.

[10] GAO, *Airline Deregulation: Barriers to Entry Continue in Several Key Domestic Markets*, GAO/RCED 97–4 (Oct. 1996).

petition. To the contrary, such measures have conferred a tremendous advantage upon entrenched incumbents at the affected airports. These entrenched incumbents are inclined to hoard their slot holdings rather than see such slots relinquished to competitors, thereby allowing them to control service and fares.

The reality is that all of the ideas and issues concerning the allocation of slots at capacity-controlled airports have been on the table for the better part of 25 years. During this time, industry consolidation has increased and serious access problems have persisted at capacity-controlled airports. As a consequence, the Federal Government must develop a market-based solution to determine the most efficient allocation of slots to airlines that are eager to launch or expand service at capacity-controlled airports. Indeed, a variety of mechanisms are available to the Federal Government, including auctions and peak period pricing to more appropriately align demand with capacity. If indeed auctions are utilized, all slots at the affected airport should be available for bid, not just a small fraction, to avoid conferring an unfair competitive advantage on entrenched incumbent airlines at the airports. On the other hand, a mere extension of the orders limiting operations at the New York area airports and reliance on the status quo at O'Hare International Airport without any mechanisms to ensure meaningful access for new entrants and limited incumbents is contrary to the pro-competitive objectives of the Airline Deregulation Act and will be harmful to consumers in the long run. In any event, the Federal Government must resolve the issue of new entrant and limited incumbent access at capacity-controlled airports through the development and implementation of a market-based solution before approving any further slot swaps or industry consolidation.

Corporate Discount Agreements

Another area of competitive concern that may arise from increased consolidation is the enhanced ability of the merged airline to use the terms and conditions of corporate discount agreements to increase market share vis-à-vis its competitors, particularly new entrants that have not yet been able to develop similarly extensive route networks.

By way of background, a corporate discount agreement is an arrangement by which an airline grants discounts to businesses with significant amounts of travel in markets served by that airline. In return for the discounts, the agreements require the businesses to meet predetermined monthly goals for travel on that airline. The amount of the discount and the required travel levels reflect the relative leverage of the airline and the business in these markets, and provide the airline with an opportunity to pursue competitive goals in the markets covered by the agreement.

These agreements may permit the merged airline to increase market power and increase market share by means of such agreements in at least three ways. First, an airline could use a dominant position in a domestic market as leverage to increase market share in other more competitive domestic markets at the expense of other competitors who lack the airline's market power in the market dominated. Second, a similar situation could arise when an airline dominates an international market that is important to corporate customers, and uses that leverage to increase market share in other more competitive domestic markets against competitors that don't enjoy domination of such an international market. In each of these two instances, consolidation exacerbates the competitive situation by significantly increasing the opportunities in which the merged airline can increase market share by means of the leverage provided by these agreements.

In a third instance, an airline may structure an agreement such that the level of discount increases as the company's use of the airline on a particular route increase. In these situations, the competitive impact is most significant on routes where the services provided by the merging airlines overlap or where access in a particular market is restricted.

In short, these corporate discount agreements are very powerful in the hands of a legacy airline with an extensive route network. Their power is significantly enhanced as legacy airlines merge with one another and operate more capacity on any given route leaving fewer airlines to compete across large networks. As a result, the merged legacy airlines will increase their market power to capture greater market shares at the expense of new entrants with much smaller networks. To the extent that the merged airline can, by use of these agreements, increase market share significantly in one or more markets at the expense of other airlines, consumers can be harmed if the loss of market shares by these other airlines compromises the ability of competitors to effectively compete against the merged airline.

Virgin America appreciates the opportunity to provide this testimony and would be pleased to respond to any questions the Committee may have concerning these matters.

PREPARED STATEMENT OF PATRICIA A. FRIEND, INTERNATIONAL PRESIDENT, ASSOCIATION OF FLIGHT ATTENDANTS CWA, AFL–CIO

Thank you for holding this vital and timely hearing on the proposed merger of United and Continental Airlines. My name is Patricia Friend and I am the International President of the Association of Flight Attendants—CWA, AFL–CIO (AFA–CWA). AFA–CWA represents over 50,000 flight attendants at 22 U.S. airlines and is the largest flight attendant union in the world. We especially thank the Committee for inviting us to testify today and giving voice to the concerns of the working women and men of these two great airlines about what this merger could mean to them.

As a front line employee in the airline industry for over 40 years, I have had a unique perspective on the cyclical and dramatic changes that have reshaped the commercial aviation industry and impacted thousands of jobs. As the President of a union representing employees from legacy or network carriers such as United, US Airways and Northwest (Delta); low-cost carriers such as AirTran Airways and Spirit; charter carriers such as Miami Air, Ryan International and USA 3000; to large majors and regional carriers such as Hawaiian, Alaska, American Eagle, Mesa and Mesaba, I am here to testify today about an aviation industry that is transforming in ironic fashion from a post deregulation industry to a consolidated industry that will look like a pre-deregulation industry. Seismic changes brought on by airline deregulation in the late 1970s caused endless bankruptcies and the end to historic airlines such as Pan Am, Eastern, TWA, Northwest and soon Continental, Each bankruptcy spelled disaster for airline employees who were left behind in the so-called rush to a market based airline industry. Thirty-two years later after the 1978 Airline Deregulation Act, I testify today about an industry that is in a swift consolidation mode. In just five short years, we have now witnessed two major mergers at US Airways and America West and at Delta and Northwest. The United and Continental merger, if approved, will mean that we have almost cut in half the number of major legacy network carriers. Credible news reports point to further consolidation on the horizon if the United-Continental merger is approved. Mr. Chairman, as I indicated, I began my flight attendant career 44 years ago and worked under a regulated industry that was stable and provided middle class jobs to thousands of workers.

When Congress voted in 1978 to deregulate the industry, the Association of Flight Attendants, and other unions, warned of the catastrophic results that would soon follow rapid and uncontrolled expansion of the airline industry. We knew that airlines would slash fares to remain competitive and that employees would be the one group who would subsidize the fare reductions through pay cuts, wage stagnation and furloughs.

Lately, I have listened intently to airline CEO's testify before this Congress about the drastic need to consolidate the industry in order to achieve a sustainable business model. After hundreds of airline bankruptcies, thousands of employee furloughs, devastating pay and benefit cuts, and 32 years of deregulation experience, it seems that airline management has figured it out, albeit in the worst fashion, that our Nation needs a stabilized and rational aviation industry The irony is that AFA–CWA—for decades—has been the leader in calling for a national and rational aviation policy that recognizes the vital role the aviation industry plays in our Nation's economy and the middle-class jobs.

Mr. Chairman, the Nation's flight attendants and all aviation workers need a stable industry as well. My experience has taught me that airline management is transient in nature with airline management coming and going and exiting our industry with a bountiful payoff while airline workers, who have truly invested in our industry, are left with a declining standard of living. Unfortunately one thing has remained constant during my career—corporate greed. If anything in that category has changed, it's that the amounts that CEOs reward themselves every year grows more and more excessive while employees earn less.

The voices of the workers often take a back seat in these hearings and in public pronouncements about the benefits of airline mergers, here today to give those of us most invested in this industry—the true stakeholders—a voice.

I have opened my testimony with this perspective because it is a story that must be told and it is entirely relevant to the discussion topic today.

As in the case of the mega merger between Delta and Northwest, this merger between United and Continental has drawn significant attention from the media, communities served by both carriers and once again, here on Capitol Hill. The attention focused on what will become the world's largest airline, for the time being, is appropriate . . . and as before necessary. Once again this merger has led to speculation about which airlines will merge next. The remaining airline CEOs continued to call

for greater consolidation in light of the anticipated rises in the cost of fuel. We would like to point out that the merger drumbeat started years earlier as airline executives sought greater profits following the epidemic of bankruptcies.

Consumers are rightfully frightened that another airline merger in particular, and anticipated consolidation of the industry as a whole, will lead to much higher fares and reduced service. We recognize the reality that airline fares must increase in order to stabilize this industry and provide more stable employment for thousands of aviation workers. In order for this industry to survive and stabilize, airlines must be able to charge a realistic fare. Airfares in the U.S. have fallen from a 1978 average of 10.08 cents per mile to 4.2 cents per mile in 2006, adjusted for inflation.[1]

To strike this balance between a stable industry and reliable air service, we assert today that the increase in consolidation activity requires appropriate regulatory oversight to protect the interests of employees and passengers. Federal regulators need to consider the impact that mega mergers have on the consumers and communities. We hope that this committee and other Congressional Committees will exercise vigorous oversight responsibilities as well.

It is unfortunate that while some protections are in place today for consumers and communities there are virtually no protections for airline workers in this merger. There has been little attention paid to the extreme upheaval that mergers create for the thousands of airline employees who find themselves unemployed or whose lives are disrupted.

This loss of protections has been yet another result of the market driven industry. There were many important protections in place for airline workers prior to the Airline Deregulation Act of 1978; the Allegheny-Mohawk Labor Protective Provisions (commonly know as the LPPs) were made a condition of government approval of virtually every airline merger. The LPPs contained extensive and specific protections—like displacement and relocation allowances, wage protections, transfer and seniority protections, layoff protection, and others—as part of a standardized set of provisions designed to shield workers from an unfair share of the burden resulting from corporate mergers.

But since deregulation, there are no real protections from our Federal Government to cushion airline workers involved in mergers. After Deregulation, airline management successfully lobbied for an end to the LPPs, arguing that those matters are "better left to the collective bargaining process." And while union contracts did provide a level of protection for employees covered by collective bargaining agreements, a series of industry bankruptcy filings have severely reduced negotiated protections in today's contracts and there remains little to no protection for nonunion airline employees.

Additionally the very employers, who argued to leave these merger protections to the bargaining process, now spent millions of dollars on union busting—through bankruptcy or other venues—trying to strip the provisions in place for decades. And today, as those same employers hold press conferences to trumpet the fact that the merger impact on employees will be minimal, they often refuse to provide information about the impact on the workers in writing.

Of all the well-developed pre-deregulation rules of the Allegheny-Mohawk Labor Protective Provisions, only one exists today—a provision establishing basic seniority protections in the event of a merger. And that provision was only resurrected a couple years ago with the advocacy of AFA–CWA and the strong support of Representative Russ Carnahan, Senator Claire McCaskill and the 110th Congress.

After deregulation, Congress was concerned that the massive post deregulation restructuring of the airline industry would displace large numbers of employees and therefore added the Airline Employee Protection Program (EPP) to the Airline Deregulation Act of 1978 in order to assist laid-off employees. Unfortunately the almost 40,000 employees who lost their jobs in the wake of Deregulation never received the benefits Congress promised since funding was never authorized for the benefits, turning the whole program into a cruel joke for airline employees in desperate need of a life line.

Congress has recognized the need to assist airline employees facing the traumatic effects of industry consolidation in the past; we need a Federal effort in what is shaping up to be another significant era of airline consolidation. As Congress looks into the impact of mergers on employees, it should look at the failed EEP as a framework to provide meaningful protections to workers in the future.

Unfortunately, there seems to be more concern for the consumer and even the airports, building and route structures of these two airlines then there is for the concern of the workers. As we have testified in the past, we are not proposing to re-

[1] James Larder and Robert Kuttner, *Flying Blind: Airline Deregulation Reconsidered*; Demos 2009.

regulate the industry today; but we do think that—at a minimum—something needs to be done to shield workers from the harshest effects of this merger and future mergers.

It seems reasonable to assume that within any airline merger there will be consolidation; blending corporate offices, the elimination of competing of hubs and overlapping routes networks may potentially lead to crew base closures. It seems that for airline workers consolidation likely translates to unemployment for far too many.

When Delta merged with Northwest in 2008 the CEOs of both corporations testified before this committee that disruptions to communities, consumers and employees would be minimal. Yet a mere 2 years later flight operations at Cincinnati, a former Delta hub, has been reduced from 600 flights in 2005 to between 160–170 flights now, cutting more than 840 jobs.[2] Not only has the number of flights been cut, there has also been a reduction in seat capacity. Routes once flown by aircraft with 150 seats—or more—are now being reduced to aircraft with 50 seats. Since the FAA mandates that there must be at least one flight attendant for each 50 passengers seats using smaller aircraft translates to a loss of two flight attendant jobs.

We can also look to the America West and US Airways merger to learn lessons from past mistakes. The synergies promised by this merger and consolidation have not occurred as promised or anticipated. Nearly 5 years after the America West/US Airways merger the two sides are still operating as separate entities. The "new" US Airways has closed four crew domiciles and displaced several hundred flight attendants, and workers at both carriers fly under separate contracts. America West flight attendants have not received a wage increase in over 7 years and US Airways flight attendants are working under a concessionary agreement from previous bankruptcies. What has failed these employees is the lack of regulatory oversight in negotiating a combined contract.

So what can the workers at United and Continental expect as they combine their workforce and route structure? While management has provided information that is otherwise publicly available, management has not been forthcoming about critical and future business plans. Accordingly, we are seeking additional detailed information from management about the impact this merger will have on our members and our Collective Bargaining Agreement at United.

As witnessed in previous mergers, base or domicile closures can be extremely traumatic to employees and their families. Even though airlines may offer assistance, the stress of being displaced and forced to move to another location can be devastating. These are workers with families and homes and who are part of communities. I call on this committee to compel United and Continental management to provide more information on their plans for current United and Continental base or domicile operations.

United and Continental are partners in Star Alliance, a global network of airlines. The Star Alliance, and other alliances, is using revenue sharing agreements, code share agreements and joint venture schemes to increase their global presence. Traditionally, global alliances incorporated an incentive for each airline to provide flying using one or the other's aircraft and ground equipment and employees. As the operator of a route, the airline collects the majority of passenger and freight revenue. In this scenario, employees benefited from the arrangement. However, a new type of joint venture goes far beyond the typical code share agreements that are prevalent today. These new joint ventures threaten the long-term job security of flight attendants.

United is the architect of a new global alliance revenue sharing scheme. They have contracted with Aer Lingus to operate a route between Dulles International Airport in the Washington, D.C. area and Madrid, Spain using Aer Lingus aircraft but employing flight attendants from a third-party operator. This has displaced United flight attendants from operating this route and United is threatening to expand this type of joint venture to other markets.

We call on this Congress to stop this type of so-called joint venture operations by passing H.R. 4788. Do not let United and Continental management use this merger as a vehicle to outsource more middle-class jobs.

While we are on the subject of globalized networks and alliances, it's time to have a discussion on recent international treaties and negotiations between our country and the European Union and China. These treaties may have far-reaching implications in the United-Continental merger, as both carriers provide significant service to Atlantic and Pacific markets.

In the spring of this year, the U.S. and the European Union (EU) concluded talks on stage two of the U.S.-EU Open Skies Agreement (Open Skies). As this committee

[2] Dan Monk and Lucy May, "Delta to cut 840 jobs at Cincinnati airport, reduce flights," *Dayton Business Journal*, March 16, 2010.

is aware, the U.S. and EU reached a comprehensive Open Skies Agreement in 2007 and the parties agreed to further talks, called stage two. The premise of Open Skies was to liberalize flying between any city in the U.S. and any city in the EU, including the United Kingdom. Notably, stage two of the Open Skies negotiations resulted in landmark labor protection language in that treaty that should provide workers some protections in a more liberalized environment.

However, AFA–CWA remains concerned and vigilant that the U.S.-EU Open Skies treaty must not provide the framework for the outsourcing of U.S. aviation jobs. We were encouraged that our U.S. negotiators and this Congress reaffirmed existing U.S. aviation law on foreign ownership and control. Those laws must remain in place and protected by Congress and the Administration.

Last week, U.S. and China negotiators began talks for a U.S.-China Open Skies-type treaty as well. The talks concluded on June 10, 2010 at the U.S. State Department in Washington. While no agreement was reached, talks will continue and AFA–CWA's concerns about protecting existing U.S. aviation laws and preventing the outsourcing of good paying middle class aviation jobs remains front and center. I call on this committee to remain vigilant as well.

We view these treaties today in much the same way we viewed the deregulation of our industry in 1978. International flying provides thousands of good paying jobs for U.S. aviation workers and we must not allow management to use these foreign treaties as a mechanism to outsource jobs.

We also ask this committee to consider the impact this merger may have on the contract negotiations underway between the Association of Flight Attendants—CWA and United management.

For almost 6 years the Flight Attendants at United have been working under a collective bargaining agreement negotiated while the company was in bankruptcy. The flight attendants at United sacrificed nearly $2.7 billion in salary and benefit concessions, and that doesn't take into consideration effects of the termination their defined benefit pension plan that was turned over to the PBGC during United's bankruptcy.

Under the terms of the current agreement, United Flight Attendants have received four meager pay increases. The last raise, a modest 1 percent, was awarded on December 31, 2008. Meanwhile, United's CEO, Glenn Tilton, received compensation that increased from $1.7 million to $3.9 million.

We are here today to ask this committee to help to ensure that the current contract negotiations, governed by Section 6 of the Railway Labor Act are completed in some manner before this merger is finalized.

Already there have been discussions that the current contract negotiations be set aside, since ultimately a new contract will need to be negotiated for the combined work group. Unfortunately we have had a front row seat and have witnessed what can happen when Section 6 negotiations are set aside in a merger. When US Airways and America West merged in September 2005, the America West flight attendants were 2 years into their Section 6 negotiations. Section 6 is a section of the Railway Labor Act (RLA) and it means that a current airline contract becomes amendable and negotiations begin to reach a new agreement. The current contract remains in place until a new contract is agreed to by the parties and members vote to ratify or approve that agreement. The RLA provides a mediation process to guide negotiations. The America West flight attendant contract talks were under the guidance of a Federal mediator prior to the merger. When the merger was announced, the America West negotiators were requested by the National Mediation Board to sot aside those negotiations and to focus on negotiating a combined contract with US Airways. Negotiations to combine contracts between unionized work groups are not governed by the RLA or the National Mediation Board.

After 5 years of negotiations, a combined contract between America West and US Airways has not been achieved. As I mentioned earlier, America West flight attendants have not received a wage increase in 7 years and US Airways flight attendants work under a concessionary agreement that cut their wages and benefits.

We cannot allow the negotiation process at United to get delayed as a result of this merger. The employees at United made deep sacrifices to keep the company flying. It's time for the workers to share in the rewards. We must have resolution to the United contract negotiations that is satisfactory to the workers there.

Labor relations at United have been combative. Management insists that flight attendants must accept additional concessions to their current contract. This is entirely unacceptable to the United flight attendants. If the focus of this hearing is on the possible effects for consumers—you only have to observe how United is treating its workers to understand how the passengers at the "new" United will fare; when you treat workers as commodities can you really expect a corporation to treat their passengers (and customers) as anything other than a commodity?

When this merger of two airlines with very different styles of labor relations is approved, there will be representational elections between the various work groups at these two companies including the flight attendants. United flight attendants are represented by AFA–CWA and Continental flight attendants are represented by the International Association of Machinists and Aerospace Workers (IAM). These elections will be conducted under the procedures defined by the National Mediation Board. However, without an open dialog with management, contract negotiations that are satisfactorily completed and support from labor groups, the integration of these two airlines will not go as smoothly as promised by management.

While much will be made over the coming months about the impact of this merger on consumers and communities, I urge you to remember the hundreds of thousands of airline employees across this country. Keep us in mind as you review this merger and the impact that it will have on our lives and our families. We are the ones who have the most to lose; and we have the least protection.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN D. ROCKEFELLER IV TO HON. SUSAN L. KURLAND

Question 1. Proponents of the merger argue that you need to have a healthy airline industry as a condition of providing service to smaller communities. Opponents argue that the merger will lead to less service to smaller communities and/or higher prices. To what extent do you believe a United-Continental merger will hurt service to small and rural communities?

Answer. Under deregulation, airlines make their own decisions on what domestic routes to serve. With a merger, the merging carriers typically seek to rationalize their levels of service, whether to large hubs or small communities, sometimes finding efficiencies by adjusting their frequencies, using larger or smaller aircraft, etc. In conducting our review of the proposed merger, DOT will be looking at carrier data indicating what service changes are being proposed, with an eye to their potential effects on small communities. Carrier data is still being received and it is too early to draw any conclusions on this.

Question 2. In 2008 the Delta/Northwest merger eliminated one major air carrier from the market. US Airways combined with America West in 2006. Republic Airways has acquired both Frontier and Midwest over the past year. In addition, some industry analysts suggest that if this merger is successful, it will lead to additional consolidation activity. There is speculation American Airlines might merge with another carrier. At what point should we begin to worry about too much consolidation in the industry?

Answer. Our experience in the domestic market shows that the level of competition depends less on the *number* of carriers serving a market than on the *type* of carriers serving the market (*e.g.,* legacy carriers vs. low-cost carriers). Over the past decade, when carriers restructured their operations and reduced services or exited the market, low cost carriers in many instances initiated new service or expanded existing service into many markets affected by such restructuring.

Question 3. What's different about the industry today that should keep us from worrying about the potential effect of the proposed merger on fares and service levels?

Answer. One thing that is different about the industry today than ten or fifteen years ago is the steady growth of low-cost carriers. Collectively, LCCs now transport approximately one out of every three U.S. domestic O&D passengers (up from one-in-five in 2000 and one-in-twenty in 1990). Low cost carrier presence in markets produces large and statistically significant fare decreases and passenger volume increases. Adjusted for inflation, fares are lower today than they were in 1978.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BARBARA BOXER TO HON. SUSAN L. KURLAND

Question 1. What steps is the Department of Transportation taking to ensure the retention of the current workforce at both airlines should the merger be approved? Is DOT concerned that this merger will have a negative impact on U.S. airline jobs?

Answer. The Department of Justice has the lead role in reviewing proposed airline mergers, due to its primary jurisdiction over the antitrust laws. We work carefully with that Department by providing advice and analysis on airline competition issues. In conducting our review of the proposed merger, DOT will be looking at carrier data indicating what the projected effects will be on their employment. Carrier data is still being received and it is too early to draw any conclusions on this.

Question 2. What steps is DOT taking to ensure that this proposed merger does not negatively affect consumer prices or service?

Answer. The Department of Justice has the lead role in reviewing proposed airline mergers, due to its primary jurisdiction over the antitrust laws. We work carefully with that Department by providing advice and analysis on airline competition issues. In conducting our review of the proposed merger, DOT will be looking at carrier data to determine if there would be any likelihood of significant fare increases in particular markets. Carrier data is still being received and it is too early to draw any conclusions on this.

Question 3. If the merger is approved, will DOT review the safety records of the regional airlines partnered with both Continental and United when deciding whether to award the carriers an operating certificate? What changes has DOT made in the context of reviewing safety during the merger approval process following the crash of Flight 3407 last year?

Answer. Regional airlines with whom United and Continental code share have their own air carrier operating certificates and are under continuous surveillance using the Air Transportation Oversight System. Although the Colgan accident didn't involve a merger, FAA oversight of airline mergers involves thorough inspection of all the airline's programs, *e.g.,* maintenance, training dispatch, that are affected by the merger. Before the affected programs are approved, FAA must determine that they meet regulatory requirements and that the airline continues to be capable of operating safely. In some cases, proving runs (*i.e.,* observation of actual flight operations) may be necessary for FAA to make this determination. Separately, when air carriers merge, the Department reviews air carrier fitness and citizenship, as well as competition issues.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. FRANK R. LAUTENBERG TO HON. SUSAN L. KURLAND

Question 1. One of the biggest public health victories in this country was when we banned smoking on commercial aircraft. However, electronic cigarettes are now being sold for use on some European commercial flights even though evidence exists that these products contain carcinogens and respiratory irritants. Does the Department plan to explicitly ban smoking of electronic cigarettes on commercial airplanes?

Answer. Smoking of electronic cigarettes is already banned on U.S. air carrier and foreign air carrier flights in scheduled intrastate, interstate and foreign air transportation. See 49 USC § 41706 and 14 CFR Part 252 (Part 252). Nevertheless, we plan to further address this matter in a notice of proposed rulemaking that would amend the existing general regulatory language in Part 252 to explicitly ban smoking of electronic cigarettes aboard aircraft.

Question 2. How would a comprehensive national high speed rail network reduce congestion in our skyways and help the commercial aviation industry?

Answer. As Secretary LaHood has stated, President Obama has a bold vision for high-speed rail within our national transportation system. As the network develops, travelers will be able to use it as an alternative or companion to air travel. Our goal would be a seamless, intermodal travel experience.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO HON. SUSAN L. KURLAND

Question 1. Do fewer main-line carriers lead to reduced competition, increased fares, reduced services, and fewer departure options at small to medium sized nonhub airports?

Answer. As a general matter, I believe that competition among the domestic carriers is critical to efficient service offerings and competitive fare levels. However, our experience in the domestic market shows that the level of price competition depends less on the *number* of carriers serving a market than on the *type* of carriers serving a market. For example, as of 2009 LCCs served 456 of the largest 500 domestic O&D city-pairs on a nonstop basis and they collectively transport approximately one out of every three U.S. domestic O&D passengers (up from one-in-five in 2000 and one-in-twenty in 1990).

Question 2. What impact would this merger have on their regional partner carriers?

Answer. While it is too early in the process to draw conclusions, among the documents reviewed by DOJ in evaluating the transaction are those that detail how the

carriers will merge their operations and the protections to be offered to stakeholders, including the public and the regional carrier partners.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK WARNER TO HON. SUSAN L. KURLAND

Question 1. With the focus of this hearing on airline consolidation, and the potential financial stability that would bring to the industry, I would be curious to know your thoughts on how that could affect the timeline for airline's equipping their planes with the equipment necessary to really making NextGen work. Do you see a possible connection between the trend toward airline consolidation and airlines' ability to pay for the upgrades to these planes needed for NextGen implementation?

Answer. While proponents of airline consolidation argue that fewer and financially stronger carriers would be better able to finance equipment upgrades needed for NextGen implementation, it is difficult to predict the extent to which such upgrading might occur.

Question 2. What are your thoughts on the current antitrust immunity framework?

Answer. Under § 41308 and § 41309, Congress has given the Department the authority to exempt airlines from the antitrust laws to the extent necessary to allow a proposed transaction to proceed, provided that the exemption is *required* by the public interest. Antitrust immunity is one tool in today's commercial and regulatory environment in which airlines are still subject to regulatory restrictions that prevent them from developing the kind of global networks present in other sectors. It should only be used when specific consumer benefits are not otherwise obtainable. We grant immunity if the public interest requires it and the parties to such an agreement would not otherwise go forward with the transaction. Our consideration of aviation economic policy focuses on what is best for a healthy and a competitive industry, for its workers, and for the communities and consumers that it serves.

Question 3. Do you believe that current law works to the benefit of airlines and consumers alike?

Answer. In an industry that is truly subject to marketplace forces, we will inevitably see carriers seeking to find greater efficiencies—which can occur in a variety of forms, including alliances and mergers. When necessary to mitigate potential harm while maximizing potential public benefit, we have conditioned grants of antitrust immunity to include effective and realistic remedies for that potential harm. Alliances are one way in which U.S. carriers can effectively and efficiently expand their international networks to provide the products and services the global marketplace demands. In the cases where the Department has granted antitrust immunity pursuant to a rigorous competitive analysis, it has found that doing so will provide travels and shippers with a variety of benefits, including lower fares in some markets, new nonstop routes, improved services, and better schedules.

Question 4. Do you believe that any changes should be made to provisions currently in place?

Answer. The Administration is not seeking a change in the statutory scheme in this area.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. JOHN THUNE TO HON. SUSAN L. KURLAND

Question. When an airline decides to reduce frequency or aircraft size to a particular market, what does that generally mean to the price of tickets to the traveling public—both leisure and business customers.

Answer. Total capacity offered in a particular air transport market plays a key role in determining prices paid in the market, but the extent to which it does so depends on the demand characteristics of the individual market, the types of airlines serving the market (*e.g.,* legacy versus low cost airlines), and the amount of capacity offered by each.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN D. ROCKEFELLER IV TO GLENN F. TILTON

Question 1. In bankruptcy United shed all of its defined benefit pensions. All except one were transferred to the Pension Benefit Guaranty Corporation (PBGC). As part of that transaction, my understanding is that you will owe the PBGC $500 million. How and when will this be re-paid?

Answer. As part of UAL's emergence from Chapter 11 bankruptcy under its 2006 plan of reorganization, UAL must issue notes to the Pension Benefit Guaranty Corporation (PBGC), such notes known as the 8 percent Contingent Senior Notes. UAL must issue up to $500 million in total principal amount of the 8 percent interest rate notes to the PBGC. UAL is to issue the notes in up to eight, equal tranches (or portions) of $62.5 million for each tranche. The notes are to be issued in each of the eight tranches when a certain financial triggering event occurs, with one tranche of notes being issued as a result of a financial triggering event.

A financial triggering event occurs when, among other things, the Company's earnings before income taxes, depreciation, amortization and rent (known as "EBITDAR") is greater than $3.5 billion during the preceding twelve months, the triggering event being measured on June 30 or December 31 of an applicable fiscal year. The financial triggering events are measured beginning with the fiscal year ended December 31, 2009, and ending with the fiscal year ending December 31, 2017. However, in the event that the issuance of a tranche of notes would result in UAL defaulting under any securities that exist at the time, UAL is able to satisfy its obligation to issue the notes by instead issuing its common stock with a market value that is equal to $62.5 million to the PBGC.

If the DOJ approves this merger, one of the biggest challenges you'll face is integrating the work forces of the two airlines. Bringing all the employees under comparable contracts will be difficult.

Question 2. What steps do you plan to take to smooth the workforce transition?

Answer. We are committed to fair and equitable, workforce integration processes leading to results that are timely and transparent. Our focus will be on creating cooperative labor relations, including negotiating contracts with our collective bargaining units that are fair to the company and fair to our employees.

Our alliance relationship has given each airline the opportunity to observe and interact with the systems, practices and procedures of the other. We expect to adopt the best aspects of each company's culture and practices. We are confident that we can integrate our operations fairly, effectively and efficiently once the merger closes. Many of our co-workers have worked closely together on our Star Alliance transition and have built productive working relationships. Together, we have an exceptional team of employees and we will foster an environment of open, honest, communication. We share a deep commitment to clean, safe and reliable air transportation and a focus on operational excellence. Both companies are committed to driving a performance culture and offering market-competitive rewards and compensation to attract and retain a highly talented workforce.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BARBARA BOXER TO GLENN F. TILTON

Question 1. Please describe the impact of the proposed merger on the current work forces of both United Airlines and Continental Airlines at California airport facilities. Do you anticipate there will be workforce cuts for either airline in California?

Answer. United and Continental Airlines employ approximately 13,800 people in California and operate at 24 airports across the state, including hubs in San Francisco and Los Angeles.

Because United and Continental have the most complementary networks of any two domestic carriers, we expect the impact of the merger on frontline employees, including employees at California airports, will be minimal., Further, any necessary reductions in frontline employees will largely be handled through retirements, normal attrition and voluntary programs.

Long-term, we expect co-workers will benefit from improved career opportunities and enhanced job stability by being part of a larger, operationally and financially stronger, and more geographically diverse carrier better able to compete successfully in the global marketplace.

Question 2. If so, where and how many will be affected? Will you commit to retaining the current workforce in California?

Answer. See previous answer.

Question 3. What steps will you take to ensure that current employees retain their jobs and their benefits?

Answer. Again, because of the minimal overlap in our networks, we expect any impact on current front-line workforce to be very limited. After the merger closes, we are committed to working throughout the workforce integration process to ensure that we have fair and equitable processes leading to results that are timely and transparent. We will work with employees and unions promptly to resolve these issues and will communicate the answers as soon as we are able.

Question 4. It is my understanding that United employs approximately 3,300 at its maintenance facility in the Bay Area and that the lease on the facility expires in 2013. What is United's long-term plans for the facility?

Answer. The current lease on the San Francisco Maintenance Facility expires July 1, 2013, with a 10-year option to extend. Today, operating as independent companies, United and Continental continually evaluate their facilities needs in the context of their ongoing business operations. Those types of decisions will continue as United and Continental integrate their operations after the merger closes.

Question 5. Will you commit to a long term extension of the lease for the facility and the retention of the current workforce?

Answer. Because the lease on the current facility is not up until July of 2013, it is too soon to comment on the outcome of negotiations. As mentioned previously, impact of the merger on frontline employees will be minimal.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. FRANK R. LAUTENBERG TO GLENN F. TILTON

Question. Often in partnership with major airlines, regional airlines operate half of all domestic departures and move more than 160 million of our Nation's passengers each year. This figure could grow under the proposed merger of Continental and United Airlines. Will you commit to having the new United assume responsibility for the safety of any carrier that flies under its brand?

Answer. With regard to the safety relationship with our airline partners, as Mr. Tilton testified at the hearing, United's focus on safety is the foundation of our business. This safety focus includes our relationships with all of our flying partners, both international and domestic, and includes multiple layers of high standards and oversight. These layers begin with FAA certification and progress through Department of Defense (DOD) quality and safety requirements, International Civil Aviation Organization (ICAO) audits, and the IOSA (International Air Transport Association Operational Safety Audit) program. For our domestic regional airline partners, United also continuously monitors safety performance and conducts on-site reviews to pursue highest industry standards. We have established a Safety Leadership Team to identify and assure a transfer of best practices between United's safety professionals and our contract regional airlines.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO GLENN F. TILTON

Question 1. How will this merger affect your relationships with your regional partners and your global code share partners?

Answer. We do not plan to change these relationships. Our regional and code share partners are indispensable to the efficiencies of our networks, and they will continue to be so for the combined network. As for our international relationships, both Continental and United are members of Star Alliance and we have informed the regulators of several foreign jurisdictions that our intention is to maintain our international code share and alliance arrangements.

Question 2. Do you plan on consolidating any of your hub airports or significantly altering your route structure?

Answer. This merger will produce synergies and will increase the value of the network to consumers, which will in turn produce greater demand for the merged airline's hubs than if the two companies remained separate. When schedules and fleets are optimized, the enhanced efficiency and greater passenger connectivity at each hub will create opportunities for growth, not contraction. We will continue to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas. The combined airline would serve 350 destinations. We estimate that the merger will create 1,282 new online city pairs, nearly half of which (626) aren't currently served by any single airline.

Question 3. With a merger, will access to all current hubs currently served by Continental and United from Little Rock National and Northwest Arkansas Regional remain available?

Answer. We have committed to continue to serve all of the communities we serve today.

Question 4. How do you plan to integrate your combined route structure at these Arkansas airports?

Answer. Within the limits allowed by the antitrust laws, we have begun a comprehensive effort to conduct the detailed planning process for combining the two companies after the merger closes. This effort includes network planning and operations.

Question 5. How will this merger enable you to better serve the small, nonhub markets?

Answer. This transaction will enhance and stabilize service to small communities and small metro areas. A difficult operating environment over the past decade has forced some network carriers to reduce service to some small communities and small metro areas. This led to a significant contraction of service, leaving many communities with a single carrier—or even, in several places, with no carrier at all.

The merger will help to reverse this contraction. The combined airline would add new online service and new destinations for small communities. Most of the more than 1,000 new online city-pair routes that would be created by the merger are comprised of small community and small metropolitan areas. This additional connectivity increases the options for consumers in these areas to fly to more places.

Question 6. With this merger, will prices for Arkansas travelers become more reasonable and competitive?

Answer. The airline industry is intensely and increasingly competitive, placing significant downward pressure on fares. As a result airfares have declined by more than 30 percent over the last decade on an inflation adjusted basis. Due to the presence of vigorous competition on every route across our combined networks, we do not believe that the merger can facilitate any price increases, nor do we plan any price increases due to the merger. None of the revenue synergies expected from the merger is modeled on a fare increase.

Question 7. Do you intend on providing any nonstop, direct flights from Little Rock or Northwest Arkansas to DCA, DIA, BWI?

Answer. It is too early in the integration planning process to address which new nonstop flights we would add, and when, but we expect to be able to add several in the near term enabled by the merger . Integration or post-merger planning should indicate new opportunities for expansion along underserved routes.

Question 8. How much revenue will airports lose as a result of the merger through leased space? How should airports make up such lost revenue?

Answer. It is too early to state with any certainty specific outcomes of the integration process. We do not overlap at our biggest facilities, our hubs, and so we do not foresee significant system-wide redundancies. Our equipment and passenger volume would require us to maintain most of the space that we currently lease. There could well be some redundancy of space and function at some airports and we will need to economize on space where it is no longer needed. Because of the lack of overlap in our networks, reductions in facilities should be minimal. We cannot estimate revenue changes for airports nor make suggestions regarding their business management plans for their facilities.

Question 9. Will this merger enable you to address the scope clause provisions of your pilots agreement thereby enabling you to bring the 90- to 100-seat aircraft to the markets that are too big for a 50-seat aircraft, but not large enough for a 130+ seat aircraft?

Answer. Today, United's contracts allow us to fly 70-seat aircraft as part of our regional carrier fleet. It is too early at this time to discuss possible changes in our fleet mix or scope clauses with various represented groups. We will work with the appropriate groups, through the negotiation process to determine what mix is good for the company, employees and communities we serve.

Question 10. How will this merger impact your relationships with each of your regional partners?

Answer. We have no plans to change these relationships. Our regional partners are indispensable to the efficiencies of our networks, and they will continue to be so for the combined network.

Question 11. How do you plan on integrating your workforce (pilots, flight attendants, machinists, etc.) and honoring existing agreements with your workforce and respective unions?

Answer. Team leaders from Continental and United have been meeting to discuss the integration planning process. While our leaders' role in successfully integrating the two companies is critical, there are labor related aspects to the integration that require the full engagement of the employees and their union representatives. Continental and United understand that management's role in the integration of Railway Labor Act employee groups is very limited; it is purely an employee decision to be represented by a union, and where comparable employee groups are represented by different unions, to decide which shall be the surviving representative. We are committed that all integrations be done in a fair and equitable manner, in accordance with the RLA, the McCaskill-Bond Amendment, and with all applicable collective bargaining agreements and company policies. We have already begun formal discussions to find the best ways to achieve these goals with the least amount of disruption with several of our unions. While we recognize that it is a difficult and often contentious process, we plan to follow the successful examples already established; the ultimate goal is, working with the unions and our employees, to finalize integration in a fair and expeditious manner.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. AMY KLOBUCHAR TO GLENN F. TILTON

Question. The BP oil spill disaster in the Gulf of Mexico is devastating communities all along the coast and throughout the Gulf states.What effect, if any, is the BP oil spill having on your airlines and the airline industry as a whole? Please be as specific as possible, including providing any statistics of which you are aware.

Answer. United is monitoring the BP oil spill and the impact on fuel prices and the refining crack spread. Fuel is the airlines largest and most volatile expense, and any changes to this market may impact overall financial performance.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK WARNER TO GLENN F. TILTON

Question 1. We have spoken about the fact that these two airlines have largely complimentary networks, and that the typical effect of mergers—loss of service due to consolidation of networks—may not be as pronounced in this case. However, the consolidated airline in this case would have two East Coast hubs relatively nearby, in Newark and Dulles. There have been reports that note that Newark stands to get busier and could stand to benefit by swapping out smaller planes in use there for larger planes that are currently serving Dulles. Can you commit today that Dulles will remain an integral cog in the merged airline's operation, and that you will not seek to cut service or downsize the hub that serves our Nation's capital?

Answer. Dulles has been a key hub for United. We have had significant growth at Dulles in our international markets, as well as domestic service in the eastern United States. In recent years, we have added service to 8 international cities from Dulles and it serves as our key gateway to Europe, the Middle East and now Africa.

The Dulles market is a unique and separate market from any of the other hubs in the combined carrier. The nation's capital has a large local population that supports significant air service both internationally, as well as throughout the United States.

Question 2. One of your strongest arguments for the merger is the increased financial stability that the companies—and the industry generally—will achieve. Will better financial stability attained by the merger allow you to consider again moving forward with plans you had to build a new concourse at Dulles?

Answer. It is too soon to comment on the consideration of specific projects, such as facilities at Dulles. Improved financial stability will create a sustainable enterprise that will benefit our passengers, the communities we serve and our employees. Today, operating as independent companies, United and Continental continually evaluate their facilities needs in the context of their ongoing business operations. Those types of decisions will continue as United and Continental integrate their operations after the merger closes.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. JOHN D. ROCKEFELLER IV TO JEFFERY A. SMISEK

Question. If the DOJ approves this merger, one of the biggest challenges you'll face is integrating the work forces of the two airlines. Bringing all the employees under comparable contracts will be difficult. What steps do you plan to take to smooth the workforce transition?

Answer. We have about 30 separate groups comprised of Continental and United leaders who have been meeting to discuss the integration planning process. While our leaders' role in successfully integrating the two companies is critical, there are labor related aspects to the integration that require the full engagement of the employees and their union representatives. Continental and United understand that management's role in the integration of Railway Labor Act employee groups is very limited; it is purely an employee decision to be represented by a union, and where comparable employee groups are represented by different unions, to decide which shall be the surviving representative. We are committed that all labor integrations be done in a fair and equitable manner, in accordance with the RLA, the McCaskill-Bond Amendment, and with all applicable collective bargaining agreements and company policies. We have already begun formal discussions with several of our unions to find the best ways to achieve these goals with the least amount of disruption. While we recognize that it is a difficult and often contentious process, we plan to follow the successful examples already established; the ultimate goal is, working with the unions and our employees, to finalize integration in a fair and expeditious manner.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BARBARA BOXER TO JEFFERY A. SMISEK

Question 1. Do you believe the flight crew of the Flight 3407 that crashed outside of Buffalo, NY was properly trained and followed appropriate protocol?

Answer. Continental and all of our employees are saddened by the tragic accident of Flight 3407 and deepest condolences are sent to those that experienced loss in this accident. As you may know, the National Transportation Safety Board conducted a thorough investigation into the accident and issued its final report, which included detailed findings and conclusions, probable cause, and recommendations, some of which relate to crew training and protocol. While Continental was not a party to that investigation and therefore has no first-hand knowledge of the bases for the findings and conclusions reached by the NTSB, we respect those findings and conclusions.

Question 2. What safety standards did Continental require its regional airlines to meet in order to partner with your airline?

Answer. Safety is our top priority and always will be. It is important to me and to all of us at Continental that members of this committee and the public in general understand and appreciate our position on this very critical issue. Just a year ago, the U.S. Senate Committee on Commerce, Science, and Transportation held a hearing on aviation safety as it relates to the relationship between network airlines and regional airlines. Captain Don Gunther, Continental's VP of Safety, provided testimony on behalf of Continental and addressed the issues you raised. Please see Attachment A, information provided by Captain Gunther, which expounds on his testimony on these critical safety issues and reflects Continental's firm commitment that safety is our top priority.

Question 3. What steps has Continental taken since that crash to improve safety at Continental and its regional airline partners?

Answer. Safety remains our highest priority. All employees at Continental, from senior management to front-line employees, are dedicated to safety. In addition to our robust internal safety culture, of which I am very proud, we remain equally committed to continuing our work with all members of the aviation community, including regional carriers, to share best practices and support other reform and initiatives that will help improve the safety. Please see Attachment A, provided by Captain Gunther which details steps we have taken since the accident in furtherance of our commitment to safety.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. FRANK R. LAUTENBERG TO JEFFERY A. SMISEK

Question 1. Continental's market share at Newark Airport is already over seventy percent and if this merger is successful, this share will only increase. You've stated that this merger will eventually result in the savings of $200 million annually for the airline. Will any of these savings come from higher fares for passengers flying in and out of Newark Airport?

Answer. Continental and United have invested billions of dollars in people, facilities, and aircraft to compete in the global marketplace, including well over $1 billion at Newark Airport. The combined company is going to continue to function in a highly competitive marketplace, and consumers will benefit from a more comprehensive network that can better sustain itself in a volatile marketplace. We expect that improved connectivity and direct service options, as well as improved service for our customers, will enable the combined airline to generate substantial revenue synergies. The combined Continental-United is expected to deliver $1.0 to $1.2 billion in net annual synergies by 2013, including between $800 and $900 of incremental annual revenue. None of the network synergies is dependent upon fare or fee increases.

Question 2. Will you commit to having the new United assume responsibility for the safety of any carrier that flies under its brand?

Answer. Safety is Continental's number one priority and will continue to be at the merged Continental/United. All employees at Continental, from senior management to front-line employees, are dedicated to safety. In addition to our robust internal safety culture, of which I am very proud, we will remain equally committed to continuing our work with all members of the aviation community, including regional carriers, to share best practices and support other reform and initiatives that will help improve safety of the merged Continental/United. Just a year ago, the U.S. Senate Committee on Commerce, Science, and Transportation held a hearing on aviation safety as it relates to the relationship between network airlines and regional airlines. Captain Don Gunther, Continental's VP of Safety, provided testimony on behalf of Continental and addressed the issues you raised. Please see Attachment A, information provided by Captain Gunther, which expounds on his testimony on these critical safety issues and reflects Continental's firm commitment that safety is our top priority.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO JEFFERY A. SMISEK

Question 1. How will this merger affect your relationships with your regional partners and your global code share partners?

Answer. We believe this merger will create more opportunities for our regional partners than exist today. Continental and United have several mutual code share partners, many of whom are also members of the industry leading Star Alliance network. We believe this merger makes the combined Continental/United a much stronger and more viable partner.

Question 2. Do you plan on consolidating any of your hub airports or significantly altering your route structure?

Answer. This merger will produce synergies and will increase the value of the network to consumers, which will in turn produce greater demand for the merged airline's hubs than if the two companies remained separate. When schedules and fleets are optimized, the enhanced efficiency and greater passenger connectivity at each hub will create opportunities for growth, not contraction. We will continue to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas. The combined airline would serve 350 destinations. We estimate that the merger will create 1,282 new online city pairs, nearly half of which (626) aren't currently served by any single airline.

Question 3. With a merger, will access to all current hubs currently served by Continental and United from Little Rock National and Northwest Arkansas Regional remain available?

Answer. Continental has been committed to service to small communities for a long time. The merger announcement does not change that commitment. In fact, the merger should allow for more service to small communities, not less.

Note that the combined carrier will serve 148 small communities and small metro areas in its network and those destinations will have connectivity over combined hubs to worldwide destinations that may not necessarily exist today. We have committed to continue to serve all of the communities we serve today.

Question 4. How do you plan to integrate your combined route structure at these Arkansas airports?

Answer. We have begun a comprehensive effort to conduct the detailed planning process for combining the two companies after the merger closes. This effort includes network planning and operations.

Question 5. How will this merger enable you to better serve the small, nonhub markets?

Answer. The Continental-United merger will benefit small communities, as the combined entity will be able not only to preserve but to enhance existing, extensive services to such communities. As network carriers, Continental and United have a long history of serving small and medium sized communities.

The Continental-United merger will enable residents of small communities to connect through eight mainland domestic hubs and travel on to hundreds of destinations on thousands of routes worldwide. The combined airline will offer these travelers online access to 350 destinations in 59 countries. Following the merger, 93 of the 116 destinations that would be new to either Continental or United passengers would be small communities. Passengers from communities in Arkansas currently served by Continental, for example, will have new service on a single airline to all the destinations that United currently serves. Furthermore, none of the few routes on which Continental and United currently offer overlapping nonstop service involves a small community point.

The merged Continental and United will continue to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas. In fact, the merger is likely to enable service to additional destinations, for two reasons: (1) by improving connectivity at the hubs, the merger will increase demand on existing spokes, and (2) by improving efficiency and realizing synergies, the merger will increase the probability that we will add new spokes to new destinations.

Question 6. With this merger, will prices for Arkansas travelers become more reasonable and competitive?

Answer. Continental believes there will be more, rather than fewer, competitive choices after the merger. We expect that improved connectivity and direct service options, as well as improved service for our customers, will enable the combined airline to generate substantial revenue synergies. None of these network synergies was modeled using fare or fee increases. The combined company is going to continue to function in a highly competitive marketplace, and consumers will benefit from a more comprehensive network that can better sustain itself in a volatile marketplace. Additionally, the combined airline will be better able to enhance the travel experience for our customers through investments in technology, the acquisition of new planes and the implementation of best practices of both airlines.

Question 7. Do you intend on providing any nonstop, direct flights from Little Rock or Northwest Arkansas to DCA, DIA, BWI?

Answer. It is too early in the integration planning process to address which new nonstop flights we would add, and when, but we expect to be able to add several in the near term as a result of the merger. Integration or post-merger planning should indicate new opportunities for expansion along underserved routes.

Question 8. How much revenue will airports lose as a result of the merger through leased space? How should airports make up such lost revenue?

Answer. There may be some level of airport leased space rationalization once the airlines' operations are combined. However, most airport leases incorporate full cost recovery rate making methodologies that allow airports to compensate for any reduction in leased space or flight and passenger activity.

Question 9. Will this merger enable you to address the scope clause provisions of your pilots agreement thereby enabling you to bring the 90- to 100-seat aircraft to the markets that are too big for a 50-seat aircraft, but not large enough for a 130 plus seat aircraft?

Answer. The pilot contracts are in negotiation, and the Air Line Pilots Association, which represents pilots from United and Continental, has already stated that it desires to quickly negotiate a joint collective bargaining agreement. Part of that negotiation will likely include scope issues. It would be premature to predict what the substance or outcome of those negotiations might be.

Question 10. How will this merger impact your relationships with each of your regional partners?

Answer. We believe this merger will create more opportunities for our regional partners than exist today. Continental and United have several mutual code share partners, many of whom are also members of the industry leading Star Alliance net-

work. We believe this merger makes the combined Continental/United a much stronger and more viable partner.

Question 11. How do you plan on integrating your workforce (pilots, flight attendants, machinists, etc.) and honoring existing agreements with your workforce and respective unions?

Answer. We have about 30 separate groups comprised of Continental and United leaders who have been meeting to discuss the integration planning process. While our leaders' role in successfully integrating the two companies is critical, there are labor related aspects to the integration that require the full engagement of the employees and their union representatives. Continental and United understand that management's role in the integration of Railway Labor Act employee groups is very limited; it is purely an employee decision to be represented by a union, and where comparable employee groups are represented by different unions, to decide which shall be the surviving representative. We are committed that all labor integrations be done in a fair and equitable manner, in accordance with the RLA, the McCaskill-Bond Amendment, and with all applicable collective bargaining agreements and company policies. We have already begun formal discussions with several of our unions to find the best ways to achieve these goals with the least amount of disruption. While we recognize that it is a difficult and often contentious process, we plan to follow the successful examples already established; the ultimate goal is, working with the unions and our employees, to finalize integration in a fair and expeditious manner.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. AMY KLOBUCHAR TO JEFFERY A. SMISEK

Question. The BP oil spill disaster in the Gulf of Mexico is devastating communities all along the coast and throughout the Gulf States. What effect, if any, is the BP oil spill having on your airlines and the airline industry as a whole? Please be as specific as possible, including providing any statistics of which you are aware.

Answer. Continental is monitoring the BP oil spill and will continue to do so. Fuel is the airlines largest and most volatile expense, and any changes to this market may impact overall operations. Aside from the impact on the cost of jet fuel, we have also been monitoring the loads on our flights into and out of the Gulf Region. While Continental has not seen significant booking reductions for the Gulf Region, Continental has seen some limited localized impacts.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK WARNER TO JEFFERY A. SMISEK

Question 1. We have spoken about the fact that these two airlines have largely complimentary networks, and that the typical effect of mergers—loss of service due to consolidation of networks—may not be as pronounced in this case. However, the consolidated airline in this case would have two East Coast hubs relatively nearby, in Newark and Dulles. There have been reports that note that Newark stands to get busier and could stand to benefit by swapping out smaller planes in use there for larger planes that are currently serving Dulles. Can you commit today that Dulles will remain an integral cog in the merged airline's operation, and that you will not seek to cut service or downsize the hub that serves our Nation's capital?

Answer. Dulles has been a key hub for United. They have had significant growth at Dulles in our international markets, as well as domestic service in the eastern United States. In recent years, we have added service to 8 international cities from Dulles and it serves as our key gateway to Europe, the Middle East and now Africa.

The Dulles market is a unique and separate market from any of the other hubs in the combined carrier. The nation's capitol has a large local population that supports significant air service both internationally, as well as throughout the United States.

Question 2. One of your strongest arguments for the merger is the increased financial stability that the companies—and the industry generally—will achieve. Will better financial stability attained by the merger allow you to consider again moving forward with plans you had to build a new concourse at Dulles?

Answer. Improved financial stability will create a sustainable enterprise that will benefit our passengers, the communities we serve and our employees. Today, operating as independent companies, United and Continental continually evaluate their facilities needs in the context of their ongoing business operations. Those types of decisions will continue as United and Continental integrate their operations after

the merger closes. It is too soon to comment on the consideration of specific projects, such as facilities at Dulles.

ATTACHMENT A—SUPPLEMENTAL INFORMATION FROM CAPTAIN DON GUNTHER, STAFF VP, SAFETY, CONTINENTAL AIRLINES

Safety is Continental's number one priority.

Aviation safety is a shared endeavor that involves all stakeholders in the industry, including aircraft operators, manufacturers, airports, service providers and the Federal Aviation Administration (FAA). Continental is committed to the role that it plays and remains committed to working with all members of the aviation community to continuously improve the safety of our air transportation system. As Mr. Smisek mentioned at the June 16, 2010 hearing, safety is, and will always be, the airline's number one priority.

As I have stated before, the commercial aviation industry operates under a regulatory framework which recognizes the FAA as the entity ultimately responsible for regulating and overseeing air carrier compliance with safety regulations. In fact, Congress has created a strong statutory mandate to the FAA to ensure all air carriers are safe for passengers to fly. In addition, each carrier is responsible for operating its flights safely, is required to uphold its regulatory obligations under its operating certificate issued by the FAA, and is directly accountable to the FAA through inspections and, if necessary, legal enforcement action to ensure safety issues are resolved properly. All carriers—mainline and regional alike—must respect the importance of compliance with safety regulations in their own right. Notwithstanding individual responsibilities, carriers should and do work together to promote and enhance, those standards of safety that have been developed within the industry.

There are many ways in which Continental supports this important initiative of airlines working together to address safety issues. For example, Continental participates in committees and task forces, such as the Aviation Safety Information and Analysis Sharing (ASIAS) program and the Commercial Aviation Safety Team (CAST). Continental also participates in safety forums and meetings where best practices and other aspects of the FAA voluntary safety programs (ASAP, FOQA, LOSA, and AQP) are shared and discussed. Both mainline and regional carriers routinely attend and participate in these programs with the common goal of promoting safety.

Continental's own commitment to safety is carried through to its relationships with regional carriers. Prior to entering into a business arrangement with a regional carrier, Continental always reviews the carrier's status with the FAA and determines whether it has a current operating certificate. Continental recognizes the FAA's leadership as the body responsible for determining a carrier's fitness to fly safely, authorizing the carrier's operation, and promoting and enforcing safety standards. In addition, Continental's contracts with regional carriers specifically require them to comply with Federal safety standards and regulations. Continental also engages in a number of other safety-specific actions before entering into commercial relationships to code-share with a regional carrier, and it continues to assess those carriers after entering into an agreement.

For example, with respect to domestic code-share operations, Continental has developed and follows a "Domestic Commuter Code-Share Safety Review Program." The purpose of the program is to validate the safety and compliance status of each domestic regional carrier with which it has a code-share arrangement. The objective of the program is to ensure, through a systematic program of evaluation, that processes exist for complying with the FAA's regulatory framework and that the code-share carrier is actually complying with its own compliance standards.

Continental obtains and reviews safety audits performed by highly qualified independent entities. These include:

- The International Air Transport Association's (IATA) Operational Safety Audit ("IOSA").
- The DOD survey, which is an audit performed by the military under the Secretary of Defense to ensure safety compliance of airlines that transport military personnel.

Pursuant to its Domestic Commuter Code-Share Safety Review Program, Continental conducts bi-annual reviews that include:

- Discussions with the code-share partners to review safety, operations and maintenance concerns;

- Noting major changes to the air carrier's fleet, organization or safety program; and
- Reviewing any threats and safety issues of the code-share carrier that may be derived from publications and other means.

Furthermore, Continental conducts biennial reviews that include:

- Obtaining and reviewing current IOSA Audit Reports;
- Obtaining and reviewing current DOD Air Carrier Survey results; and
- Conducting an on-site visit at the code-share partner's facilities.

Continental also communicates about code-share operations with those regional carriers which operate under its code to discuss various industry developments and safety issues. If Continental determines at any time that a carrier is having safety issues, it promptly addresses those issues with the carrier.

Additionally, Continental conducts Regional Partner Safety Summits twice a year. During the Summits, safety and operational issues affecting our airlines are discussed. These Regional Partner Safety Summits afford Continental and the regional carriers with which we contract the opportunity for open dialogue concerning industry trends, best practices, voluntary programs, and strategies for managing and enhancing operational safety. A collaborative agenda and allowing ample time for open discussion have resulted in lively contributions and positive responses from the session participants.[1]

The FAA holds each carrier—whether mainline or regional—responsible for ensuring proper qualifications and training for its own flight crews. It would be inconsistent with the regulatory structure that Congress established for ensuring aviation safety for any airline to require certain elements to be included in the FAA-approved training program of another airline, which is separately certificated by the FAA. It is recognized throughout the industry that, coupled with appropriate oversight by the FAA, the carrier that operates the aircraft must develop and implement an appropriate crew qualification criteria and training for a specific aircraft.

Continental reserves the right to choose the carriers with whom it maintains a business relationship. Continental will not maintain a business relationship with any carrier that does not meet FAA standards. Nor will it maintain a relationship with any carrier that does not share in its commitment to a robust safety culture. Safety is Continental's highest priority in all aspects of its business, including the decision to enter into a code-share arrangement with another carrier.

The aviation community understands that safety is not a perfect science and requires continuous improvement and innovation. Thank you for your consideration.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN THUNE TO GLENN F. TILTON AND JEFFERY A. SMISEK

Question 1. In your testimony you pointed to this merger allowing your combined 700 aircraft fleet to be reassigned to better meet demand on different routes, which would result in "a net increase in annual passengers and improving the business mix of those passengers." Can you tell me how you envision this additional flexibility when it comes to increasing annual passengers in South Dakota—or the two largest cities that you serve in my state? If I understand your testimony correctly, what you are referring to here is increased frequencies or expanded aircraft in existing markets that your two respective airlines currently serve.

Answer. It is too soon in the integration planning process to state with certainty the new schedule or equipment assignments for the merged carrier or for any specific route. Our integration planning includes scheduling and optimal equipment reassignment, and will be focused on creating additional flexibility for travelers across the network.

Additional flexibility means greater availability of flights, rational use of equipment to accommodate demand, and increased passenger choice. Passengers will enjoy substantially increased flexibility from the immediate rise in the number of online destinations accessible from South Dakota post-merger. As Continental cur-

[1] Continental offers one example of the shared benefits that can flow from such collaboration. At a recent summit, Continental shared and discussed information about our Line Operations Safety Audits (LOSA) program (LOSA is a program for the management of human error in aviation operations). Following the summit, Continental provided two trained observers to work with a regional carrier that was in the process of initiating such a program. This allowed that regional carrier to leverage Continental's LOSA experience in conducting its own operational safety audit.

rently does not serve South Dakota, the merger will create more than forty new domestic destinations that United does not currently serve.

Question 2. In your testimony you explained how Low Cost Carriers (LCCs) have impacted the business model and passenger volumes of mainline carriers. Can you explain to me what the approach is generally when United or Continental are faced with increased competition from one or more LCCs at a nonhub airport—or even LCC competition at a nearby nonhub airport that is within a close geographic proximity (less than 4 hours by car) of a city that you serve? For instance, if United and/or Continental serve a particular airport but a LCC is taking away your customer base at another airport, is it your business practice to allow that LCC(s) to take away those passengers which reduces the need for you to provide a certain level of service or aircraft type at such a city, or is your approach to match any price disparity that may exist to reduce the amount of lost passengers that would otherwise occur.

Answer. Continental and United compete vigorously for every passenger. As a general rule, a carrier's service patterns are based on demand from passengers and each of us competes with other carriers, including LCCs, to satisfy that demand. Airports with significantly larger traffic volumes enable airlines to operate at a lower per-passenger cost than smaller airports. Carriers are constantly striving to achieve balance between pricing and costs to maintain the passenger base and service levels to satisfy demand in each market.

United's present share of passengers traffic at Sioux Falls is approximately 25 percent. Continental does not currently serve Sioux Falls, so the merger will not result in a loss of any competition and in fact will allow for more online destinations for the community than are currently available, including forty new domestic destinations and ninety-two international destinations.

Question 3. From an operations standpoint, can you explain to the Committee what generally occurs to the traveling public (leisure and business customers) when either of your airlines reduces frequency or aircraft size to a market—particularly when it comes to the price of tickets?

Answer. The principal result from changes in frequency or gauge is retention of service on a particular route. Over the last 2 years, United, Continental and many other carriers have reduced capacity in the domestic market as a result of record high fuel costs and the economic recession. During that time average fares have continued to decline to historic lows. We have continually tried to match our capacity with demand. Fares are determined by the market place and in this hyper-competitive industry competition has continued to keep fares low.

We are always trying to accommodate demand and meet our costs. Two ways we do this is by keeping our fleet "right sized" and our schedules responsive to the volume of passengers. The point of the United-Continental merger is to create a carrier that can provide travelers with better access, wider choices, and greater flexibility, thereby retaining current passengers and attracting additional ones. We think that the enhanced service that we will be able to provide will give passengers these benefits, in South Dakota, and at all our destinations

As a company, we do not see continual reduction of our fleet and service as a positive strategy for the long term. Therefore, a key reason for this merger is to grow our network, providing more service options to passengers. While we know we will continue to face challenges to our industry from many fronts, we are committed to building a sustainable business that will benefit our employees, customers, shareholders and the communities we serve.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN D. ROCKEFELLER IV TO ROBERT ROACH, JR.

Question 1. What are the primary issues you have with the potential merger between United and Continental?

Answer. As the largest airline union in North America, the IAM has maintained a long-standing opposition to airline mergers since they result in job losses and disruptions for our members. We feel that the United/Continental merger will be no different. Despite the promises of airline executives, it will result in reduced service, higher fares, closed hubs, and job cuts.

The track record of airline mergers is clear, leaving behind a trail of shuttered airport facilities in cities such as St. Louis, Pittsburgh, and Cincinnati. Each time, be it with the American/TWA merger, the US Airways/America West merger, the Delta/Northwest merger, or the current United/Continental merger, airline executives maintained that no hubs would be closed and no front line jobs would be lost. This fallacy has been borne out in each merger we have seen to date, most recently

in Cincinnati where Delta has laid off over 800 employees at its hub there and has reduced its operations to one concourse from three.

Question 2. What specific issues would you like the airlines to work with on as they move forward with the proposed merger?

Answer. Protecting the interests of the 10,000 IAM members at Continental Airlines and the 16,000 IAM members at United Airlines is of the utmost importance to this union. One of our primary concerns is the subject of pensions. Continental Airlines employees still enjoy a single-employer defined benefit pension plan, while United Airlines employees had their single-employer plans terminated during that company's bankruptcy. The Pension Benefit Guaranty Corporation (PBGC) has inherited the liabilities of the United plans and as a result, United Airlines is currently barred from sponsoring a single-employer pension plan. The company has not yet developed its policy concerning merging the retirement benefits of employees at the new airline, but it is extremely unlikely that the underfunded Continental plans could take on additional pension obligations for United employees. One of the sole options for preserving defined benefit retirement plans for the employees on the merged carrier is the IAM's multiemployer plan, in which our United Airlines members already participate.

Question 3. To what extent are the airlines working with you as they move forward with their merger proposal?

Answer. The airlines have already established a more cooperative relationship with us than we saw in the Delta/Northwest merger, where the airline's management team refused to even meet with the IAM leadership following their merger announcement. However, because the United/Continental merger was put together so hastily, the management team has yet to provide us with concrete answers about how work groups will be integrated and any possible changes to their route networks.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO ROBERT ROACH, JR.

Question 1. Do you believe this merger will integrate these airlines workforce (pilots, flight attendants, machinists, etc.) in a manner that will honor existing agreements with between management and labor?

Answer. We do believe that the integration process will be conducted in a fair and equitable manner which will preserve the current agreements in place until representation issues are settled and joint collective bargaining agreements have been negotiated. This, however, does not allay the IAM's fears concerning potential job losses and loss of retirement benefits.

Question 2. What major changes do you anticipate?

Answer. Bringing two airlines together brings such a myriad of changes for their employees that it would be impossible to list them all here. Among them include transitioning to new computer reservation systems, synchronizing maintenance and inflight safety procedures, integrating seniority lists, merging collective bargaining agreements, developing a new pass travel program, and creating a new brand and marketing image. It has also been stated by the company that they intend to bring Continental's employee-friendly "Working Together" culture to the new United, where employees have been laboring under concessions extracted during bankruptcy.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. JOHN THUNE TO ROBERT ROACH, JR.

Question. When an airline decides to reduce frequency or aircraft size to a particular market, what does that generally mean to the price of tickets to the traveling public—both leisure and business customers?

Answer. When an airline reduces its frequency of service or the size of aircraft to a particular market, it can have a profound effect on pricing in that market. Both leisure travelers and business travelers alike will find their access to affordable air service diminished, especially in smaller cities such as Sioux Falls or Rapid City. Across the United States, these types of cities have already seen their mainline jet frequencies replaced with smaller regional "express" carriers. In the wake of the 2008 airline capacity reductions, non-hub airports saw their capacity reduced by 11 percent over the previous year. The same capacity reductions saw 38 small communities lose their air service entirely, according to a study by the Government Accountability Office. The same report also showed that airports which had experi-

enced a decline in capacity of more than 10 percent, such as those in small cities, experienced a 21 percent increase in airfares when comparing 2007 to 2008.

For leisure travelers, these increases mean delaying or canceling a vacation or visit to family members. For businesses, these costs are even more insidious. They constrain growth because firms cannot afford to deploy their sales force to other cities to sell their products. Their clients and supplies cannot afford to travel to these smaller cities to make deals face-to-face. They make it difficult for businesses to attract and retain talented employees. Reducing capacity is one of the key ways that a merged airline can capture the "synergies" of which airline executives are so fond of proclaiming. What these synergies truly entail are fewer flights to smaller destinations, on smaller aircraft, at higher fares. These are among the many reasons why the International Association of Machinists and Aerospace Workers remains opposed to airline mergers.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. FRANK R. LAUTENBERG TO CHARLES LEOCHA

Question. An airline recently announced that it was going to start charging passengers to store their bags in the overhead compartment. Will the flying public be subjected to more of these arbitrary fees just so airlines can make a quick buck?

Answer. I expect that the airlines will find more and more ways to separate fliers from their money. The most important factor is not the imposition of fees and new charges, but the refusal of the airlines to release these fees to central reservation systems so that consumers can compare the total costs of travel.

Personally, I do not think that the fee approach is good for the airlines in the long run, but they have made that decision. Now it is Congress' and the DOT's responsibility to make sure that these fees are transparent and understandable to the traveling public.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO CHARLES LEOCHA

Question 1. How will this merger affect relationships between mainline carriers and their regional partners and global code share partners?

Answer. If I had a crystal ball, I might be of better help here. Regional airline relationships always changing as the mainline carriers get better deals from their regional partners. I believe that the same safety standards should be applied to the regional carriers that the mainline carriers apply to themselves. Unfortunately, that is not always the case when the main effort is to save money.

Global code-share partners will continue to get stronger now that the government has agreed to antitrust immunity. From a consumer's point of view, this is a massive mistake, but DOT has drunk the airline Kool Aid over the objections of Justice.

Question 2. Do you believe this merger will lead to the consolidation of hub airports or significantly alter mainline carriers' route structure?

Answer. There is no doubt that this merger will affect Cleveland. It will be downsized as Chicago grows. Perhaps the overcrowding of Chicago O'Hare will end up helping Cleveland. However, I expect the number of flights and support staffing levels to fall dramatically.

Question 3. Will it be easier or more difficult for low-cost carriers to grow in an ever increasing consolidating industry?

Answer. If the major airlines end up raising prices significantly, it will provide an opening for low cost carriers. Low cost carriers will maintain pricing control on major carriers on many popular routes, but not on regional and international routes.

The major airlines are already moving out of routes where they compete directly with low cost carriers. They are focused on becoming connecting carriers and creating a large money-making international business now that alliances have created three large airlines that now virtually control international travel. Low cost carriers will have a much harder time breaking into the international market.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. MARK WARNER TO CHARLES LEOCHA

Question. With the trend in airline consolidation, airlines appear to be focused primarily on profitability rather than service expansion. This focus is accompanied by a desire to ensure full flights, at the expense of providing service to some of the

smaller communities in our country. In my state, a proposed swap of flights between two carriers looks like it will lead to elimination of service to a Virginia airport—service that is vital to smaller communities in that area of the state. I have concerns that airline consolidation could lead to similar eliminations of service. What's your take?

Answer. All airlines will follow their profits. They are in business to make money. The subsidies for local airline service will continue to be one of the driving factors for regional airlines and for the hub and spoke systems. The major airlines are moving to an area where they rely on subsidies and the lower costs of regional air service and at the same time they use international routes to generate additional cashflow through a system with reduced competition. Congress provides a big part of the current airline subsidiaries for local service. They can insure continued coverage when it is in the local public's interest.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. JOHN THUNE TO CHARLES LEOCHA

Question. When an airline decides to reduce frequency or aircraft size to a particular market, what does that generally mean to the price of tickets to the traveling public—both leisure and business customers.

Answer. The change in aircraft size may mean that airfares will go up, or it may mean that airfares will go down. Airlines strive to maximize their use of aircraft efficiencies. The closer the airline can match type of aircraft to a particular route, the better it is for the airline's bottom line.

Sometimes matching aircraft to traffic means reducing flights. Other times it means resizing aircraft serving particular airports.

The size of aircraft and frequency of flights when done properly will lower costs and allow airlines to reduce their airfares.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. FRANK R. LAUTENBERG TO DANIEL MCKENZIE

Question. An airline recently announced that it was going to start charging passengers to store their bags in the overhead compartment. Will the flying public be subjected to more of these arbitrary fees just so airlines can make a quick buck?

Answer. As a traveler, I'm empathetic to the perceived "nickel and diming" by airlines. These ancillary fees were pioneered by Ryan Air in Europe and fine tuned by Allegiant Travel Corp here in the United States. The bag storage fee for overhead bin space referenced was proposed by Spirit, a low cost and ultra low fare airline whose pricing philosophy is to charge a steeply discounted low fare and then via add-ons, walk a customer back to a higher fare . . . and at the end of the day, still charge a lot less than the legacy airlines.

Looking ahead, I don't believe you'll see this particular ancillary fee as the backlash would be too great, but there are other ancillary fees that airlines may charge in the future. Jeff Smisek, Continental CEO, talks about charging for things people value, which based on my conversations with management teams at other airlines, is the prevailing industry philosophy behind incremental ancillary fee initiatives.

For example, UAL has an economy plus product, where for an extra charge (say $49), you get more leg room. On the other hand, Southwest passengers have the option to pay a $10 "early bird fee" in order to buy themselves the right to be one of the first to board the plane and thus, the right to pick their desired seat.

I suspect we will see incremental fees, but my sense is that they will be for things that passengers value. For whatever it's worth, corp travel managers have lashed out at airlines over some of the fees; and moreover, computer reservation (CRS) systems are not geared to accommodate the additional charges that airline would like to push through. So the sky is not the limit with these types of fees.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. MARK WARNER TO DANIEL MCKENZIE

Question. With the trend in airline consolidation, airlines appear to be focused primarily on profitability rather than service expansion. This focus is accompanied by a desire to ensure full flights, at the expense of providing service to some of the smaller communities in our country. In my state, a proposed swap of flights between two carriers looks like it will lead to elimination of service to a Virginia airport—service that is vital to smaller communities in that area of the state. I have concerns

that airline consolidation could lead to similar eliminations of service. What's your take?

Answer. Thanks for the question. In short, expansion generally results from profitability; losses prompt contraction as airlines cut back unprofitable flying (why of course airlines that file for Ch. 11 shrink). My take is that senior management teams today remain "shell shocked" by the balance sheet destruction wrought by $34B in losses over the past decade; a super spike in crude to $147; and then the Great Recession. That is, it's impossible for an airline to grow or add new service when it doesn't know what its cost structure will be. Open labor contracts and volatile fuel prices represent about 55 percent of total industry costs, and depending, this 55 percent has the ability to move strongly. So unfortunately for consumers, cost volatility has disciplined mgmt teams to focus on profitability vs new service at least for the near-term.

Further out as business models stabilize (*i.e.,* as airlines become more profitable), I believe they ultimately will add new service, with service to smaller cities balanced by new service internationally.

As for the slot swap, interestingly, US Airways management tells me they approached Southwest first before going to Delta, and that Southwest turned them down. We'll see where the slots end up—I suspect its not a finished story at this point.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. JOHN THUNE TO DANIEL MCKENZIE

Question. When an airline decides to reduce frequency or aircraft size to a particular market, whit does that generally mean to the price of tickets to the traveling public—both leisure and business customers?

Answer. Senator Thune, sure—if the same number of people want to travel, but there are less options available, all else equal, prices would rise.

However, there have been a few factors driving the reduction infrequencies and aircraft size:

1. The worst recession since the great depression has resulted in less people traveling over the past couple of years;
2. the spike in fuel prices to $147/barrel resulted in billions in losses as the industry was unable to pass along that increased cost of doing business, so the airlines are trying to stabilize balance sheets after losing $34B over the past decade; and
3. I've been seeing a lot the down gauging in size due to low-cost carriers (low-cost capacity) displacing high-cost legacy carriers (high-cost capacity). You may not be seeing that at Reagan National or in South Dakota unfortunately, however, it is occurring at Denver, Milwaukee, and Boston for example.

If there is a silver lining in the picture, it's that AirTran is working hard to turn Milwaukee into a hub, which may be a source of low-cost capacity into your state at some point.

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