# IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES

**(110–129)**

## HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 14, 2008

Printed for the use of the
Committee on Transportation and Infrastructure

U.S. GOVERNMENT PRINTING OFFICE

42–528 PDF WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
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# CONTENTS

Page

## SUBMISSIONS FOR THE RECORD



## ADDITIONS TO THE RECORD

**U.S. House of Representatives**
**Committee on Transportation and Infrastructure**
**Washington, DC 20515**

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James W. Coon II, Republican Chief of Staff

May 13, 2008

**SUMMARY OF SUBJECT MATTER**

**TO**: Members, Subcommittee on Aviation

**FROM**: Staff, Subcommittee on Aviation

**SUBJECT**: Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines

## PURPOSE OF HEARING

The Subcommittee will meet on Wednesday, May 14 at 2:00 p.m. in room 2167 Rayburn House Office Building to receive testimony regarding the impact of consolidation on the aviation industry, with a focus on the proposed merger between Delta Air Lines and Northwest Airlines.

## BACKGROUND

In the past few months, network carriers have been exploring possible mergers. After several months of negotiation, Delta Air Lines and Northwest Airlines announced their intent to merge. There are also reports of merger discussions between the remaining U.S. air carriers, including United and Continental, and United and US Airways. However, Continental recently announced that it would remain an independent carrier. According to press reports, exploratory discussions are still underway between United and US Airways.

### I. The Delta-Northwest Proposal

On April 15, 2008, Delta Air Lines (Delta) and Northwest Airlines (Northwest) (the 3rd and 6th largest airlines) announced an agreement in which the two carriers will merge in an all-stock transaction with a combined value of $17.7 billion. The airlines claim that the transaction will generate more than $1 billion in annual revenue and cost synergies from more effective aircraft utilization, a more comprehensive and diversified route system, reduced overhead and improved operational efficiency. The combined carrier expects to incur one-time cash costs not to exceed $1 billion to integrate the two airlines, and expects to have liquidity of nearly $7 billion at closing.

Under the terms of the transaction, Northwest shareholders will receive 1.25 Delta shares for each Northwest share they own.

The new airline will take the Delta Air Lines name, and current Delta Chief Executive Officer (CEO), Richard Anderson, will be the CEO of the combined company. The new Board of Directors will be made up of 13 members, seven of whom will come from Delta's board, including Anderson, and five of whom will come from Northwest's board, including Doug Steenland, the current Northwest CEO. One director will come from the Air Line Pilots Association (ALPA).

According to the carriers, the new Delta will continue to headquarter in Atlanta, and will have executive offices in Minneapolis/St. Paul and New York, and international executive offices in Amsterdam, Paris and Tokyo. The combined carrier will have more than $35 billion in aggregate annual revenues, operate a mainline fleet of nearly 800 aircraft and employ approximately 75,000 people worldwide. However, until a deal is completed, Delta and Northwest will continue to operate as two separate airlines.

## II. Roles of the Departments of Justice and Transportation

### A. Department of Justice

The competitive effects of mergers and acquisitions are principally governed by Section 7 of the Clayton Act, which prohibits such transactions "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[1] Generally, Section 7 is primarily enforced by the Federal Trade Commission and the Department of Justice's (DOJ) anti-trust division. The Hart-Scott-Rodino Act requires reporting to both of these agencies by both the acquiring and acquired parties of stock and asset acquisitions where the acquiring party would hold at least $50 million (adjusted annually for inflation, currently $63.1 million). No transaction covered by this may be consummated without compliance with the reporting and waiting periods of the Hart-Scott-Rodino Act. The notice and waiting period provide an opportunity for the two agencies charged with assessing the competitive aspects of the transaction to review the proposal prior to its completion, and file suit if it is found to violate the antitrust laws.

The DOJ has primary responsibility to review proposed mergers in the airline industry. It will examine the proposed merger, conduct a market-by-market review, and determine whether the merger is likely to cause a substantial reduction in competition in any relevant market. The DOJ's main focus will be on the impact of the merger on any overlapping routes. If it finds that the merger may reduce competition, it may file suit in Federal Court. The DOJ consults with the Department of Transportation (DOT) during its investigation where appropriate (i.e., to put certain practices into context). The DOT makes recommendations, and supplies data and policy input to DOJ on these issues. The DOT will also review the transfer of international routes to assure that consolidation does not damage competition or otherwise harm the public interest, as discussed in the next subsection.

DOJ's principal concern under antitrust laws is the creation or enhancement of any one firm's market power in any relevant market. A merger between two major airlines will likely be

[1] 15 U.S.C. § 18 (2006).

viewed as a horizontal merger. A horizontal merger typically involves competitors in the same product and geographic market.

There are several possible consequences of a horizontal merger. One possible economic outcome is that the merged company's market power may grow to such a degree that it would have an undue level of control over pricing. This would also be the case if a merger results in a reduction in the number of competitors and, as a result, an increased concentration in the relevant product and geographic market area.

In addition, a reduction in the number of competitors in a market may make it easier for the remaining firms to collude on prices or other competitive terms. Another potential consequence of a horizontal merger is that with relatively few companies in a given market, it becomes possible for firms to predict accurately how rivals will react to changes in price without any explicit agreements. Further, an increase in concentration may also enhance a company's ability to engage in predatory conduct toward competitors, producing new barriers to entry for new firms, leading ultimately to higher prices.

To assess the competitive impact of a transaction, DOJ must identify the relevant market and market participants, assess market concentration resulting from the merger, and determine the likely competitive effects for the increase in market concentration resulting from the merger. DOJ's review is likely to take 3-6 months at a minimum.

In undertaking its competitive review, the DOJ normally begins by determining the relevant markets. Relevant airline markets are usually scheduled airline service between one city and another ("city pairs"), while non-stop and connecting service in the same city pair may be considered as separate markets. As such, DOJ is generally more concerned about mergers between airlines with more overlapping networks, because the number of overlapping city pairs will be larger. If a merger presents few city pair overlaps, DOJ may agree to settle if the merged carriers divest assets (including airport gates and aircraft) to other carriers to take over competitive service in those city pair markets. Generally, the courts and the DOJ do not rely exclusively on this data but also look at the likely competitive effects of a transaction based on real life experiences, taking into account airline-specific practices such as loyalty programs and online reservation systems with instantaneous fare information. In addition, DOJ evaluates the ease of entry into competitive markets by other competitors as well as the potential future consequences of the proposed merger, including "downstream" effects such as whether the merger will lead to other mergers.

As to the timing of a merger evaluation, after the two carriers file notice with the DOJ, the agency will have 30 days to conduct a preliminary review. After a preliminary review, DOJ will most likely request extensive information from the carriers. The carriers have as much time as they want to compile the requested information and submit it to the DOJ, depending on how quickly they want to move forward. Once the information has been submitted to the DOJ, the agency has 30 days under the statute before the carriers can consummate the transaction, though this waiting period can be extended under the statute for another 30 days, or through a timing agreement with the parties. If DOJ determines the merger violates the Clayton Act, it may file suit to block the merger. If the carriers agree to the conditions that DOJ imposes to correct competitive problems, DOJ may settle the suit and enter into a consent decree, which is subject to public comments and court approval. The DOJ may also decide not to take any action, in which case the parties can consummate the transaction immediately.

## B. The Department of Transportation

Overall, the DOT's role in the process of determining whether a merger should proceed or not on antitrust grounds is secondary to DOJ's lead. According to the DOT, in some past merger cases, it has given its views privately to DOJ on the possible competitive consequences of proposed mergers.

Independently, the DOT would consider whether to approve the transfer of the acquired air carrier's international routes to the surviving entity. The air carriers must file a joint application requesting that the DOT transfer the economic authorities under 49 U.S.C. § 41105 (transfer of the certificate).

The DOT may approve a transfer of international routes only if it finds that it is consistent with the public interest. By statute, the DOT must specifically consider the transfer's impact on the viability of the parties to the transaction, on competition in the domestic airline industry, and on the trade position of the United States in the international air transportation market. The DOT would also examine any other public interest issue raised by the transfer and whether it is inconsistent with international policy. The DOT's decision on the route transfer would be subject to Presidential review under 49 U.S.C. § 41307.

While the transfer application is pending before the DOT, the air carriers could request that the 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 the DOT's decision on their route transfer application. The DOT's decision on the exemption request would be conditioned upon the air carriers remaining separate and independently operated entities under common ownership.

From an economic fitness perspective, both air carriers must provide DOT updated fitness information on the merged entity, and DOT would also have the authority to review any code share arrangements or alliances involving the two carriers that would be affected by a merger between the two airlines.

## III. Issues Associated with a Merger

### A. Competition

Delta/Northwest state that the combined carrier (and its regional partners) will provide passengers access to more than 390 destinations in 67 countries. Domestically, Delta/Northwest state that there would be little overlap in the nonstop routes the two airlines serve, with direct competitive service on 12 of more than 1,000 nonstop city pair routes currently flown by both airlines. However, there will be impacts on competition in these 12 markets. Currently, Delta and Northwest offer direct service from Cincinnati to Minneapolis. With the merger, however, there will be only one airline offering direct service. The only other alternatives are connecting services. This will impact 21,450 passengers. The same is true on the Detroit to Salt Lake City route, which will impact 34,840 passengers and on the Minneapolis to Salt Lake City route, which impacts 54,500 passengers. With regard to the Cincinnati to Detroit route, where there is no alternative air service other than the new merged airline; 118,634 passengers will be affected.[2] Some believe that these

[2] Bureau of Transportation Statistics (BTS) data (May 9, 2008).

routes would attract low cost carriers, to provide competitive service in the markets. These are issues that the DOJ will consider in its review of the merger proposal.

Concerns have been raised that a merger between these two carriers could raise fares substantially. Fewer large carriers could mean more monopoly power at the hubs these carriers dominate. Delta currently operates four hubs, including Atlanta, Cincinnati, Salt Lake City, and New York-JFK. Northwest operates hubs at Minneapolis-St. Paul, Detroit and Memphis. The carriers state that they do not intend to close any of the seven hubs as a result of the merger. Therefore, a combined Delta/Northwest would be a generally bigger competitor at these hubs, and have a greater ability to discourage competitors from entering the market. In 1993, the Government Accountability Office found that fares at concentrated hubs are higher than fares elsewhere.[3] Moreover, the Transportation Research Board noted in a 1999 report on competition in the airline industry that: "[h]igher average fares in concentrated hub markets compared with unconcentrated hub and nonhub markets have been observed in several studies" and that "the consistency with which hub markets appear among the highest fare markets is noteworthy and raises the possibility that hub carriers are exploiting market power in ways that would not be sustained if they were subject to more effective competition."[4]

Delta/Northwest in its merger briefing papers state that the growth of low cost carriers has created new competition that would offset historical regulatory concerns with mergers. However, opponents argue that over-reliance on low cost carriers is not the answer. This is because low cost carriers do not serve many of the same markets that the large network carriers serve. In addition, for some traffic, low cost carriers may be non-competitive because they do not offer the same benefits as network carriers, such as frequent flier benefits to foreign destinations. Moreover, many low cost carriers are struggling financially, with several going out of business or having filed for bankruptcy. Due in part to increased fuel prices, in the last few weeks, low cost carriers MAXjet, BigSky, Aloha, ATA, Skybus, Champion and Eos have ceased operations. Frontier Airlines has filed for Chapter 11 but is continuing to fly. Faced with larger network carriers, some low cost carriers may well be driven out of the industry or into a merger with a network carrier.

As to small community service, Delta/Northwest states that it will serve more than 140 such communities in the United States. Recently, however, many carriers, including Delta and Northwest, have reduced capacity in an effort to save on fuel costs. Delta has announced that it plans to cut 10 percent of its capacity during 2008, while Northwest has stated that it will cut capacity by 5 percent. Some of the routes that have already been cut by these carriers served small communities. Given high fuel costs and a slowing economy, there is no guarantee that, whether this merger is approved or not, the combined carrier or individual carriers will continue to serve all 140 or so markets that they now serve. Those small communities that do lose service may find it difficult to attract successor carriers to the market. In addition, as capacity and competition is reduced, fares will invariably increase.

Concerns have also been expressed that if this merger goes forward, other major carriers may propose mergers of their own, and the airline industry would be reduced to three or four large network carriers. As noted above, United and US Airways are purportedly in merger discussions. With only a few remaining carriers, opponents of the merger are concerned that competition will be

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[3] *See* Government Accountability Office, *Airfares at Concentrated Airports* (GAO/RCED-93-171).

[4] Transportation Research Board, *Entry and Competition in the U.S. Airline Industry: Issue and Opportunities* (1999) at 96.

limited, and that each carrier will concentrate on areas where it is strong and not challenge others by increasing capacity or lowering fares. Fewer competitors could mean that it may be more likely that fare increases will stick.

Last, consolidation of U.S. carriers could also impact international markets. Delta/Northwest argue that a merger will allow them to compete on a more equal footing with other larger international carriers. Specifically, they believe that by combining the domestic and international routes of Delta and Northwest that they will have a network breadth that is as strong as that of other international carriers, such as Lufthansa and British Airways.

However, many U.S. carriers, including Delta and Northwest, already belong to international alliances with strong market presence in Europe. Currently, Delta and Northwest belong to the SkyTeam alliance, which also includes KLM, Air France, Czech Airlines and Alitalia. United and US Airways belong to the Star Alliance, along with Lufthansa, SAS, and bmi, among others, and American belongs to the oneworld alliance, which also includes British Airways. In addition, many of these alliance partners have antitrust immunity, which allows them to coordinate on prices, capacity and customer service issues.[5] In particular, concerns have been expressed that in the United States -- Continental Europe market, where immunized alliances (i.e., SkyTeam and Star) already control a significant share of the traffic, the consolidation of U.S. air carriers would further concentrate the market share within these alliances, thereby making it more difficult for new competitors to enter the market.

### C. Employee Integration/Customer Service Issues

According to Delta/Northwest, frontline employees of both airlines will be provided seniority protection through a seniority integration process, if the airlines are combined. In addition, U.S.-based non-pilot employees of both companies will be provided a 4 percent equity stake in the new airline upon closing. The company also states that there will be no involuntary furloughs of "frontline" employees as a result of this transaction and the existing pension plans for both companies' employees will be protected.[6]

To date, the only employee group that has reached agreement with Delta and is supportive of the merger is its pilots union, represented by ALPA. The Northwest pilots, also represented by ALPA, are not included in this agreement. The Northwest pilots seek a joint pilot contract. Until such time as a joint contract is agreed to, Delta/Northwest will be able to integrate their route structures but limitations will remain in international markets currently served by Northwest.

Other employee groups that will be affected by this proposed merger include flight attendants and ramp, customer service, reservation agents, among others. In addition to the pilots, only the dispatcher workforce at Delta is unionized. This is not true for the Northwest workforce. The Northwest flight attendants are represented by the Association of Flight Attendants-CWA (AFA-CWA) and ramp service, store clerks, customer service agents, reservation agents, flight

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[5] Note that on April 9, 2008, the DOT tentatively approved an application by SkyTeam members for an immunized alliance in transatlantic markets.

[6] In March 2008, Delta announced a separation package, in the hopes that 2,000 employees will leave the company voluntarily. This is 4% of its workforce and is the largest mass reduction since 2005. They want to cut 1,300 "front line" jobs such as flight attendants and airport agents as well as 700 administrative staff.

simulator technicians and plant protection employees are represented by the International Association of Machinists and Aerospace Workers (IAM).[7] The AFA is currently seeking to organize Delta's approximately 13,500 flight attendants. The IAM states that it is currently assessing the interest of Delta's ramp service and customer service agents (approximately 14,000 employees) in unionizing.

On April 24, the National Mediation Board (NMB) mailed voting instructions to Delta flight attendants and the voting will end on May 28th. Should the Delta flight attendants choose to join the AFA-CWA, and the merger is implemented, then the flight attendants can move forward on integrating their two groups through the AFA-CWA's constitution and bylaws, and eventually negotiating a new contract with the merged carrier.

If the flight attendants choose not to join AFA-CWA at this point then, assuming a merger takes place, a union election would automatically be triggered if 35 percent of the combined workforce is represented by a union (in this case, AFA-CWA). The same would hold true for the rest of the workforce. However, if the 35 percent threshold is not met upon consummation of a merger, any union seeking to organize a newly-combined workforce would have to initiate a new organizing campaign.

Historically, integration of employee groups has presented serious hurdles to airline mergers. Consumer service generally suffers while management grapples with merging two cultures, and dealing with employee concern and morale issues over potential closing of facilities and the integration of seniority lists. For example, US Airways and America West merged in 2005. Three years later, there is still considerable employee unrest, especially with the pilots who have yet to agree on a final uncontested seniority list. In addition, there have been many press reports about the decline in customer service and infrastructure issues immediately following that merger.[8]

As the *Weekly Standard* recently opined:

> History is on the side of the pessimists. In the period immediately following every airline merger, chaos is the order of the day – or year. Pilots find that the control panels on the merged carriers differ; baggage losses mount, as they did when Northwest acquired Republic Airlines in 1986; the merging of reservation systems causes kiosks and websites to malfunction, as US Airways and America West discovered; strikes occur as disgruntled employees find the new pension package inferior to the old one. All of these are in the new Delta's future . . . .[9]

### D. Other Integration Issues

In addition to integrating different employee cultures, Delta/Northwest would have to merge several fleet types. Every type of aircraft, even if it is made by the same manufacturer, has its own unique requirements in terms of operations, training, and maintenance. A highly diversified fleet mix can be a significant cost. Delta and Northwest have substantially different fleet mixes. In

[7] Note that a small group of Northwest mechanics is represented by the Aircraft Mechanics Fraternal Association (AMFA).
[8] *See e.g.* Dan Reed, *US Airways highlights drawbacks of consolidation*, USA Today, March 5, 2008.
[9] Irwin M. Stelzer, *Come Fly With Us*, The Weekly Standard, April 28, 2008.

response to concerns about the expense of incorporating Northwest aircraft into the Delta fleet, Delta has maintained that the merging of the fleets does not present a problem. Rather, Delta has referred to it as an opportunity for "fleet maximization," which would allow the combined carrier to better match the right aircraft with demand on a certain route. A recent *Wall Street Journal* article noted that "although it's possible the new airline could tailor many of its routes in such a way, certain expenses wouldn't disappear. Not only would the airline have to keep separate maintenance programs for each of the plane models, managers would have to make sure all their bases had adequate equipment and crews on hand to handle the difference among jets."[10]

Interestingly, when Delta's former President and CEO, Gerald Grinstein testified before the Senate Commerce, Science and Transportation Committee in opposition to the proposed takeover of Delta by US Airways in 2007, he expressed his concerns about merging with an airline that had a different fleet mix. Noting that Delta is an all-Boeing fleet and US Airways fleet was 57 percent Airbus, Mr. Grinstein stated that "...you can screw up a lot of things in the airline industry, but you have to have fleet simplification. And by having a consistent manufacturer and supplier it gives you that opportunity." Currently, 72 percent of Northwest's fleet are aircraft other than Boeing; 42 percent are Airbus, representing the largest number of aircraft supplied to the airline by one manufacturer. On the other hand, 70 percent of Delta's fleet is Boeing. The only aircraft the two airlines have in common is the Boeing 757.

### E. Financial Condition

Over the last five years, the U.S. airline industry has lost over $35 billion. These losses are the result of many different factors including the economic slowdown, a decline in business travel, the aftermath of the 9/11 terrorist attacks, the SARS epidemic, increased competition from low-cost carriers and, most recently, dramatically increased fuel prices. However, in 2006 and 2007, the airline industry turned a corner, including "the *first back to back net profit for the U.S. airlines since 1999-2000.*"[11] For 2008, however, it is widely expected that industry will suffer steep losses as a result of increased fuel prices. Many experts believe that the industry must cut capacity one way or another.

Fuel prices have hit unexpectedly high levels and this added expense has impacted the cost of airline operations. Many airlines, though not all, are reporting a loss in the first quarter of 2008.[12] Delta and Northwest reported losses of $274 and $191 million respectively.[13] As of May 9, 2008, the price per gallon for jet fuel was $3.57 per gallon. Last year at this time, the price was $ 2.08 per gallon. As a rule, the Air Transport Association estimates that each fifty cent increase in the price of jet fuel adds $10 billion to the airline industry's expenses. The industry has reacted to these changes by reducing capacity.[14]

[10] J. Lynn Lunsford, *Fleet Could Be Just Plane Trouble*, Wall Street Journal, April 16, 2008, at B1.
[11] Air Transport Association, 2008 Outlook: "A Global Perspective,." (emphasis in original).
[12] Southwest Airlines reported a profit of $34 million.
[13] Both Delta and Northwest, unique amongst the airlines in their financial reporting, also show a goodwill write down in the market value of their companies, of $6.1 billion and $3.9 billion, respectively. However, this does not reflect their before tax operating profits or losses.
[14] Despite the increased fuel costs, passenger load factors are at an all time high. According to the BTS load factors have increased each year for the past five years and in 2007 reached an average of 79.1%, with load factors as high as 86 percent during June and July. BTS states that first quarter 2008 load factors, show a slight increase in domestic markets, but overall are considered steady.

Delta states that merging the two carriers will "create a financially stronger airline . . . that will help it weather the impact of fuel prices . . ."[15] However, it is not clear that the merger will help with fuel costs. The carriers acknowledge that they will not be able to purchase fuel more cheaply. Rather, any ability to weather fuel increases, according to the carriers, will come from integration savings, capturing high fare business traffic, and profits from international routes. Moreover, much of the increase in fuel costs will be passed on to consumers. Just last week, both Delta and Northwest levied a $20 per round trip fuel surcharge on passenger tickets.

## WITNESS LIST

### PANEL I

**Mr. Richard H. Anderson**
Chief Executive Officer
Delta Air Lines, Inc.

**Mr. Douglas M. Steenland**
President and Chief Executive Officer
Northwest Airlines Corporation

### PANEL II

**The Honorable James J. O'Connell, Jr.**
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice

**The Honorable Michael W. Reynolds**
Deputy Assistant Secretary for Aviation and International Affairs
U.S. Department of Transportation

### PANEL III

**Captain Lee Moak**
Chairman, Delta Master Executive Council
Air Line Pilots Association, International

**Captain David V. Stevens**
Chairman, Northwest Airlines Master Executive Council
Air Line Pilots Association, International

[15] The State of the Airline Industry and the Potential Impact of a Delta/Northwest Merger Before the S. Comm. on Commerce Science and Transportation, Subcomm. on Aviation Operations, Safety and Security, 110th Cong. 1 (May 7, 2008) (Statement of Richard Anderson CEO of Delta).

**Ms. Patricia Friend**
International President
Association of Flight Attendants-CWA, AFL-CIO

**Mr. Robert Roach, Jr.**
General Vice President of Transportation
International Association of Machinists and Aerospace Workers

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Business Travel Coalition

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Calyon Securities

# HEARING ON IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES

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**Wednesday, May 14, 2008**

HOUSE OF REPRESENTATIVES
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE,
SUBCOMMITTEE ON AVIATION,
*Washington, DC.*

The Subcommittee met, pursuant to call, at 2:00 p.m., in Room 2167, Rayburn House Office Building, the Honorable Jerry F. Costello [Chairman of the Subcommittee] presiding.

Mr. COSTELLO. The Subcommittee will come to order.

The Chair will ask all Members, staff and everyone to turn electronic devices off or on vibrate.

The Subcommittee is meeting today to hear testimony on the impact of consolidation on the aviation industry with a focus on the proposed merger between Delta and Northwest Airlines. The Chair will announce that I will give an opening statement then recognize the Ranking Member, Mr. Petri, for an opening statement or any remarks he may have. We expect Chairman Oberstar, the Chairman of the Full Committee, to be here. He will be giving an opening statement or comments and so will Mr. Mica.

At this time, the Chair would ask unanimous consent to allow Mrs. Miller to participate in today's hearing under Committee Rule 3(d). Hearing no objection, so ordered.

I welcome everyone to our Subcommittee hearing on the impact of consolidation on the aviation industry with a focus on the proposed merger between Delta and Northwest Airlines. On April 15th, 2008, Delta and Northwest announced a proposed merger, claiming that such a move would generate more than $1 billion in annual revenue and create cost synergies for more effective aircraft utilization, a more comprehensive route network and improved operational efficiency. This merger announcement has increased speculation that other carriers within the industry would merge. According to published reports, discussions are underway between United and U.S. Airways. The long-term implications of a series of mergers could have a major effect on the future of the industry, resulting in just a few megacarriers here in the United States.

Why are the airlines discussing mergers? Many believe it is because of fuel prices. Every penny increase in the price of a gallon of jet fuel results in an additional $195 million in annual fuel costs for the U.S. airline industry. Although most airlines made a profit in 2007, the increase in fuel and the slowing economy have caused the majority of the airlines to report significant first quarter losses for 2008. In the last month, increased fuel prices have in part caused four air carriers to stop operations and other carriers to reduce capacity.

With very few areas for airlines to reduce costs, some view merging as the only way to remain viable. While I am not entirely convinced that this is true, we must take a look at the impact of fuel on the industry.

I have some grave concerns about airline mergers. Previous mergers have rarely produced the projected benefits and efficiencies promised. This has frequently led to reduced competition and higher fares. Mergers have been good for airlines executives, but not so good for consumers or employees. In addition, I doubt that the merger proposed by Delta and Northwest would retain both carriers' existing hubs, as they have indicated, at their current level. We have heard that before. American Airlines executives, when they acquired TWA, sat in this very Committee hearing room and testified from that table that they would keep their hub in St. Louis and would keep the TWA hub at its current level in St. Louis. Yet, less than two years later, flights from St. Louis were cut from over 500 per day to about 250 per day, just about in half in a two-year period. And many TWA employees lost their jobs and saw their pensions reduced.

Past mergers have shown that customer service tends to suffer as carriers attempt to merge cultures, IT systems and fleets. We must make sure that consumers and employees do not end up paying a hefty price for consolidation.

I look forward to hearing from both the Department of Transportation and the Department of Justice on the process used in making decisions on proposed mergers and when a decision could be expected in this case. I am also interested in hearing more about how this potential merger will affect the employees. I understand that Delta pilots are supportive but other employee groups have not reached any agreement with management.

Further, I am interested in hearing from the analysts on our fourth panel today regarding the pros and cons of this merger for both consumers and employees, and also if they believe that this merger will lead to more mergers in the future.

Finally, Members of the Subcommittee should know that the Department of Transportation and the Department of Justice witnesses can answer questions on the review process, but cannot give specifics on the Delta and Northwest merger proposal currently pending before the Department of Justice.

With that, let me again welcome all of you here today. We certainly welcome our witnesses that will be testifying before the Subcommittee. Before I recognize Mr. Petri for his opening statement or any remarks that he may have, I ask unanimous consent to allow two weeks for all Members to revise and extend their remarks and to permit the submission of additional statements and materials by Members and witnesses.

Without objection, so ordered.

The Chair at this time recognizes the Ranking Member, Mr. Petri, for his opening statement or any comments he may have.

Mr. PETRI. Thank you very much for holding this important hearing today.

It is essential that this Subcommittee focus on the financial issues facing the airline industry right now, not the least of which issues is the unprecedented price of airline fuel and energy generally. The Air Transportation Association is projecting that the industry's 2008 jet fuel bill will be 72 percent higher than last year's. It seems as though we are hearing of record fuel prices being reached on an almost daily basis.

Increases in fuel prices impact the airlines in much the same way as it impacts families filling up the tanks of their cars and minivans. Difficult budgeting decisions have to be made.

Skyrocketing fuel prices will inevitably lead to and has already lead to tough decisions by air carriers. They must consider ways to reduce costs and increase revenue where possible. Air carriers without enough cash on hand will be unable to weather the storm. In fact, eight airlines have filed for bankruptcy since December. Many already have cut capacity, added surcharges, tried to increase fares, perhaps slowed down the flight rate that the planes are flying at to operate a little more efficiently on a per-mile basis.

This is certainly not the first time that the airlines have faced difficult economic times. Indeed, the airline industry is a cyclical business. But the record fuel prices we are seeing is an unprecedented event. Last month, Delta and Northwest Airlines announced a proposed merger. The record high price of jet fuel, global competition and the slowing economy are cited as the main reasons for the merger. Since the proposed merger was announced, aviation experts, labor groups, consumer advocates and other interested parties have commented both for and against airline mergers in general and the proposed Delta-Northwest merger in particular.

The proposed merger's impact on the marketplace, competition, the air service, employees and airfares have been the subject of a great deal of speculation. Today we have before us representatives of interested groups to testify about airline consolidations, focusing on the Delta-Northwest merger. We will also hear from the chief executive officers of both of these airlines.

Finally, the Department of Justice and the Department of Transportation are here to explain the extensive and lengthy Government reviews required before any merger can actually occur. So I look forward to the testimony and I again thank all the witnesses for their participation and Chairman Costello in particular for organizing the hearing today.

Mr. COSTELLO. The Chair thanks the Ranking Member and now recognizes the gentleman from Illinois, Mr. Lipinski, for any comments or opening statement that he may have.

Mr. LIPINSKI. Thank you, Mr. Chairman.

First let me thank Chairman Costello and Chairman Oberstar for holding this very important hearing, also Ranking Member Petri and Ranking Member Mica.

I have serious concerns about the proposed Delta-Northwest merger and further airline consolidations in general. That is not to say that I summarily oppose any mergers, but as I am sure will be expanded upon throughout today's hearing, a number of past airline mergers have failed airline employees and consumers. These mergers have created decreased choice, higher fares, more frequent flight disruptions, lost luggage, disrupted workforces and losses in employee benefits.

In March, I sent a letter co-signed by 46 of my colleagues to the Attorney General and the Secretary of the Department of Transportation, expressing our concerns about the potential impact airline mergers could have on consumers and airline employees. Now that these Federal agencies are actively considering the proposed Delta-Northwest merger, I once again urge them to strongly consider the concerns that we have expressed and place the interests of the consumers and the workers first.

As I said, I understand the desire to have these mergers. The disruption right now being caused in the airline industry, especially because of the high prices of oil right now, and of jet fuel, so I understand that. But I think we need to take a careful look at any mergers that are considered, not just the Delta-Northwest merger, but any mergers.

So I look forward to hearing from the witnesses today and hearing their testimony on this. I yield back.

Mr. COSTELLO. The Chair thanks the gentleman from Illinois and now recognizes the gentlelady from California, Ms. Richardson.

Ms. RICHARDSON. Thank you, Mr. Chairman. I would also like to thank Ranking Member Petri for holding this very timely hearing. I would say not only is it very important, it is very timely that we have this discussion while we can still be engaged in the process.

Admittedly, the current economic challenges that we are facing, that commercial airlines are facing as well, has really caused us all, I think, to take a step back of what is happening currently in our economy. I was really disturbed when I read a newspaper article that talked about the percentage of a lot of the airlines, of how many of the planes now are not even being serviced here in the United States, but actually, a great amount of them are being serviced outside of this Country.

I will tell you that in my district, I represent the area with the Long Beach International Airport, the Compton-Woodley Airport, and just neighbors to the Los Angeles International Airport. Economically, this is a critical engine in my particular district, employing thousands and delivering over 49,000 tons of goods each year.

Let me say, as a Member of Congress, we are all going through tough times. If there is a role that we have to play, I hope that eh witnesses would share with us not only this proposal that you feel you need to take in order to survive, but give us some suggestions of what we could do to work with you to ensure that we can continue this industry. I do not believe ultimately that this is best for our Country, but we all have a role to play in fixing that. If there is something we can do, I would very much like to hear about it today.

Thank you very much. I yield back the balance of my time.

Mr. COSTELLO. The Chair thanks the gentlelady and now recognizes the gentleman from Colorado, Mr. Salazar.

Mr. SALAZAR. Thank you, Mr. Chairman, and thank you for having this important hearing.

I would like to submit my entire statement for the record. I can understand and fully sympathize with what is going on with the proponents of this merger. I think we can pinpoint everything back to the high price of fuel. We see that Frontier Airlines has also filed Chapter 11. There are many airlines that are suffering.

But it is not only the airline industry. It is almost every single factor in the entire economy, whether it is high food prices because of the high cost of transportation. Mr. Chairman, I want to make sure the people understand that most of the blame has to go back to the high price of fuel on everything that is going on in this Country right now. But I would also like the witnesses to explain to us what their proposal is and what impact it is going to have, the merger specifically, on layoffs, on seniority integration and pensions.

So with that, Mr. Chairman, I would yield back. Thank you.

Mr. COSTELLO. The Chair thanks the gentleman from Colorado and now recognizes the distinguished Chairman of the Full Committee, Chairman Oberstar.

Mr. OBERSTAR. I thank you, Mr. Chairman, and thank our witnesses for being here today. It is a long list, a very important list of witnesses on an extremely important subject. Not the first time that the Subcommittee on Aviation of the Committee on Transportation and Infrastructure has visited the issue of airline finances, alliances and mergers and leveraged buyouts. We have been through all of that over a great many years.

This one, however, has a far-reaching significance for the future of aviation in America and worldwide. This should not be and must not be considered as a standalone, individual transaction, but rather, as a trigger of what will surely be a cascade of subsequent mergers that will consolidate aviation in the United States and around the world into three global megacarriers.

I know that the witnesses, the two principal carries involved, will disagree with that in their own self-defense. I expect them to. But the reality is that that is what will happen.

There are only a few of us left who were here in the dawn years of deregulation. I sat just somewhere down there where Mr. Cohen's seat is, and I rubbed my worry beads about voting for deregulation. It was after I proposed an amendment that succeeded in Committee, for what we know today as essential air service, that I decided that in the end, the balance was in favor of deregulation.

Offering my amendment for essential air service, I said, Mr. Chairman, if we don't succeed with this amendment, there are communities in my district that without air service, the only way to get there is to be born there. Thirty years ago, everybody laughed. They understood it. And the amendment passed.

But the principle is the same today. If this merger results, there would be communities at the end of the spokes in the hub and spoke service after all the dust settles with the merger, that will not have air service. Reducing the airline industry as a whole sector of aviation to three major carriers substantially will reduce competition, will limit consumer choice and result in higher fares. In established carriers' control markets, the tendency is for the carriers not so much to compete as to do price following. Fares become identical, passenger choice is limited. It will be even more magnified, those issues will be, if there are only a few major airlines.

The strategy will result in a path leading to not the greatest service but the greatest mutual profitability. Profit is a good thing in the private sector. But not when it simply results in disadvantageous effects on the traveling public. Competition in such a scenario, many will reason, could prove suicidal.

The Department of Transportation said "Economic theory teaches that the competitive outcome of a duopoly is indeterminate. The result could be either intense rivalry or comfortable accommodation, if not collusion, between the duopolists." Mergers discourage competition at major hubs. GAO found that fares at concentrated hubs already are higher, in some cases 30 percent higher, than fares elsewhere. That would only worsen in a merger environment.

Airlines have the right to defend their hubs, but not in a monopoly construct. I hear Delta and Northwest say that the merger proposal is pro-consumer, because they will provide single carrier service in many new markets. I don't see how they are not going to reduce service. I don't see how, when they are flying, with 85 percent of seats filled, they can provide new service without reducing it somewhere else.

They say they will increase revenues without raising fares by selling more seats in international markets where they can charge higher fares. If they fill the seats with international passengers, there are going to be fewer seats for passengers paying low fares.

The effect on international competition will be significant. Two groups will control 80 percent of the traffic between the U.S. and continental Europe. Mergers between U.S. carriers will lead to less competition within and among the three alliances. They already have, were on their way at Northwest, to getting antitrust immunity with their relationship with Air France—Air France, KLM, and other continental carriers, and their relationship in the Pacific Rim.

Government studies time and again, going back to the hearings I held in the 1980s and early 1990s, markets where merging carriers now compete, after a merger, fares go up. Delta and Northwest also, as has been previously mentioned, cite fuel costs as the need to get together, larger purchasing pool just means larger costs for the bigger carrier. Last week, Delta and Northwest levied a $20 round trip fuel surcharge, the 11th increase since December of 2007. They are doing their best to pass the costs on. That is what they should be doing in a deregulated market environment.

But to say that to keep doing that we need to merge stretches credibility. Then there are all these problems that result in the aftermath of the merger. Customer service drops by the wayside while management tries to bring together two very proud airline cultures, dealing with employee unrest, integration of seniority lists. I saw those first-hand in the Northwest-Republic merger. At one point there were 10 million lost suitcases. We spent a lot of time trying to untangle all that web.

The Weekly Standard, which is a supporter of free markets and limited government regulation, recently wrote: "History is on the side of the pessimists." Count me in. "In the period immediately following every airline merger," they write, "chaos is the order of the day or year. Pilots find that control panels on the merged carriers differ. Baggage losses mount as they did when Northwest acquired Republic. The merging of reservation systems causes kiosks and websites to malfunction, as U.S. Airways and America West discovered. Strikes occur as disgruntled employees find the new pension package inferior to the old one. All of these are in the new Delta's future."

The inescapable lesson for me of 29 years of deregulation is that mergers and reduction in competition lead to higher fares, deterioration of service, financially weakened survivor. And we did not deregulate aviation in order to allow the consolidation, the subsequent consolidation of this industry into just a handful of carriers.

With that, I welcome the testimony and approach it with an open mind.

[Laughter.]

Mr. COSTELLO. The Chair thanks the Chairman of the Full Committee and now recognizes the Ranking Member of the Full Committee, Mr. Mica.

Mr. MICA. Thank you. And thank you for calling this timely hearing. I think it is appropriate that Congress does conduct oversight over what is taking place with passenger service in the United States, and particularly in light of the proposed merger between Delta Airlines and Northwest.

This may be the precursor of things to come, as you have heard and others have said. I struggled as Chair of the Aviation Subcommittee through six of what I thought were the most difficult years. Right now, though, I think there is a new set of incredible challenges that the industry faces.

I was Mr. No, I said just say no to Government bail-outs and probably forced some of the airlines into bankruptcy. Because of the disastrous effects of 9/11, many of them, through bankruptcy, undertook a difficult task of paring down their operations, cutting wages, eliminating sometimes outdated equipment, and work procedures. The whole nature of travel in this Country changed. Thousands of jobs were lost, even in the service industry of catering, for example.

Right now, airlines feel the same pressure. This Committee will not make a final decision on whether they can proceed, Delta and Northwest, with a merger. That is up to the Department of Transportation, as you know, and the Department of Justice. My take is that there is not an overlap of, or an attempt for one entity to consolidate all of the service or create a monopoly, and more likely that this merger will be granted. Having met with thousands of employees who lost their jobs as a result of 9/11, this may be the beginning of another disastrous situation for employment in the industry.

My biggest concern is that people, through the consolidation, will also lose positions, seniority and other things they have built up. That is very difficult, I know, for them to deal with personally. But the industry in fact is under tremendous pressure. And if they can't cut oil prices, they are going to cut everything else.

I think that is the biggest concern that I have in this question of to merge or not to merge. We will probably end up with about three major carriers. I think that if their reliance is on international fares, I believe that is a myth. Because with Open Skies, they will face discount international competition unlike any they have seen. You have carriers like Rhine Air, Sky Europe and a host of others who will be in these markets and fares will go down.

So do I have a solution for this? No. Maybe we will end up with three major carriers, we will get back to some regulation. My final concern would be, though, if the industry does go south again, God forbid, a terrorist attack or dramatic reversal of the economy, and we end up with three megacarriers, even with re-regulation, the Government would be left holding basically the financial bag and the obligations of what is left. That is not a very bright prospect.

So this is an important hearing. There are a lot of questions that we need to ask and find out where we are going. And again, this may be setting the pattern that we will see in the future.

So I thank you and yield back the balance of my time.

Mr. COSTELLO. The Chair thanks the Ranking Member and now recognizes the gentleman from North Carolina, Mr. Coble.

Mr. COBLE. Thank you, Mr. Chairman. I will be brief, Mr. Chairman. I thank you for having called this hearing.

I appreciate you all being here. As you may know, the topic of this hearing, Mr. Chairman, provides a nexus between my work on this Committee and my tenure on the Judiciary Committee, which is also conducting a hearing now. I may have to leave for that. Generally, Mr. Chairman, I believe it is important to withhold judgment on merger proposals until the details are put forth, so I will limit my remarks to the proposed merger between Delta and Northwest for that reason.

I would like to acknowledge that I understand the tremendous constraints placed on the aviation industry and the impact this has put on the industry's condition. Unfortunately, due to the increasing pressures in the marketplace, a carrier that had a strong presence in my district had to recently cease operations.

Further, Mr. Chairman, I would like to note that I believe it is important that the Department of Justice Antitrust Division have the time and ability to effectively and efficiently review the proposal and the impact upon consumers. It is also equally important that they receive input from all the stakeholders.

Finally, gentlemen, should the merger be approved, I would like to be the first to extend an invitation to you all to expand your operations at the Piedmont International Airport in North Carolina.

[Laughter.]

Mr. COBLE. I feel remiss, Mr. Chairman, I have taken advantage of this forum. But having said all that, I thank you, Mr. Chairman, and thank you all for being with us.

Mr. COSTELLO. The Chair thanks the gentleman.

Before we go to our first panel of witnesses, we will finally recognize the gentleman from Tennessee, Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman and thank you for calling this hearing. I will be very brief.

We have the best aviation system in the world, by far. We should be thankful that the Government hasn't been running that system, or we wouldn't have had that. I know this, though, we had a hearing last week in this Committee in which we heard that each one penny increase in diesel fuel costs the trucking industry as a whole

$391 million a year, and the diesel prices have gone up far more than that. I have heard for years that each one penny increase in aviation fuel costs the airline industry $190 million to $200 million a year. So these oil prices have really caused some very serious problems for several airlines. We have to have some more domestic energy production or we are going to have even more airlines in trouble.

But as a general rule, the Country is better off, the consumers are better off if they have more airlines instead of fewer. I wish we had many more airlines. Because of that belief, I think we need to look very closely at this proposal. In fact, I think that generally, we should not approve a merger unless the survivability of an airline is in question. But I am willing to keep an open mind through these hearings and look at any and all information about this.

Because of that, I appreciate, Mr. Chairman, your calling this hearing. Thank you.

Mr. COSTELLO. The Chair thanks the gentleman.

Finally I will recognize for brief comments the gentleman from Georgia, Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

I just want to thank Mr. Anderson, especially, for being here and the Delta family and what it means to Georgia. We understand that with fuel costs where it is and the environment that the airline industry is that there were not a lot of choices out there. I think Delta and their board has made the best choice possible.

So I hope that this Committee will look at it and understand that the survivability of an airline today is much different than what it has been in the past, and that Delta has always, at the top of its list, had customer service routes that make it possible for people to move all around this Country and now all around the world, that we have some of the best employees in the world and in the airline industry. I think that we are trying to do the best that we can to make sure that they all survive.

Not only that, but welcoming the Northwest family to that airline and making it the best airline in the world. With that, Mr. Chairman, I will yield back the balance of my time.

Mr. COSTELLO. The Chair thanks the gentleman and would note for the record Congressman David Wu from Oregon was here earlier. He has submitted questions that we will ask the witnesses to reply to in writing.

With that, we will go to our first panel and introduce Mr. Richard Anderson, who is the Chief Executive Officer for Delta Airlines; and Mr. Douglas Steenland, who is the President and Chief Executive Officer for Northwest Airlines.

Gentlemen, your entire statement will appear in the record and Mr. Anderson, you are recognized for your testimony.

## TESTIMONY OF RICHARD H. ANDERSON, CHIEF EXECUTIVE OFFICER, DELTA AIR LINES, INC.; DOUGLAS M. STEENLAND, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NORTHWEST AIRLINES CORPORATION

Mr. ANDERSON. Thank you, Mr. Chairman. Thank you, Mr. Oberstar, Members of the Committee.

First, I would just like for the record to introduce a binder. We have letters of support from 33 States and the District of Columbia. We also have a statement of support from the Delta Board Council, which is a representative council of Delta employees, in support of the transaction.

With that, on behalf of the many employees of Delta Air Lines here with me today and the 47,000 Delta employees worldwide, we appreciate the opportunity to talk about the industry and the important issues that all of you have raised in your opening comments.

The world that we face is a rapidly changing world. With Open Skies agreements around the world and free trade agreements around the world, we need to be strong to compete against the foreign-flag airlines. In order to do that, you really have to have strong financial footing and you really have to have a network that has the breadth and scope of being able to provide service to corporations around America doing business around the world.

Open Skies agreements have now resulted in foreign-flag carriers carrying substantially more U.S. passengers between the United States, Europe and Asia. If you just look at it on a daily basis, foreign-flag carriers carry about 22,000 passengers to Asia versus 15,000 on U.S-flag carries carrying passengers to Asia. If you look at Europe, the Middle East and Africa, about 40,000 passengers a day are carried by foreign-flags and 30,000 by U.S-flags.

More importantly, if you look at the order book of international wide body airplanes, U.S. airlines only have 5 percent of the worldwide outstanding wide body airplane orders on their books. Ninety-five percent of all Boeing and Airbus airplanes that are used for international service, two aisle, two engine and four engine airplanes, are held by foreign-flag carriers.

We have talked about fuel, you have all talked about fuel. I won't touch that subject again. I think everyone understands the tremendous impact that it has on this business. We aren't here to ask you for financial support. I sat here six days after September 11th and asked you for support, and Congressman Oberstar, you came to the aid of the industry. This time we are here not asking for that but asking for your support to allow us to do what we think is in the best interest of our communities, employees and shareholders. Hopefully, we can answer your questions along the way and put your minds at ease about this.

It really does give us the power to compete in a global environment. Delta and Northwest have very complementary networks. If you look at where Delta has historically flown, it has not flown and does not fly in the places that Northwest flies. So unlike many of the other transactions that this Committee may have looked at over time, Delta and Northwest are very complementary. Out of nearly one thousand city-pairs, there are really only 12 markets where we compete with each other on a non-stop basis in the U.S. Internationally, Delta has no route network in the Asia Pacific and Northwest is really the number one carrier to Japan and has the most extensive route network in Asia.

So the complementarity of the route network should ease your concerns about competition, because these are end to end networks. We move forward in a world of European Union Open Skies, and in Open Skies, we have very strong foreign-flag carriers in Europe who have been allowed to consolidate. And in order to be able to compete against those carriers, they are much better capitalized and they are buying their fuel with Euros, which means when we pay $125 a barrel for fuel, they are probably paying about 50 percent less than that, because they are not using dollars, they are using Euros.

So the merger really provides, and I know there are some skeptics on the Committee, and I hope we can work through this with you, but it really provides stability for the employees in these airlines. We have kept the employees in mind as we have gone forward here, because we have been able to craft an agreement that allows us to keep all the hubs of the two airlines. And these hubs have been scrutinized closely by both carriers. Both carriers just came through bankruptcy. And in the bankruptcy process, you have the right to reject aircraft leases and airport leases.

So both of these businesses have been through the scrutiny of creditors' committees and the bankruptcy process and have gotten to a core business model that is a core business model that will be viable over the long term with all of these hubs. We have committed to provide substantial ownership in the company to the combined employee groups. We have committed to fair and equitable seniority integration under Allegheny-Mohawk and have written that in the merger agreement.

In addition, this Committee, of course, and Congress, enacted that into law last December, in legislation we supported. We have committed to support the defined benefit pension plans that have since been frozen but will be funded over the course of the next 17 years. We have committed to keep our front line employees from being furloughed as a result of the transaction.

Let me speak really quickly about small communities and try to address some of Chairman Oberstar's concerns directly. Hub and spoke airlines are really built for small communities. The discount carriers have never shown any interest or built airline infrastructure, bought airplanes or bought gates and made investments to serve small communities. When you looked at the combined route network of these two airlines, a strong route network of a hub and spoke carrier is the most secure way to be certain we continue to serve small communities. Small communities are really the bread and butter of a hub and spoke system.

I do agree with Chairman Oberstar that we do need a real essential air service program in this Country, one that really works. We have been clear about that, both Doug and I, that we would support that. Because we together serve more small communities than any other two airlines in the United States.

We have made a lot of investments to serve those small communities. So we have 34-seat airplanes, we have 50-seat airplanes, we have 76-seat airplanes and we have made a lot of investment over the years to be able to serve those small communities.

When we go back to the competition issues and the issues around consolidation, each of Continental, America, Southwest, AirTran, JetBlue, have all been very clear in stating that they are remaining independent. Since we have had our announcement here, there has been an earnings cycle in the industry, so there were the usual analyst meetings. They have all been pretty clear in stating that they desire to remain independent.

This combination will ultimately, given the pull-downs that Delta is in the process of making, because of fuel, this combination will have perhaps around 17 percent market share around the end of the year, given where we are going with pull-downs. The low-cost carriers have over a third of U.S. passengers, 60 percent of all domestic aircraft orders and have been growing at double digits.

At the Senate Commerce Committee hearing last week, Pat Murphy, whom many of you know as the Under Secretary of DOT for many, many years, he, always a staunch proponent of competition, essentially stated that the domestic market is perfectly contestable and that there is free entry now and that with the growth of the low-cost carriers, there really isn't an issue of contestability in the U.S. market.

We have free entry in this business and real yields in this business are down 30 to 50 percent in real dollar terms since deregulation. The bottom line is, we think it is pro-competitive. It is good for small communities and it will be good for our employees.

I am sorry I was a little long.

Mr. COSTELLO. The Chair thanks you, Mr. Anderson, and now recognizes Mr. Steenland.

Mr. STEENLAND. Chairman Costello, Chairman Oberstar, other Members of the Aviation Subcommittee, my name is Doug Steenland, I am the Chief Executive Officer of Northwest Airlines and I appreciate the opportunity to appear here this afternoon to explain the benefits of the merger between Northwest and Delta, and the fact that this merger will not lessen competition.

Let me acknowledge and thank the Northwest Airlines employees in this room for their contribution to running a great airline. Let me also just take one second to acknowledge and thank Congressman Kagen who provided some very important medical assistance to a passenger on one of our airplanes last week, Thursday, between Washington D.C. and Minneapolis. A passenger fainted and the Congressman was able to provide some very necessary and needed medical assistance. I want to take this opportunity to thank him for that.

Mr. KAGEN. Mr. Chairman, may I respond? I have to say it was an honor to be available, and I have never had a flight that landed so quickly and got to the gate so quickly.

[Laughter.]

Mr. STEENLAND. Let's hope that does not become a continuous pattern, needless to say.

The U.S. airline industry is at a crossroads, creating two choices for Northwest. One is to continue on the road now traveled, as a standalone airline, being whipsawed between rising oil prices, which will cost Northwest over $1.5 billion more this year versus last year, facing increased competition from domestic carriers that have now captured more than one third of the U.S. domestic market, and facing heightened international competition from large, well-funded foreign airlines that have been allowed to consolidate and are increasing service to the United States under Open Skies agreements.

The other choice is to merge with Delta to create a single, stronger airline, better able to face these challenges. By combining the complementary, end to end networks of two great airlines, we will achieve substantial benefits and build a more comprehensive and global network.

More importantly, the merged airline will be more financially resilient and stable, better positioned to meet customer needs, better able to meet competition at home and abroad, and better able to provide secure jobs and benefits. In this merger, importantly, no hubs will be closed. I would like to focus on that just for a second. Northwest operates hubs in Minneapolis, Detroit and Memphis, and service to those hubs will continue. The merger will create over $1 billion in annual benefits that will help the merged carrier withstand volatile fuel prices and cyclical downturns. All of these benefits will be achieved without harming competition.

The existing domestic and international routes of Northwest and Delta are complementary, so the two carriers compete only to a minimum extent today. Let's start with international markets. The question of competition internationally has been asked and answered already by the U.S. Government. Recently, the United States Department of Transportation tentatively granted antitrust immunity to Northwest, Delta, Air France and KLM, and in doing so, found that there would be no reduction in competition over the trans-Atlantic from a combination of Delta and Northwest.

Northwest doesn't serve Latin America, a Delta stronghold. And Delta has only minimal service to Asia, which Northwest has served extensively since 1947. Domestically, Northwest routes are focused in the upper Midwest, while Delta is strong in the South and the East and the Mountain West.

And the most important fact to remember regarding competition, at today's hearing, is that of the 800 domestic routes that Northwest and Delta today collectively fly to, there are only 12 overlap city-pair markets between them. On the vast majority of those 12 routes, there is robust, non-stop competition that makes certain that substantial competition will remain in the future.

The domestic airline industry has undergone a competitive sea change over the past several years. Low-cost carriers have grown at an average annual rate of 11 percent since 2000. Southwest Airlines is the largest domestic airline in the United States, carries more domestic passengers than any other airline, and will continue to do so even after this merger is consummated.

In addition, online technologies, having some of the most powerful search engines in the world, run by Orbitz, Travelocity and Expedia, have created a consumer revolution. Customers can quickly and easily compare the offerings of competing carriers on any given route. If they so choose, they can push the lowest-applicable fare button that is guaranteed to give them access to the lowest fares. All of these developments ensure the continued competitiveness of the U.S. market post-merger.

There clearly has been speculation about a potential wave of mergers that might take place. However, recently Continental announced that it would not pursue a merger with United, and at a minimum, Delta, Continental, American and Southwest, together with AirTran and JetBlue and other low-cost carriers that exist today and will enter into this market, will continue as independent competitors in the domestic marketplace.

With this merger, we have achieved our goal of crafting a transaction that creates benefits for all of our constituents, especially when we take into account the massive oil price increases that we have experienced. The combined airline will be more stable and better positioned to meet the challenges of the future both at home and abroad.

Thank you very much.

Mr. COSTELLO. The Chair thanks you, Mr. Steenland.

Mr. Anderson and Mr. Steenland, if you will, you have heard my opening statement and Chairman Oberstar and other Members who spoke about their concerns of how the employees will be affected with the merger, how consumers will be affected. I have read the reports from your testimony over in the other body that if I am correct and if the reports that I read were accurate, you indicated that when the merger takes place, if in fact it does, that you do not intend to have layoffs, that you are going to keep the existing workforce, and that you are going to maintain the hubs that you currently have. Is that correct?

Mr. STEENLAND. With respect to the layoff issue, we have extended that to front line employees, which has been defined as pilots, flight attendants, reservation agents, ramp workers, customer service agents and others who are directly involved in the provision of air service. And again, because this is an end to end merger, that involves little or no overlap, we don't expect and we don't anticipate service reductions as a result of this merger.

As we discussed, we obviously have a competing challenge whether we have merged or not, that is the impact of fuel prices. We will have to take actions accordingly. But as a result of the merger, we don't anticipate any reductions in service.

If we could talk a second about hubs, if you think——

Mr. COSTELLO. If I can ask you to clarify a point. When you say that you don't expect a reduction in service with the merger, how does that affect the employees? Same number of employees when the merger takes place?

Mr. STEENLAND. Not in totality, because we have acknowledged that clearly, within the management ranks, there are redundancies and there will be reductions and there will be reductions as a result of that. But again, with respect to front line employees, if you think about Minneapolis-St. Paul, for example, we operate a large hub in Minneapolis-St. Paul. We anticipate continuing to operate a large hub at Minneapolis–St. Paul, and probably on any given day we have more vacancies in the Northwest workforce than Delta has employees in Minneapolis. So we anticipate meshing those workforces quite easily in that hub operation, and clearly would expect no layoff of front line employees. That is just one example of how we would anticipate that working.

Mr. COSTELLO. Surely in your discussions, when you began discussions, talking about the merger and talking about how you achieve efficiencies, you acknowledge that there will be some administrative people who will be affected. What are your estimates? How many people will be affected? How many will either lose their jobs voluntarily or involuntarily on the administrative side and total number of workforce?

Mr. STEENLAND. We haven't come up with an exact number yet. We kicked off last week the transition planning process. And as that gets more detailed and we get more specific, we would expect to have a more precise answer as to what that number might be.

Mr. COSTELLO. So you might be able to provide that number when?

Mr. STEENLAND. I would say two months from now.

Mr. COSTELLO. The issue of maintaining your current hubs after the merger is approved, if in fact it is, you heard me say in my opening statement that American Airlines executives sat in this room at that table and assured me and other Members of the Subcommittee that they in fact would continue to maintain their current hubs after taking TWA over. And in particular, in St. Louis, that not only would they maintain St. Louis International Airport as a hub, but the current level of service as well.

So when you say that we are going to continue to have, to maintain the hubs at the current level of service, I indicated we were told that St. Louis, same level of service, less than two years later, the number of flights went from over 500 per day to about 250 per day, a significant reduction, and a number of employees were affected or had their pensions reduced. So I wonder if you might comment about the level of service at both hubs.

Mr. ANDERSON. If I may draw a contrast between the TWA-American transaction——

Mr. COSTELLO. And we understand the contrast. TWA was in trouble, TWA was going bankrupt and they were going out of business. We understand that issue.

Mr. ANDERSON. Right.

Mr. COSTELLO. But the point that I am making is, we were given assurances by American Airlines. They could have said, we don't know, we don't know what the price of fuel will be, we don't know what the future holds. But that is not what they said. They said that we are going to maintain the hub in St. Louis at its current level of service.

So what I am asking you is, how can you give us assurances here that you are going to maintain the same level of service in both, at your hubs, and continue basically with the same workforce? What is the point of merging if in fact you are not going to see reductions in either service or employees to achieve efficiencies?

Mr. ANDERSON. You are not going to see a reduction in the front line employees, because, go back to the example that Doug used, there is so very little overlap between the two airlines that there really aren't any redundancies. I used the example of Salt Lake City where Northwest has five flights and five employees. We have at Delta 500 flights, counting our regional carriers, and the absorption of their flights onto our gates and their employees will be seamless. So because it is not an overlapping consolidation, you have the ability to be able to transition.

Now, that is not true, just so we are clear, Mr. Chairman, that is not true with respect to overhead, general and administrative expenses. And as Mr. Steenland said, we are in the process now of doing a bottoms-up analysis of how you put the two airlines together. And we will be forthcoming to the Committee with what that is, at your request.

The main factor that is going to drive capacity up or down is going to be fuel prices. And it won't be sa a result of this merger, as I go back to the point I made in my earlier remarks, both of these airlines just went through bankruptcy and if you will, really cleaned up their strategies. If the Cincinnati, Memphis, Detroit, Atlanta, if any of these hubs were not viable, you can bet that the creditors' committee and constituents in the bankruptcy process would have required the carriers to reject the leases and the airplanes. So we are really comfortable that we have solid assets there.

But as to level of service, it is going to be dictated by fuel prices, whether this merger occurs or not.

Mr. COSTELLO. Final question, at least at this point, then we can move on to other Members who have questions. Mr. Steenland, you stated, I believe, in your testimony that small communities will benefit, and the reason they will benefit is you will even have a larger national and global network. Both Northwest and Delta, you have both already announced a decrease in capacity, that you are going to reduce capacity.

So if in fact you already have plans to reduce capacity, wouldn't the small communities be the first to be affected, since they are the least profitable for both airlines?

Mr. STEENLAND. No. First, I don't think it is a correct assessment to necessarily say that they are the least profitable. As Richard said, we have designed a network, and we have purchased equipment to be in a position where possible, obviously there are EAS cities where it is not possible, but whether we are flying into Brainard or we are flying into smaller cities in North and South Dakota, we have airplanes that range from 34 seats to 50 seats to 76 seats, all of which are tailored to meet the needs of that small community and try to provide a frequency of service.

That small community, someone coming out of Chisholm can come into Minneapolis and has the opportunity to basically go to approximately 175 destinations that we serve, with 500 or more departures a day. As a result of this transaction, there will be more additional online destinations that will be available through that hub. We have created a network and we have created an infrastructure that is designed to serve those cities in a profitable way. Otherwise, we wouldn't be there.

Mr. COSTELLO. Thank you. The Chair now recognizes the Ranking Member of the Subcommittee, Mr. Petri.

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

I was corrected, I misspoke earlier when I said that since December there had been eight airlines that have filed in bankruptcy or suspended business. I was wrong, there have been nine, as Air Midwest this morning suspended, announced it was suspending operations.

A question for both of you. The airline business is obviously a local and a regional business in the United States, but it is also a global business. We have laws requiring that there be American-controlling ownership of airlines who each have alliances with overseas airlines, that have themselves an alliance, Air France and

KLM. So as this consolidation goes on, is there where a lot of the savings are going to occur? Is this irrelevant to your merger? Our Government looks evidently totally at domestic implications of the merger. How are they defining the market that is merging, I guess is what I am asking? Does the European alliance or merger between those two airlines, is that in part driving your merger here in our domestic market?

Mr. ANDERSON. Globally, the industry has been consolidating, when you look at what has occurred in Asia and Japan, for instance, what has occurred in Europe. So there is consolidation globally. But our alliance with Air France and KLM will be improved by this transaction, because Northwest and KLM have an immunized alliance across the trans-Atlantic. And Delta and Air France have an immunized alliance across the trans-Atlantic. And where the real efficiency comes is when you are in our position of a Northwest or Delta, and we are trying to appeal to the business traveler in Europe. So we have a strong base in the U.S. and we want to appeal to the business traveler in Bucharest or Frankfurt or any of the other large firms in Europe.

We don't have a sales and distribution or brand that travels the way Northwest travels in Minneapolis and Delta travels in Atlanta. In those countries, everyone looks at KLM and Air France and the foreign-flag carriers as their flag carrier. So in order for us to get into those markets, and one of the things that this transaction gives us the opportunity to do through our relationship with Air France-KLM, is to have a strong and significant presence in foreign markets. Because we essentially sell our product through the Air France-KLM distribution network. So we aren't treated as an "American flag-carrier," we really get to participate in those large traffic pools as a participant with Air France-KLM.

Mr. PETRI. Is there a difference in the profitability of international as opposed to domestic flights?

Mr. ANDERSON. Yes.

Mr. PETRI. Which is more profitable?

Mr. ANDERSON. International.

Mr. PETRI. So this could drive, this could be a significant benefit in increasing your international business over time?

Mr. ANDERSON. Correct. You could be an airline executive.

[Laughter.]

Mr. COSTELLO. The Chair thanks the gentleman and now recognizes the Chairman of the Full Committee, Chairman Oberstar.

Mr. OBERSTAR. Thank you, Mr. Chairman, and I thank Mr. Petri for his thoughtful comments and questions, and our Ranking Member of the Full Committee for his thoughtful opening statement.

We have before us two of the smartest, most seasoned and most experienced airline executive in the industry today, the best. That is why you are dangerous.

[Laughter.]

Mr. OBERSTAR. You referenced international competition. And just accepting your figures, foreign carriers have roughly 60 percent of the Pacific traffic, and 55 percent of the Atlantic traffic. That is a bit of a shift from just less than 10 years ago, when we had 70 percent of the Pacific and 65 percent of the Atlantic for U.S. carriers. But that is still U.S. against the world.

So what will the merger accomplish in trans-Atlantic service that the alliance, which you will be given tentative antitrust immunity, will not accomplish? And I was an advocate for that joint venture, for the alliance, the JV has not yet been accomplished. And I interceded with Air France, it is on the record, I sent a letter urging them to reapply after the first turn-down. So I have supported this alliance.

But what will the merger do that the alliance cannot?

Mr. STEENLAND. I would say, Mr. Chairman, that if we just isolate the trans-Atlantic, the merger will be incrementally beneficial on top of the benefits that the alliance, the immunized alliance would otherwise provide. Clearly, the immunized alliance will provide benefits, the record speaks for itself. You are a strong supporter of it, and the Department of Transportation, with the advice of the Department of Justice, concluded that there were no anticompetitive impacts created by the formation of that alliance.

Now, where the benefits get to be better is, for example, on the United States, there will be a single frequent flyer program between Northwest and Delta, as compared to having separate frequent flyer programs. So a person can, instead of having to build up miles on the Northwest account and then build up miles on the Delta account and not being able to put them together, now it will be all part of one pool, which will make us a better competitor and a more effective competitor. We will be able to share best practices that we previously could not do, because under the alliance, Northwest and Delta remained competitors domestically. And here we will actually be able to sort of roll up our sleeves, compare notes as to what we each do and we will both be able to learn from each other's companies to be sure that we put our best foot forward.

The alliance and the immunity that the DOT has tentatively granted is important and has real value. The merger provides incremental value to that.

Mr. OBERSTAR. Heathrow continues to be the obstacle, though, does it not, under Bermuda II, to an expanded U.S. presence in the European market? You would agree with that? There are only four carriers, U.S. carriers, really operating in that market under Bermuda II, and even under the EU, they haven't expanded. So how does the merger improve access to the European market coming through London, where now you have two carriers competing out of London Heathrow, and, well, only Northwest in Gatwick? How does that improve competition?

Mr. ANDERSON. Mr. Chairman, the last round of EU liberalization opened up Heathrow to both Northwest and Delta.

Mr. OBERSTAR. But they are of no value unless they build another runway. No really substantial value unless they build another runway.

Mr. ANDERSON. They should build another runway. They should build another runway, but we have been able now to commit service from our hubs to London Heathrow Airport, which candidly was not something I don't think we ever expected would occur. But it did occur, and through our alliance relationships, we were able to procure slots and gates.

So we both started service from our hubs to Heathrow. I think we all started in March, April time frame. So we have been able to procure access. And Heathrow really is a spoke off of our U.S. hubs. That access is sufficient for us, because our principal hubs in Europe will be Amsterdam and Paris.

Mr. OBERSTAR. Yes. Well, that I understand. But still, Heathrow is a massive entry point to the continent. It will continue to be.

Mr. ANDERSON. By far the largest O&D market in the world is the U.S. to Heathrow.

Mr. OBERSTAR. Right. You mentioned in a post-merger environment the continued presence of what you call low-cost and what I call low-fare carriers and cite Southwest as the largest domestic airline. But if you look at Southwest's market model, they have 3.9 percent of the market out of Detroit. They have 13.8 percent of the market in Salt Lake City, zero in Minneapolis-St. Paul, zero in Cincinnati, zero in JFK, zero in Memphis.

So when is Southwest going to open their routes to London, to Paris, to Amsterdam, to provide international competition?

Mr. STEENLAND. I don't know.

Mr. ANDERSON. We don't know.

Mr. OBERSTAR. They are not challenging you at your strongholds.

Mr. STEENLAND. Well, I think they are. Southwest, even though their percentage in Detroit might be relatively small, they have a very big wake in terms of the fares that they set and the impact that they have on the community. They operate in other parts of our network, they operate to St. Louis, they operate to Kansas City, they operate in Omaha, all of which affects the heartland market.

Mr. OBERSTAR. In smaller markets. My point is, a bigger carrier is going to be even more of a frightening effect upon the smaller so-called low-fare, point to point domestic carriers. I don't see Southwest morphing into a United Airlines and becoming an international carrier, as United did after deregulation in 1978. Everybody dismissed United, said, who are they. Pan Am was expected to be the big winner, and Pan Am turned out to be the big loser, because it was the domestic network carrier that had the gravitas to compete in the international trade. That is the market.

Southwest has no inclination to do that. And they have no inclination to challenge you big carriers in your major hubs.

Mr. ANDERSON. In the case of Delta, we have a second hubbing carrier in Atlanta, and that is AirTran, and we have a second hubbing carrier in JFK, JetBlue. And we have a very strong Southwest in Salt Lake City. I would note that Southwest got its position in Salt Lake City through an acquisition of Morris Air about 15 years ago.

So across the Delta network, we are in many, many contestable markets.

Mr. OBERSTAR. I will withhold questions, there are other Members. I want others to have an opportunity. Thank you.

Mr. COSTELLO. The Chair thanks the gentleman and now recognizes the gentleman from North Carolina, Mr. Coble.

Mr. COBLE. Thank you, Mr. Chairman.

Gentlemen, thank you all for being with us and for your testimony. I have a couple of questions.

There has been some discussion about vertical versus horizontal mergers. How would you classify this merger and why?

Mr. STEENLAND. I think you would classify this as a horizontal merger, because it is two network air carriers getting together who are in the business of being hub and spoke providers. We are end to end carriers. So we are taking our existing businesses and we are expanding them, but we are remaining in the same business. We are not merging with a catering company, we are not merging with a maintenance provider. We would like to merge with an oil company, but I am not quite sure that would work in this environment.

So that is why I think we would call this horizontal, and it would emphasize the end to end nature of it.

Mr. COBLE. Mr. Anderson, do you concur with that?

Mr. ANDERSON. I do concur, and I would like to merge with an oil company.

[Laughter.]

Mr. COBLE. So would I—so would we all.

What, gentlemen, would be the impact on communities that are seeking to attract air service?

Mr. STEENLAND. I would think that the benefit would be the same if not better, because if it is a spoke community that is trying to get access to one of our collective hubs, the scope of service that that hub would provide would be greater, and therefore, it would increase the likelihood that service from that spoke would be more feasible and economic.

Mr. COBLE. Mr. Anderson?

Mr. ANDERSON. I concur.

Mr. COBLE. And I agree with that as well.

There has also, gentlemen, been discussion about the state of the industry as a whole, given that approval of this merger would maybe create a domino effect with other carriers. What is your view of the industry as a whole if this proposed merger is approved versus if it is rejected?

Mr. ANDERSON. From the standpoint of the organization of the industry, as I remarked in my opening comments, each of Southwest, American, Continental, AirTran, have each been clear in stating that they want to be independent. From a contestability standpoint, and you look at the size of the remaining independent airlines, approval of this transaction in the domestic marketplace, which is the only place where there is even an issue of antitrust concern, there is plenty of competition in the marketplace, and it will remain unchanged after this transaction.

So we believe that what we are proposing here should pass muster under the antitrust laws.

With respect to the overall industry, I think it was you or, no, it was Congressman Petri, Ranking Member Petri noted that there have been nine bankruptcies in the industry since the first of the year. With fuel prices continuing to rise, there is going to be more difficulties in this industry. And the industry has to change and adapt as rapidly as it can to increasing fuel prices if the prognostications that we hear from the experts in the oil industry and the commodities business are correct, that the price of fuel is going to $200. What this merger allows us to do is create a much stronger, much more durable airline that allows us to generate $1 billion to

$2 billion in additional benefits, which makes us stronger in whatever fuel environment we face.

Mr. STEENLAND. Congressman, if you think about one of the unique features of the airline industry, it is that airplanes are mobile. If you are in the hotel business and you build a hotel, you can't exactly pick it up and move it if you don't like the market that you set it down in. If you are in the airline world, your airplane can fly away and you can go attack any market you want.

If you think about just what has happened over the last six months or nine months, if you look at Denver and you look at the increased competition that Southwest has brought into Denver, facing up against United, facing up against Frontier. I think that is testimony of how airplanes are a very mobile arsenal. This industry will remain intensely competitive for the long, long term.

Mr. COBLE. Thank you both, gentleman. Thank you, Mr. Chairman, I yield back.

Mr. COSTELLO. The Chair thanks the gentleman and now recognizes the gentleman from Illinois, Mr. Lipinski.

Mr. LIPINSKI. Thank you, Mr. Chairman.

Thank you for your testimony here today. It is obviously not an easy case.

I want to start out by talking about my district in Chicago. It is home to Midway Airport and we have O'Hare Airport close by. They are both major economic engines, and thousands of my constituents are employed at the airports or with the airlines that operate out of these two airports. And of course, my constituents rely on these airports when they travel.

My understanding is right now, Midway has 15 Delta flights and 11 Northwest flights each day, and O'Hare has 23 Delta flights and 21 Northwest flights each day. So my first concern is the impact that you expect this merge would have on prices and flight options going in and out of the Chicago area, and the impact on Delta and Northwest employees based in the Chicago area. Is there anything that you could tell me about that right now? I see you are going through a lot of papers there.

Mr. STEENLAND. One of the points I would just note for starters is that Southwest has a major presence at Midway. It is one of the most competitive airports, I think, in the Country. We operate to Midway just from our hubs. And we do so with a level of frequency that, all things being equal, our expectation would be for it to remain the same.

Mr. ANDERSON. And I was just looking up, we have a service summary, because we anticipated this, so we went and checked every one of your districts to determine where we stood.

[Laughter.]

Mr. LIPINSKI. Good homework, there. It is a big book.

Mr. ANDERSON. It is a big book. And we have eight and a half, I don't know how you have a half a trip, but we have 8.5 trips to Atlanta and 6.5 trips to LaGuardia from Midway. We serve Atlanta, Salt Lake, New York and Cincinnati from O'Hare. As a result of this, there wouldn't be any change.

I think the only place in that market where we, separate from this or we are always examining, is our service from Midway to LaGuardia. We are trying to operate a shuttle product from

LaGuardia to Washington National, Boston and Chicago with pretty high frequency. That has been a sometimes difficult market, because there is a lot of service in the Chicago-New York market.

So that will happen, though, separate from whether or not this transaction closes.

Mr. LIPINSKI. So you are saying the transaction isn't necessarily, as you see it right now——

Mr. ANDERSON. It won't have any effect on this service, the transaction won't. We will still serve all our hubs.

Mr. LIPINSKI. One other issue I wanted to discuss in the last couple of minutes I have here, I wanted to ask you, Mr. Anderson, I know in your testimony before the House Judiciary Committee, you didn't really succinctly answer the question on whether or not you are remaining neutral in the representational election of the Delta flight attendants, or whether you were advocating a position. Do you still stand by this? Or are you advocating a position on this?

Mr. ANDERSON. Yes, we are advocating a position. The way the National Mediation Board works, and the process, Mr. Congressman, is a process that essentially provides for democracy, a democratic process where everyone is engaged, and many of our employees are engaged. We have a view in that regard, but at the same time we respect the determination of our individual employees.

If you look at Delta's, and I think Congressman Westmoreland said it, Delta has been unusual in that it has had a long sort of direct relationship culture. While we have collective bargaining units that we have great respect for and work very closely with, you will hear from one after me, Captain Moak and our dispatchers who are represented by collective bargaining agreements, Delta has a long history of the Delta family. We think that the employees have the right to decide and we respect that. And we have a view about that, but we think it should be fair and open and we respect the outcome either way.

Mr. LIPINSKI. I understand that you certainly can't take a position. I watched this video earlier today and I did have some concerns about the phrase being used, when you were suggesting that the flight attendants, when they get their voting instructions, to give them a rip. That did concern me a little bit in the suggestion there about what to do.

Mr. ANDERSON. It is an odd process under the Railway Labor Act. The way you vote under the Railway Labor Act is not return the ballot. I actually anticipated that question, and I don't think I brought with me a ballot and the ballot instructions from the National Mediation Board, but the way you vote, you either vote yes and send it in, or you don't send it in. And that is how the process is conducted by the National Mediation Board. That is how the balloting instructions work.

Mr. LIPINSKI. I understand that. I did have some concern about what the suggestion was there. I respect that you certainly can't take a position on this. But I just want to express that concern.

Mr. ANDERSON. That is fair. I think at the heart of it, we want this to be a good place to work. If you look at the history of Delta, Delta is the only major network carrier that has never had a strike. It has always paid its employees and provided benefits that were historically among the best in the industry. And even today, when you compare our wages and benefits with Northwest, they are higher. So in the end, we want it to be a very good place to work, whether our employees are organized or not. We respect that process.

Mr. LIPINSKI. The employees definitely deserve that right to organize.

Mr. ANDERSON. They do.

Mr. COSTELLO. The Chair thanks the gentleman from Illinois and now recognizes the Ranking Member of the Full Committee, Mr. Mica.

Mr. MICA. Thank you. Just a couple of quick questions.

You described a horizontal integration or consolidation of the companies. Where are the biggest savings going to come from? If you gave me like, one, two three?

Mr. STEENLAND. I will start and just mention one.

Mr. MICA. The top one?

Mr. STEENLAND. I would say it is in the top three. That has to do with the better utilization of our aircraft. For example, Northwest has almost 50 airplanes that are 300 seats or larger. Delta has no wide body airplanes that are larger than 275 seats. It has a lot of wide body airplanes that have 200 seats.

Mr. MICA. Do you have two and three? Mr. Anderson, where are the savings going to come from?

Mr. ANDERSON. Where are the savings coming from? I will give them to you right in a row.

Mr. MICA. If you only have 12 sites where there are overlapping markets, so there can be some consolidation there.

Mr. ANDERSON. I can get you $675 million to $950 million in annual operating expense savings very quickly; $75 million to $100 million in selling expenses, single sales force, single set of corporate sales agreements. Information technology, go from one massive platform, from two to one, that is $125 million to $150 million a year. The overhead reduction that we have talked about earlier is $150 million to $175 million a year.

Our facility overlap, take a location like Congressman Lipinski's location in Chicago, we each both have pretty big terminals in Chicago. We will be able to move to one terminal. That is worth $150 million to $200 million a year. We think that across the enterprise, general business productivity, $75 million to $100 million. And on our supply chain, dealing with all the vendors, $125 million to $185 million a year, steady state, which puts us at least at $675 million on a steady state basis.

Mr. MICA. Do you project any reduction in numbers of personnel? I think somebody told me there are 75,000 in the consolidated organization.

Mr. ANDERSON. Yes, we do expect reductions in management, overhead and corporate staff.

Mr. MICA. What about the rest of the crew?

Mr. ANDERSON. The front line employees, we don't expect any and won't have any involuntarily layoffs of front employees. I would note that Delta just went, we have just gone through a significant downsizing that is in the process of being finalized right now. We are in the process through an early out of voluntary early out, early retirement program of reducing about 13 percent of our staff.

Mr. MICA. So you can take some of that through retirements and voluntary separations?

Mr. ANDERSON. Yes.

Mr. MICA. I think that is important, that people know where the cuts are going to come from, how the consolidation is actually going to take two airlines that are losing money and hopefully have them, at least reduce their losses, hopefully make a profit.

I had talked to you briefly and some of the other executives, too, about the constraints you have in increasing your ticket price. What could we do to allow you to keep the price of the ticket concurrent with the fuel prices? Your fuel prices have gone from 19 percent of your operating costs in 2004 to 40 percent. That is a trajectory that is, no matter what you consolidate, how you dance around this, we have to address this. You don't have the ability to pass some of that on, is that correct? Or can you do that?

Mr. ANDERSON. It is a very tough market.

Mr. MICA. Is there a constraint legally?

Mr. ANDERSON. No, not that I am aware of.

Mr. MICA. There is no constraint? So you can pass that on?

Mr. ANDERSON. You can put it in your prices, but the marketplace is going to determine what the market-clearing price is.

Mr. MICA. The other thing too is you are paying 4.3 cents fuel tax. What do they pay in Europe? Is there an aviation fuel tax? Does anybody know?

Mr. STEENLAND. I don't know.

Mr. MICA. Does anybody in the audience know?

Mr. ANDERSON. Don't know.

Mr. MICA. I know that our gasoline tax is 18.4 cents, and most countries in Europe it is $3 or $4. I just wondered what they pay.

Mr. ANDERSON. I actually think that aviation bilateral treaties prevent that kind of discrimination. In other words, you can't put a large tax under the aviation bilateral agreements like that to discriminate against aviation bilaterals. But we can get back to you, Congressman Mica.

Mr. MICA. I am just trying to see, you are describing a consolidation, I see problems that aren't going away. I am looking for solutions. One is increasing your revenue. You told me how you are going to cut your costs, through some consolidation. But fuel is the big enchilada right here, and we have to find a way to help you survive, help people who are trying to fill up their gas tanks survive, and a host of other things. I don't have time to get into all of them right now, because Mr. Costello wants to take back my time.

Thank you.

[Laughter.]

Mr. COSTELLO. The Chair thanks the gentleman.

Let me say to the gentleman that I think when you were out of the room, both Mr. Anderson and Mr. Steenland committed to give an estimate of about 60 days from now, that they would know the numbers, how many administrative people would be affected in the consolidation. So they have committed to getting that information to us.

Mr. MICA. I am also interested in down the chain.

Mr. COSTELLO. We are very interested in down the chain as well, and they are supposed to supply that to us.

The Chair would announce that we are being called now to the Floor for a series of three votes, but we have time to recognize one, possibly two more Members for questions, and then I will announce when we recess how long it will be, we will try and get a determination to come back.

The Chair now recognizes the gentlelady from California, Ms. Richardson.

Ms. RICHARDSON. Thank you, Mr. Chairman. I will try and be as brief as possible.

First of all, with all due respect, our Chairman here asked you in several very polite ways how you expected to maintain facilities at both locations and you gave us various reasons why you expected no change at all. I have to be honest with you, I am very skeptical, and that is a kind word that I am using. So I would like to hear through additional discussions of really the need, what is the real, true commitment that you intend upon giving this Committee that there would be no hub changes, that there would be no staff changes. Are you prepared to give that to us, and give this Committee in writing? If not, to me it is not worth a whole lot, the minimal statements that you have made.

The second point I wanted to state, the gentleman, you said that you are not asking us for support. I tell you, I would much rather you ask us for support today to help this industry than for you to cut back and us have to pay for unemployment, us have to pay for people who don't have health insurance. We are either going to pay one way or the other.

So I would rather us fix the situation, truly fix it. This issue of oil prices, and we have talked about it and talked about it, and maybe it is a key point. But that is not the only point of why this merger is being brought to the table. I think to lay it only on the oil issues really is not being fair and appropriate.

So those are my very brief comments, if you would like to respond.

Mr. ANDERSON. We have been very clear in testimony now, this is the fourth time, twice in the Senate, twice in the House, and in all the written materials we have provided with respect to our strategy to keep the hubs and to not have involuntary furloughs of front line employees. Now, with respect to facilities, which I think I heard in your comment, with respect to facilities, there will be facilities that we will close and consolidate. Take Los Angeles International Airport. Northwest is in terminal 2 and Delta is in terminal 5 and 6. We will figure out, between the two airlines, where we can accommodate both of us and then work with the city to rationalize facilities. So that will definitely happen and we will be able to consolidate our operation.

We appreciate very much your concern about the industry. It is always difficult in a deregulated industry to figure out how effectively the Government can participate. This industry was regulated for its first 60 years of existence. For a whole lot of policy reasons, as Chairman Oberstar said, that was changed in 1978. So it is difficult to sort of hazard what you would do from a public policy standpoint, but we appreciate your concern about the industry. One of the hardest things you face in this business is when you have losses and you have to take cuts in your cost structure that affect people and communities, because in the end, the only really viable way to have job security is to have a viable airline. That is really what we are doing here, is building a much stronger airline in combination so that we have a good place to work for our employees.

Ms. RICHARDSON. Well, I would just summarize in saying, and I want to yield back, because the Chairman really wants to give other Members who have waited an opportunity to speak, I worked in the private sector for Xerox Corporation and I have a masters in business. For people who have been around a little bit, and I may be a new Member of Congress, but I wasn't born last night. When you say involuntary, non-voluntary, that is the same as saying, if you are going to close the terminal in L.A., well, yes, you can keep the job if you are going to move to Minnesota. That is not necessarily dealing with the employee issues.

You also stated the fact that, well, you could let us know in two months what you think might happen with some of the people. Well, if you are expecting our support in this issue now, I can't give that to you if you can't even answer the question.

Thank you. I yield back the balance of my time.

Mr. COSTELLO. The Chair thanks the gentlelady and now recognizes the gentleman from Michigan, Dr. Ehlers.

Mr. EHLERS. Thank you, Mr. Chairman.

In view of the time, I will be extremely brief. I have been watching this particular proposal for some time and I have had the opportunity to ask a number of questions over that period of time, so I won't belabor the issue by asking questions now.

But let me just express one concern which has nothing to do with this proposed merger. I do worry a bit that if this merger goes forward, it might give an excuse to a couple of the other airlines to attempt mergers, and we end up with only two or three airlines in the Nation. And then I would begin to worry. But I see nothing to indicate that we should stand in the way of this particular merger. But I just want to serve notice that if anyone else tries, we could end up with some very serious antitrust situations in the future.

With that, I yield back.

Mr. COSTELLO. The Chair thanks the gentleman for his comments and now recognizes the gentlelady from Hawaii, Ms. Hirono.

Ms. HIRONO. Thank you very much.

I will keep my questions very short. I know that both of you have testified, or Mr. Anderson has testified that there are a number of other airlines who have expressed a desire to remain independent. However, the fact that the two of you would like to merge, would either one of you be surprised that other U.S. airlines would want to merge in order to compete with your merged airline? Would either one of you be surprised with that result?

Mr. STEENLAND. No.

Ms. HIRONO. Thank you.

Now, you have also testified a couple of times that you intend no layoffs of front line employees, both of you. We know that that number amounts to thousands and thousands of employees. I think the key question is, though, can either one of you tell us for how long you intend to not lay off front line employees or for how long you intend to maintain your hubs and your current level of services? In all honesty, can either one of you commit to any length of time for that kind of a goal, which is very worthy? We appreciate that.

Mr. ANDERSON. Right. Well, the word I used in the Senate Commerce Committee is that it is as definite as you can ever make a commitment in any business. We have both been operating from these facilities and in these airports for 20, many, many years. And it is a core part of what we do as an airline, serving Atlanta, Salt Lake, Cincinnati, Minneapolis, Detroit, Memphis. We have collectively been serving those locations in most instances since the beginning of this industry in the early 1920s and 1930s. It is our intention and our business strategy to stay operating in these hubs and providing the service that we provide to those communities.

Ms. HIRONO. However, your merger does come in the context of a changing industry and worldwide competition. So if you wanted to ask some——

Mr. STEENLAND. No, I was just going to provide an example. Today, Northwest flies two wide body airplanes a day from Honolulu to each of Tokyo and to Osaka. Delta doesn't serve those markets.

Ms. HIRONO. I know that you were one of the original ones.

Mr. STEENLAND. We were one of the original ones.

Ms. HIRONO. And that is why you have that.

Mr. STEENLAND. And on those airplanes, it is probably 99 percent Japanese tourists coming to Hawaii. So those airplanes will continue to fly, subject to economics of fuel and the like. No impact on those routes will be as a result of this merger.

Ms. HIRONO. I wouldn't think so, because Northwest I know has a very favored status with regard to Japan.

Just one more thing. One of my colleagues expressed a concern about the fact that Delta Airlines flight attendants are in the middle of deciding whether or not they want to be unionized. I note Mr. Anderson's testimony that says that employee relations are really important. That all sounds really nice, I commend you for that. And of course, you are going to abide by any decision, which by law you have to.

But I have some information which leads me to think that the position of management with regard to this unionizing effort is what I would call very aggressive and in your face. I have a concern about those kinds of tactics and I would like to express those concerns to you here.

Mr. ANDERSON. And I respect your concerns. Thank you.

Mr. COSTELLO. The Chair thanks the gentlelady.

We are down to about five minutes on this vote, so we will recess. There are two additional votes. I will ask our witnesses, I think we have other Members who want to ask questions of these witness. I would ask everyone to come back in 20 minutes. At 4:05 we will resume the hearing. The Subcommittee stands in recess until 4:05.

[Recess.]

Mr. COSTELLO. The Subcommittee will come to order.

The second panel consists of the Honorable James J. O'Connell who is the Deputy Assistant Attorney General, Antitrust Division for the U.S. Department of Justice and the Honorable Michael Reynolds who is the Acting Assistant Secretary for Aviation and International Affairs with the U.S. Department of Transportation.

Mr. O'Connell, you are recognized under the five-minute rule, and you both should be aware that your entire statement will be entered into the record.

**TESTIMONY OF THE HONORABLE JAMES J. O'CONNELL, JR., DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, AND THE HONORABLE MICHAEL W. REYNOLDS, ACTING ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION**

Mr. O'CONNELL. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Committee, I am pleased to appear before you today to explain how the Antitrust Division evaluates the likely competitive effects of airline mergers. I would note, as the Chairman noted at the beginning of these proceedings, that as pending transactions are pending law enforcement matters, I will not be speaking specifically about the Northwest-Delta merger today.

The Antitrust Division has pursued an active program of enforcement in the airline industry for many years in order to ensure that consumers receive the benefits of airline competition. In October, 1998, for example, the Division sued to undo Northwest Airlines' acquisition of a controlling stake in Continental Airlines and, in 2001, the Division announced its intent to challenge the proposed merger of United Airlines and U.S. Airways after concluding that that merger likely would reduce competition and result in higher fares on routes throughout the United States and internationally. The parties abandoned their merger plans in response to that decision.

The Division has also successfully challenged other transactions that would have substantially lessened competition, including proposed acquisitions of gates or slots that we concluded would have eliminated competition in certain markets.

In addition to challenging transactions, the Division has investigation and challenged collusion under Section 1 of the Sherman Act, most recently, for example, in an ongoing Antitrust Division criminal probe of international airlines for fixing rates for cargo shipments and for passenger transportation, more than $770 million in criminal fines have been imposed, and guilty pleas have been entered by several international airlines.

My written statement provides additional examples of our enforcement in these areas as well as some additional details.

All of these efforts have as their goal the assurance that U.S. consumers receive the benefits of a competitive marketplace. Most mergers raise no competitive concerns and can benefit consumers. However, certain proposed mergers do raise serious competitive issues.

Antitrust analysis is highly fact-specific and, in each case, we carefully review the facts and the evidence to determine whether a particular merger would violate the antitrust laws. The Antitrust Division reviews mergers under Section 7 of the Clayton Act which prohibits the acquisition of stock or assets where the effect of such a transaction may be substantially to lessen competition or to tend to create a monopoly. The primary focus is to determine the likely competitive effects of a merger in the future.

The methodology that the Division follows in all merger reviews, including those in the airline industry, is set out in our long-standing horizontal merger guidelines. Under the guidelines, mergers should not be permitted to create or enhance market power or to facilitate the exercise of market power. By market power, we mean the ability profitably to raise prices above competitive levels or to reduce competition on dimensions other than price such as product quality, service or innovation for a significant period of time as a result of the transaction.

The antitrust agencies generally assess a merger's likely competitive effects in all relevant markets—the product, service and geographic markets in which the merging companies compete—in order to determine whether the transaction would likely substantially lessen competition in those markets. In the case of airline mergers, those markets typically consist, at least, of scheduled passenger service between a point of origin and a point of destination. These are generally referred to as city pairs.

The Division also considers broader issues in addition to the concern over competition in city pair markets. To mention just one example, concern about the merger's potential competitive impact on competition for large corporate travel contracts and government travel contracts was one of the factors that drove our decision in 2001 to announce our intention to challenge the United-U.S. Airways merger.

Once the relevant markets have been identified, the Division looks at the number of other carriers serving each market and at the nature of that service. We then focus our analysis on those markets that might be conducive to the creation or enhancement of market power as a result of the merger.

In conducting this analysis, we consider a variety of market factors and industry-specific practices to determine the likely effects of the merger. For example, we examine entry by other firms, and we consider merger-specific efficiencies of the kind likely to enhance the merged firms' ability and incentive to compete if such efficiencies exist.

The Division examines all available qualitative and quantitative evidence when evaluating a merger's likely competitive effects. We obtain evidence from the merging parties as well as from their competitors and their customers. We obtain evidence from other sources such as consumer groups and third party experts and, in the case of airline mergers, we consult with the Department of Transportation so that we can take advantage of their extensive experience in this area as well as the significant amount of data that they maintain.

By carefully evaluating all of this evidence, the Division develops a highly detailed and thorough understanding of the markets that are likely to be affected by a proposed merger.

In conclusion, Mr. Chairman, competition in the airline industry is critical for the millions of Americans who depend on air travel in their business and personal lives, and the Division has a strong record of enforcing the antitrust laws to protect competition in this important sector of our economy. If we determine that a proposed merger will violate those laws or that air carriers are engaging in illegal collusive or monopolistic conduct, we will not hesitate to take appropriate enforcement action to protect competition and American consumers.

Mr. Chairman, this concludes my prepared remarks. I will be happy to answer any questions the Committee may have.

Mr. COSTELLO. The Chair thanks you, Mr. O'Connell, and now recognizes Mr. Reynolds.

Mr. REYNOLDS. Chairman Costello, Chairman Oberstar, Ranking Member Petri, thank you for the opportunity to discuss the state of the airline industry, issues related to airline consolidation and the role of the Department of Transportation in the industry's ongoing restructuring. Although it would not be appropriate for me to discuss the specifics of any transaction, I hope that I can shed some light on the process.

With respect to the state of the airline industry, U.S. carriers have been emerging from a major restructuring, one that was precipitated by a fundamental change in passenger demand that began prior to September 11, and it revealed an outdated industry structure built around an unsustainable cost structure.

Despite fuel price increases, the industry as a whole was profitable for 2007. Legacy carriers had successfully restructured and adapted their business models to compete in a more price-sensitive environment with low-cost carriers that have continued to expand throughout the decade.

In 2008, however, persistent record high fuel prices have eclipsed the benefit of legacy carrier cost reductions and efficiency gains and are changing the fundamental economics of the industry. Going forward, the outlook for airlines has certainly become cloudy. The industry faces three major challenges in 2008: significantly higher than expected fuel prices, a potentially weaker economy and labor cost pressures.

Wall Street currently estimates that with oil at $110 a barrel, the U.S. airline industry will lose approximately $4.5 billion this year. Clearly, the major challenge for the industry remains record high fuel prices, and we have heard a lot about that today.

Fuel is now the largest single cost center for airlines, from 19 percent of total operating expenses in 2004 to nearly 40 percent for 2008 based on current trends. While the industry posted an operating loss of approximately $1.7 billion in the first quarter of 2008, it would have posted an operating profit of $3.6 billion in that quarter had fuel prices remained at 2004 levels.

Ongoing fuel price pressures have motivated industry-wide cost and capacity discipline. All carriers are trying to adjust their business models to cope with yet another significant challenge. As low cost carriers continue to expand, legacy carriers, in particular, must find ways to become more efficient producers.

With respect to the broader economic environment, passenger carriers report that demand currently remains fairly strong going into the busy summer travel season. However, there is some regional weakening in domestic markets and greater concern for the fall and winter.

With regard to the process associated with airline transactions, the Department of Justice is responsible for reviewing proposed airline mergers due to its primary jurisdiction over antitrust laws. The DOT typically provides the DOJ with advice and analysis on airline competition issues. Of course, my colleague from Justice has just explained his department's role and perspective on these matters.

If the Antitrust Division does not challenge a transaction between major airlines, DOT would then consider a wide range of regulatory issues that fall within its jurisdiction including international route transfers, economic fitness and code sharing.

With respect to the role of government in the industry, the issue of consolidation should be understood in the broader context of allowing deregulation to address the airline industry's perennial challenges. In an industry that is truly subject to marketplace forces, we will inevitably see restructuring. Each proposed transaction must be considered on a case by case basis. The airline industry should be held to the same antitrust standards as every other industry, and there will inevitably be transactions that fail to satisfy a rigorous antitrust test.

Our consideration of aviation economic policy must focus on what is best for both a healthy and a competitive industry. Our goal must be to strike what is admittedly a difficult balance in the face of a complex and changing industry.

That concludes my oral statement. I would be pleased to take any questions.

Mr. COSTELLO. Mr. Reynolds, thank you for your testimony.

Mr. O'Connell, does the Department of Justice consider the impact of one proposed merger on the entire industry and as a whole and whether one merger might lead to others?

Mr. O'CONNELL. Well, Congressman, when we examine a merger, we examine each merger that is brought before us when it is brought before us and make our determination as to whether the transaction may violate the antitrust laws based on the facts of that transaction.

Mr. COSTELLO. So would that be a yes or a no?

Mr. O'CONNELL. We do take all the factors into account. We do examine the state of competition in all of the affected markets. But ultimately the decision on any particular transaction, because if we determine that a transaction may violate the antitrust laws, we then have to go to court and demonstrate that to a judge based on the facts of that deal.

The decision is based on the transaction itself, but we do take every factor into account when we are examining them.

Mr. COSTELLO. That is one of the factors, how it affects the industry and a whole and if one merger may trigger other mergers?

Mr. O'CONNELL. Well, Congressman, if I may, when we are examining a merger, we are trying to determine whether it is going to result in market power or enhanced market power in the affected markets, and so the industry-wide implications can play a part in that, but we do focus on the impact of the transaction in specific markets.

Mr. COSTELLO. Mr. Reynolds, in your testimony, you, of course, point to the fact that DOT approves alliances between airlines. As all of us know, some of these alliances are extensive and involve some of the world's largest international carriers.

You heard a question asked. I think it was by Mr. Cohen or Mr. Kagen earlier, and that is: Given the worldwide scope of these alliances, do airlines really need to merge in order to gain access to international markets?

Mr. REYNOLDS. I don't know that mergers are necessary for access to markets. It may be a question of whether they feel they can compete better in a particular position or not, but in terms of whether they have pure access or not, I don't know that the merger plays either way into that.

We are trying to break down barriers, open skies and provide access for our carriers—all our carriers across the board.

Mr. COSTELLO. The Chair now recognizes Mr. Petri for any questions that he may have.

Mr. PETRI. Thank you, Mr. Chairman.

I note we have several more panels, and we are starting to get into the hour. So I will submit several questions for written response and really only want to extend a question that our Chairman asked, and that is something that is happening in antitrust law more and more. How do you coordinate with the European, in particular, antitrust authorities?

These are international organizations either themselves or through alliances. The Europeans evidently allowed Air France and KLM to merge, anyway they are part of the same structure. Now these companies are both allied with one or the other of those. So they have, in effect, merged in Europe already. Does that influence your decision?

How do you define the market? Are you just looking at Chicago and Atlanta or are you looking at how this impacts on a global basis because a lot of these industries in communications and entertainment and now here in air travel have basically gone beyond national jurisdictions?

Mr. O'CONNELL. Congressman, two points: When we examine a transaction and, again, not to speak specifically about this one but any transaction in this industry, we look at all dimensions of competition.

We look at, as I said in my opening statement, city pair markets. We also look at other factors, other dimensions of competition between the merging parties to determine whether the transaction poses any competition issues in any of those dimensions. And so, that would include looking at international routes as well as domestic routes.

On your question about coordination with the European Commission, we do coordinate very carefully with our counterparts in Brussels and also in the European member states. Often transactions raise similar issues in different markets especially if you are talking about reaching towards a consistent remedy so you don't end up with different outcomes where the company is faced with conflicting results.

And so, our staffs coordinate very closely with one another, and we also coordinate all the way on up the line, discussing individual matters, provided that we are clear to do so by the parties because there are confidentiality restrictions in there. But we work very closely with the Europeans to make sure that, to the greatest extent possible, we reach results that don't conflict.

Mr. PETRI. Thank you.

Mr. COSTELLO. The Chair thanks the Ranking Member and now recognizes the Chairman of the Full Committee, Chairman Oberstar.

Mr. OBERSTAR. I have been waiting all day long for your testimony. It is very important testimony. I stayed up, in fact, quite late last night, reading both the Department of Justice's and the Department of Transportation's testimony and evaluating and digesting it.

I take great heart in your statement on page 5 where you responded to Chairman Costello's question about this issue. The agencies, meaning the Justice Department's Antitrust Division and the Federal Trade Commission consider both post-merger market concentration and increased concentration resulting from the merger.

That begs more questions about what you consider to be included in the concentration in market and resulting from merger. You go on to qualify that statement somewhat.

But earlier on that same page, you say the unifying theme of our guidelines to the two agencies is that mergers should not be permitted to create or enhance market power or facilitate its exercise. You define market power as the ability profitably to—very carefully worded—to raise prices above competitive levels for a significant period of time.

Now, let's translate that into today's market structure. In exchange with the industry panel, I pointed out that while the airlines are fond of saying there is lots of competition. The network carriers are fond of saying there is lots of competition from the low fare carriers.

Yet, at Detroit, Southwest that they all point to as the leading domestic competitor has a 3.9 percent market share. That is in competition with Northwest. In Salt Lake City, in competition with Delta, it is 13.8 percent. In Minneapolis-St. Paul, it is zero. Cincinnati, it is zero with Delta presence. Atlanta, another Delta presence, it is zero. At JFK, it is zero. At Memphis, it is zero.

So a low fare carrier, the biggest one in the business, is not willing to challenge existing network carriers at their strong point hub. How much more reluctant will that market be to challenge a carrier that is more than 50 percent bigger than what now exists in any of those markets?

Mr. O'CONNELL. Well, Mr. Chairman, that is the sort of question that we would set out to determine in conducting a review of a transaction, one of the questions we would set out to determine.

As I explained in my opening statement, we would look at all aspects of competition including hub competition and city pair competition to determine what the current state of play is and, most importantly, to determine to what extent, if any, the transaction will alter that state of play, will change the competitive dynamic.

If we determine that there is a problem in such a market, we would take appropriate action.

Mr. OBERSTAR. Now, while that merged carrier would be 50 percent bigger than the smaller of the two and while it would not be the sole seller in the market, it really is a monopolist in those markets, is it not?

Mr. O'CONNELL. Mr. Chairman, a question like that would get a little close to the facts that we would be determining in the transaction that we are reviewing, and so I wouldn't want to hypothesize on specific markets.

Mr. OBERSTAR. You don't have to. I just want to plant the idea with you.

Mr. O'CONNELL. So planted.

Mr. OBERSTAR. And nurture it.

[Laughter.]

Mr. OBERSTAR. Now, Mr. Reynolds, your testimony is delightful. There are all sorts of wonderful, tantalizing statements except that you don't bite the bullet. You don't say we will counsel the Department of Justice on our views on this particular or any merger. If they don't act, then you would take some action.

I think you have a greater responsibility to the traveling public because your jurisdiction is, in a way, broader. Your scope of review is much broader than that of Justice. It was looking at these very narrowly, very important, powerful. Would that Teddy Roosevelt were still here as President, we would be having a much more interesting discussion.

Powerful as that is, yours is a much broader scope. I wonder whether you have, at DOT, given consideration to the market consequences of this merger proposal.

Mr. REYNOLDS. Well, for the same reasons as my colleague was reluctant to comment on this particular proposal, so am I. But, as a general matter of course, as involved in aviation policy matters, we do try and take a broad view of all the things going on in the industry, including restructuring, in terms of any competitive implications of any particular transaction.

Of course, that is judged based on the antitrust laws and by our colleagues at the Department of Justice and specifically the Antitrust Division. They have the primary jurisdiction there. So if there are anti-competitive effects, they are the ones who will take steps to potentially address that in any potential transaction.

Mr. OBERSTAR. Yes. I understand that.

At the very end of your statement, you say: @@Our consideration of aviation economic policy must focus on what is best for both a healthy and a competitive industry.''

But you don't say a healthy and a competitive consumer environment. You have left out a very important sector here. It is the traveling public that you also have a responsibility to, do you not?

Mr. REYNOLDS. Oh, we do, and we are very concerned about the traveling public from a number of standpoints. We believe that vigorous competition in a health industry will serve the public best, serve the consumers best, provide them more choices, better fares, better offerings and potentially have a wider variety of carriers providing a wider variety of services. We have seen that a great deal in the current marketplace, and we think that that is the proper course.

Mr. OBERSTAR. You do say here: @@Our goal must be strike a difficult balance in a complex and dynamically changing industry.''

It must also embrace not just short-term but the longer term view on stakeholders. That is such a vague term so frequently used. No one really understands what it means. Do you include it in that the air traveling public?

Mr. REYNOLDS. Absolutely, no doubt about that.

Mr. OBERSTAR. You should have said that. It would have been very comforting to a lot of people.

Mr. REYNOLDS. Well, we do care.

Mr. OBERSTAR. When you did the antitrust—not you particularly but when the Department did the review—I assume along with the Justice Department, of the alliance between Northwest and Air France-KLM to consider antitrust immunity, you considered a very broad set of factors, did you not?

Mr. REYNOLDS. Yes.

Mr. OBERSTAR. Can you cite those?

Mr. REYNOLDS. Well, at the moment, that is an active proceeding.

Mr. OBERSTAR. But just the factors, not how you came to it, but the factors that you considered because they are spelled out in the document that you issued.

Mr. REYNOLDS. Sure.

Mr. OBERSTAR. For the record, could you just say what you considered in that process?

Mr. REYNOLDS. We, obviously, looked at a variety of factors including competition in various markets, both at city pairs, country to country, Europe to the United States. So we looked at a wide variety of issues in coming to our tentative decision.

Mr. OBERSTAR. Would it not be appropriate to look at those and other factors in evaluating the domestic scene of this merger proposal?

Mr. REYNOLDS. Whatever the transaction, not speaking to this one in particular, of course, we try and take a broad view and understand what is going on in the industry and with a particular transaction.

Mr. OBERSTAR. Would you consider, in providing counsel to the Justice Department, the effect of a merger in an Open Skies treaty versus the effect of an alliance with antitrust immunity in the context of that same Open Skies treaty?

Mr. REYNOLDS. We will look at the big picture with regard to international aviation policy, with regard to any transactions that we may be facing.

Mr. OBERSTAR. Would you also then look at the potential shrinkage of competition where there is now a Delta presence in the London Heathrow and Northwest presence in London Heathrow and at Gatwick and what the consequences of a domestic merger might have on that international market competition?

Mr. REYNOLDS. Well, again, those are very fact-specific issues.

Mr. OBERSTAR. I am not asking you to make a conclusion about it but whether you would consider those as factors.

Mr. REYNOLDS. Oh, yes, we look at all those factors. Yes.

Mr. OBERSTAR. You would. You would give some thought to it?

Mr. REYNOLDS. I think we have actually done that already as part of our tentative decision in Sky Team, which we have not yet finalized.

Mr. OBERSTAR. Would you also give consideration to the consequence both for the carriers and for the Pension Benefit Guarantee Corporation and well as for another group of stakeholders, the employees of the two carriers, of the current as well as outstanding future obligations that would be incurred in the event of a bankruptcy of that bigger carrier to the PBGC?

Mr. REYNOLDS. The broader issues associated with pensions and a lot of the labor issues are not directly within the Department of Transportation's purview. Of course, we try to have an understanding of all factors that affect the airline industry, but that is not where our expertise or jurisdiction lies.

Mr. OBERSTAR. True, but that is probably a ten or twelve billion dollar—I am just horseback estimating—factor that weighs heavily on the economic ability, that is the fitness, of the two carriers or the merged carrier to compete in the marketplace. That is a very important economic consideration.

Mr. REYNOLDS. Well, it could be, depending on the particular merger involved.

Mr. OBERSTAR. Yes. Again, I want you to consider those factors. I think they are very important for you to.

Coming back, Mr. O'Connell, to I said I took heart from your statement concerning both post-merger market concentration and increased concentration resulting from the merger. Chairman Costello pursued it somewhat with you. I want to pursue it a little further.

Isn't it reasonable for the Justice Department to give consideration to the consequences to the marketplace of a merger of carriers of this dimension, this magnitude, and the cascade of actions that will take place in its wake?

Mr. O'CONNELL. Mr. Chairman, yes, and that is something that we do look at. When we look at individual markets to determine the effect of a transaction in a marketplace, we look at all available information. But, again, when the decision comes, if the decision comes to challenge a particular transaction, we then have to go to court and demonstrate to a judge that that deal, based on its merits, is anti-competitive.

So we do look at the entire industry. We do look at all the factors, but ultimately at the end of the day the situation with a given transaction has to rise and fall on the merits of that particular deal in those affected markets, which can vary significantly across markets.

Mr. OBERSTAR. Yes. Market concentration, as we discussed earlier, relates to the ability of other competitors to enter a fortress hub and compete effectively. That competition can be one dimension with a smaller carrier but a vastly different dimension with a much bigger carrier in frightening off competition.

If that structure results in a collapse of the industry into three network carriers, then you have a vastly different domestic market competitive structure, don't you?

Mr. O'CONNELL. That would be a potential result which is why we would look at each transaction that would be presented to us as it is presented to us. The decision in one investigation doesn't necessarily bear on what we would decide in another.

The facts are always very different. The impacts can be very different. We look at each as a separate analysis and don't consider ourselves bound by decisions in previous transactions in that industry. We take each one as they come.

Mr. OBERSTAR. I take great heart from your responses.

Would you, finally, then look abroad to see what the consequences of a domestic merger would be in the international marketplace, considering that Americans, our fellow citizens, are traveling on these two carriers and would have fewer options, fewer competitive choices in an international marketplace such as Heathrow? It accounts for—let's see. It's the entry point for 50 percent of the European market.

Mr. O'CONNELL. Well, without commenting on the facts here, in any airline merger, we would look at its impact on American consumers whether you are talking about purely domestic routes, New York to Atlanta, or whether you are talking about U.S. to abroad or abroad to the U.S.

The entire spectrum of the competitive effects of the deal on American consumers is part of our analysis, and we would look at all of that.

Mr. OBERSTAR. You would not limit yourself to the domestic scene but also consider the international competitive implications?

Mr. O'CONNELL. Absolutely.

Mr. OBERSTAR. And the same to you, Mr. Reynolds?

Mr. REYNOLDS. Absolutely.

Mr. OBERSTAR. I take heart from those comments. Thank you.

Mr. COSTELLO. Thank you, Mr. Chairman.

The Chair now recognizes the gentlelady from Hawaii.

Ms. HIRONO. Thank you, Mr. Chairman.

The industry panelists both said that they would not be surprised if as a result of this merger, should it be approved or allowed to go through, that there would be more mergers coming down the pike. However, as we have more mergers, though, I would say that there would be less competition.

So would the subsequent merger analysis be more difficult for the Department to approve because you are just going to end up with more and more concentration in the industry?

It is a hypothetical. Would that be what the Department would be faced with analyzing?

Mr. O'CONNELL. Well, Congresswoman, any merger review has to take as its starting point the condition of the marketplace that is presented to us as it exists at that time. So previous activity in an industry would be relevant. We would take the market as we find it and make our decision based on how we thought the merger was likely to change the market going forward based on the facts of that case.

Ms. HIRONO. Wouldn't it make sense that as more and more airlines begin to want to merge, that it is going to be harder to justify and there would be more of an anti-competitive impact?

Mr. O'CONNELL. Well, Congresswoman, if I could step back a little bit from the airline context so I don't get too close to the things that are pending in front of us, different transactions, it all depends on the facts. I mean the facts are stubborn things, and that is what we have to focus on.

Individual transactions can have different impacts on different markets. You could have a transaction that is highly anti-competitive in one market and not in others. You have a transaction that is fine. It varies enormously from transaction to transaction. So it is difficult to generalize.

Ms. HIRONO. Well, I am talking about the ones that involve really large airlines.

Mr. O'CONNELL. It is difficult.

Ms. HIRONO. United, Continental, those kinds of airlines because we can anticipate that those could be coming down the pike.

Mr. O'CONNELL. The Antitrust Division would look at any proposed transaction very carefully based on the facts as they exist at the time, and we would take appropriate action if we determine that the transaction, any future transaction was going to lead to a problem in any market.

Ms. HIRONO. I don't want to beat a dead horse, but it seems reasonable to think that if we have subsequent mergers of really large airlines, that the analysis becomes, I suppose, the anti-competitive impact on the marketplace would be more pronounced.

Mr. O'CONNELL. Well, again, Congresswoman, it would depend on the facts of those deals. Each deal is different. They each raise different issues in different markets, and I wouldn't want to hypothesize about what we might decide in a future investigation.

Ms. HIRONO. Okay. Well, I guess we can draw our own conclusions.

I do have one quick clarifying question. It is about Open Skies. We have heard that reference made by the industry panelists. I wanted to have clarified, do we allow non-U.S. airlines to come into one of our cities, say, New York, pick up American passengers, and go on to another U.S. city and pick up U.S. passengers?

Mr. REYNOLDS. No. That would be illegal. The cabotage laws prevent that.

Ms. HIRONO. Yes. So we still have first, second, third, fourth, fifth, all those freedoms and limitations.

Mr. REYNOLDS. No. That isn't allowed under the Open Skies.

A carrier could fly between New York and Los Angeles. It just couldn't carry any passengers, paying passengers on that load.

Ms. HIRONO. Right. So we actually have in place a lot of restrictions on the competition from foreign carriers. I know that the industry, what they have done is they do code sharing and all of that to try and get around some of those limitations.

Mr. REYNOLDS. Yes.

Ms. HIRONO. They are able, in other ways, to compete with the non-U.S. carriers without merging, don't you think?

Mr. REYNOLDS. Are you speaking of international air carriers, foreign air carriers?

Ms. HIRONO. Yes, they can compete against foreign carriers because we do have a lot of limitations on what foreign carriers can do in our Country.

Mr. REYNOLDS. Not for domestic traffic, they couldn't compete for that in any way even if it was through code sharing.

They can compete for traffic that involves an international point, a foreign point, depending on the air services agreement. Under Open Skies, of course, there are very, very few limits, if any, on what carriers may do on those international routes.

Ms. HIRONO. It is just domestically that we pretty much keep out the international carriers.

Mr. REYNOLDS. That is correct.

Ms. HIRONO. Thank you very much.

Mr. COSTELLO. The Chair now recognizes the gentlelady from the District of Columbia, Ms. Norton.

Ms. NORTON. Well, thank you, Mr. Chairman.

I stayed to perhaps get some clarification on a question I asked earlier because Mr. Reynolds raised in his testimony the challenges of the merger between two very different airlines. His testimony mentions the unexpected costs and delays in integration that are likely when you have two different airlines merging.

I am certain that everybody wants to succeed, and they will make fairly conservative estimates, but there is some precedent off of which to work. That is that historically when large mergers occur, there are quite high near-term costs and less, of course, near-term revenue than the acquiring company had projected.

Assuming integration costs, because I would like to know how you go about, given the fact that you are given a set of figures yourself and you indicated that you understand that there could be unexpected costs, so I have to assume that they would be costs that the parties haven't given you.

In this case, if there were higher than anticipated revenue projections, they would meet at the same time very substantial business risks that are perhaps unique to this industry. There would be the oil prices which may strike them even worse than everybody else, all the rest of us. There would be the ever tightening credit markets. Look when they are coming forward. Then there would be a downturn in the economy because it doesn't look like it is turning up any sooner.

I wonder how you would, in light of your testimony, deal with and analyze the unexpected costs and delays in integration that are unanticipated in trying to decide whether this is a worthy merger.

Mr. REYNOLDS. Well, again, I don't want to speak to this particular merger. As you indicated, airline mergers can be costly, complex, difficult undertakings and with a lot of up-front costs. We have seen that several times.

We definitely have a very challenging environment for air carriers; the fuel, the potentially weakening economy as I cited. So there are a lot of things that are going to be difficult for them.

Of course, it is going to be a business decision for any two companies in any industry to decide how they are going to behave, whether or not it is in a merger or consolidation of some kind, and how they undertake that and whether they move forward.

As to whether those sorts of factors play into approving it or not, that would really be, again, for the Department of Justice. I don't know how they factor those particular aspects.

Ms. NORTON. Then I will have to ask the Department of Justice.

Mr. O'CONNELL. Congresswoman, when we examine a merger under the antitrust laws, what we are setting out to determine is whether the transaction will result in a substantial lessening of competition in the affected markets.

Transactions succeed or fail for a variety of reasons. I am not just speaking about airline mergers here. Consumers may not be as enamored of the combined product offerings of the company as the parties thought. Management may have difficulty integrating cultures, any one of a number of reasons why transactions can succeed or fail.

Many of those factors are not factors that are relevant to the antitrust analysis because what we are setting out to determine is a very important question but a relatively narrow one which is whether post-merger the combined company will have market power.

Ms. NORTON. Well, I don't know why he passed the question on to you then.

First of all, Mr. Reynolds, you raised the issue of unexpected costs and delays in integration.

I understand what you are saying, Mr. O'Connell.

I was interested in, for example, whether these companies would be worse off, given what looks like an unusually challenging set of factors they face at the time that the merger is going forward or would wish to go forward, whether they are better off or worse off as a merged entity than as standalone airlines. They thought they would be actually better off as a merged entity.

Since you are the Transportation official and you have to look directly at that issue, that is why I directed the question to you in the first place.

Mr. REYNOLDS. Thank you, Congresswoman.

I think it is more that we are just pointing out some of the issues. Mergers can have positive and negative impacts on many of the different stakeholders, whether that is the owners, the employees, the communities being served.

We don't take a view as to necessarily whether the mergers themselves are positive or negative. They are part of the marketplace, and if carriers make mistakes or if any companies make mistakes in combining, if it is a bad deal, if it is a bad business decision, the marketplace will punish them. That is not the basis.

Ms. NORTON. Well, okay, Mr. Reynolds, you have truly frightened me because, in other words, if you are left with two airlines going down the tube, that is not merely the marketplace punishing the two airlines, whatever that means. It is punishing the American public.

That is why I was interested in whether or not it mattered to you, whether or not standalone airlines, they could take it more easily than if these same factors, unexpected factors, challenge them as a merged entity.

It does seem to me that somebody has to take that into account, whether the United States is better off with two standalone airlines in bad shape or a merged airline in better shape, given—and this is what I posited because I got this from your testimony—that there are all kinds of unexpected costs, even costs beyond what they factored in because that is the history of these mergers, except that I am not sure we have ever had a merger of an airline in a more challenging environment than this one. So I can only that these be matters that you would at least consider so that the matter would be on the table somehow.

Thank you, Mr. Chairman.

Mr. COSTELLO. The Chair thanks the gentlelady and thanks both you, Mr. O'Connell and you, Mr. Reynolds, for your testimony today.

We look forward to your making a very thorough and careful review of this proposal, and we look forward to your decision. We will be monitoring it with great interest. We thank you.

AFTER 6:00 P.M.

Mr. COSTELLO. The Chair would now ask the third panel to come forward, and I will introduce the panel as they are coming forward.

Captain Lee Moak, Captain Moak is Chairman of Delta Master Executive Council, Air Line Pilots Association, International; Captain David Stevens who is the Chairman of Northwest Airlines Master Executive Council, Air Line Pilots Association, International; Ms. Patricia Friend, International President, Association of Flight Attendants; and Mr. Robert Roach, Jr., General Vice President of Transportation, International Association of Machinists and Aerospace Workers, if you will take your seat at the table.

You should know that all of your statements will appear in the record as they have been submitted, and we would ask that you summarize your testimony in five minutes.

The Chair now recognizes Captain Moak.

**TESTIMONY OF CAPTAIN LEE MOAK, CHAIRMAN, DELTA MASTER EXECUTIVE COUNCIL, AIR LINE PILOTS ASSOCIATION, INTERNATIONAL; CAPTAIN DAVID V. STEVENS, CHAIRMAN, NORTHWEST AIRLINES MASTER EXECUTIVE COUNCIL, AIR LINE PILOTS ASSOCIATION, INTERNATIONAL; PATRICIA FRIEND, INTERNATIONAL PRESIDENT, ASSOCIATION OF FLIGHT ATTENDANTS-CWA; ROBERT ROACH, JR., GENERAL VICE PRESIDENT OF TRANSPORTATION, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS**

Mr. MOAK. Mr. Chairman, Ranking Member Petri and Members of the Committee, thank you for providing me the opportunity to testify at today's hearing. I have submitted a written statement for your consideration, so I will keep my testimony brief.

My name is Lee Moak. I am a 20 year captain with Delta Airlines, and I am the Chairman of the Delta Master Executive Council of the Air Line Pilots Association, International, the union that represents 7,300 pilots of Delta Airlines.

I welcome the opportunity to testify in support of the proposed merger between Delta Airlines and Northwest Airlines.

My goal and the goal of our union is that our pilots be provided with pay, benefits and retirement commensurate with the responsibility and experience we bring to the profession. An airline with the increased potential to be financially healthy with a stable long-term future provides the best opportunity to ensure that that happens.

Prior to the announcement of the merger, the Delta Pilots Union was able to reach a consensual agreement with Delta management designed to facilitate the merger while providing financial returns for the unique value that we brought to the transaction. This agreement will provide a solid framework for a new joint collective bargaining agreement to include the Northwest pilots.

We welcome the Northwest pilots as partners in the building of the new merged airline and look forward to not only the rapid completion of a new joint agreement but also a fair and equitable negotiated seniority list. Our goal is for both to take effect at the close of the corporate merger.

So why are we here today to talk about a merger? Since the terrorist attacks of September 11th, 2001, our Nation's aviation industry has been through the worst seven and a half years of its existence. Last week, the price of crude oil went through $126 per barrel, an increase of over 90 percent in the past year. The Nation's economy is suffering, and the credit markets have become increasingly difficult, if not impossible, to access.

Last month, four U.S. air carriers ceased operations. Another announced that it will be closing its doors on May 31st, and yet another filed for Chapter 11 protection.

In short, our Nation's aviation industry is now in jeopardy for the second time since September 11th, 2001. If our industry is to survive and, more importantly, thrive, there must be change. The time for rational and sensible industry consolidation has arrived.

Careful Government scrutiny and oversight must ensure that any potential industry consolidation is in the best interest of the traveling public. I submit that this merger, the proposed merger between Delta and Northwest, is not only in the best interest of the traveling public but also the employees of both airlines, the communities we serve, the communities we live in and our Nation's economy and aviation industry.

We look forward to working with all 78,000 employees of the merged Delta as we help build our Nation's first truly global airline.

On behalf of the 7,300 pilots at Delta Airlines, thank you for the opportunity to testify before the Committee. I welcome the opportunity to respond to any questions or comments you might have.

Ms. HIRONO. [Presiding.] Captain Stevens, you have five minutes to present your testimony.

Mr. STEVENS. Thank you, Madam Chairman and Members, for holding this hearing and providing me with the opportunity to testify with regard to the proposed merger between Northwest Airlines and Delta Airlines.

I am Captain Dave Stevens, and I am Chairman of the Master Executive Council of the Air Line Pilots Association at Northwest Airlines. I am a 23 year Northwest pilot previously employed by People Express and proudly served in the U.S. Air Force as an active and reserve pilot.

There are currently over 5,200 ALPA-represented pilots flying for Northwest Airlines. The pilots at Northwest have undertaken an ongoing review of the proposed merger. We recognize that the combined company has the potential of becoming a stronger and more viable airline. However, the Northwest ALPA Master Executive Council and our pilots strongly oppose the merger as it now stands.

The total economic potential of the combined corporation will not be achieved without a joint pilot contract which is the only way for all of the predicted revenue enhancements and cost savings to be realized. A joint contract would also resolve potential labor discord which is counterproductive to achieving economic success.

Given the current high cost of fuel, the broad economic downturn and substantial costs related to an airline merger, the future viability of the combined company will be in question if it is unable to take advantage of every revenue opportunity. A critical evaluation of the economics of the proposed merger is in the best interest of all groups affected by the merger.

Management of the two airlines has stated that the merger will produce greater profitability as a result of a series of synergies that allow increased revenue and reduced costs. They will predict a financially stronger airline, one better to serve all its stakeholders including its customers. According to management, these synergies will result from an end to end merger rather than a traditional overlap production merger.

However, many of the synergies and therefore much of the economic benefit management is counting on will be unavailable without a common contract that includes the Northwest pilots. Indeed, for the new combined Delta-Northwest to have any chance of fully realizing its potential, all employee groups must be treated fairly regardless of their pre-merger carrier.

Why is this true? Without a joint pilot contract, the two airlines' flight operations must remain separate. Without a single airline operation, much of the needed revenue growth and cost savings will not be achieved. Layer in the bad will created by contractually treating Northwest employees as B Scale, and the matters will be even worse.

We appreciate Delta management's statement of optimism that we can obtain a common contract and an integrated seniority list prior to the date of corporate closing. However, we believe actions speak louder than words. To date, we have no negotiating session scheduled.

Furthermore, Delta management has found the time to reach a tentative agreement with Delta pilots effective on the date of closure that excludes Northwest pilots. The more we review this document, the more questions we have as to Delta management's intent. We feel there is no reason to have several of the provisions in the new Delta pilot contract if the intent is truly to have a joint contract before closing.

We are concerned that the reason for this agreement may be to put economic pressure on the Northwest pilots to agree to an unfair seniority list. We will not do that. Contract terms can be changed. Seniority lives forever.

We agree with the statement from Delta that in their analysis a merged Delta-Northwest airline is stronger than a Delta standalone airline. However, our review shows that as currently structure the same is not true for Northwest. Given the current structure of this merger, we believe a standalone Northwest is stronger than a merged Delta and Northwest.

Our review also shows that Northwest Airlines is the best place of any legacy carrier to weather the current high cost of fuel and economic downturn. Northwest has an enviable route system that includes the Pacific hub, a flexible fleet a fuel efficient order book of Boeing 787 aircraft and the most relative cash on hand of the legacy carriers.

We understand that integrating the operations of these two large carriers will require a delicate balancing act to minimize the employee discontent and maximize the employee harmony required to access the proposed synergies necessary for the merged carrier to be successful going forward. However, the steps to date will largely have the effect of maximizing employee discord.

Rather than a joint statement by Mr. Anderson and Mr. Steenland that the new carrier was committed to a fair and equitable integration of the workforces, we have only the statement of Mr. Anderson that he will protect the seniority of Delta employees with the implication being that current Northwest employees will have to fend for themselves. Rather than negotiating a joint contract, Delta Airlines chose to negotiate contract improvements only for Delta pilots.

Notwithstanding the events leading to this point, the officers and representatives of the Northwest MEC are willing to negotiate with Delta management and Delta ALPA. However, time is critical. There is a small window of opportunity remaining in which to conclude a joint contract and a joint seniority list outside the traditional merger process.

I have tried in this statement to explain to you, Northwest ALPA's concern about the current situation. I ask that you evaluate this merger in the current context. I urge you to critically examine management's promises and statements of their present intentions.

Will the company meet its financial obligations and manage to abide by its promises to maintain current service and hubs or will it shrink and shed thousands of jobs?

What will the loss of those jobs mean to the broader economies of the States and regions affected?

Will this merger work if management cannot achieve the expected synergies?

In short, what happens if the merger does not succeed?

We believe the marketplace shares our concern as evidenced by tremendous loss of value of the share price of both companies since the merger announcement.

In our view, the proposed merger is risky for Northwest and Delta passengers, communities and employees. With the price of oil, the weak economy, the closed credit markets and the huge costs of combining the two companies, there will be no margin for error. As it now stands, the combined company will not have access to the predicted synergies due to lack of a joint pilot contract.

Ms. HIRONO. Captain Stevens, your time is up, if you could just wrap up.

Mr. STEVENS. The same lack of a joint contract is likely to cause a pilot labor friction. Labor friction in other employee groups is possible. The net result may be a weak combined carrier in a terrible economic environment. We must all seek to avoid this result.

Again, Madam Chairman and Members, thank you for calling the hearing and providing me with the opportunity to testify regarding the Northwest pilots' perspective on the proposed merger. I stand ready for any questions you may have.

Ms. HIRONO. Thank you.

Ms. Friend.

Ms. FRIEND. Thank you, Madam Chair, and we wish to extend our thanks to Chairman Costello and Mr. Petri for holding this hearing on this proposed merger. We very much appreciate having a seat at this table to share our views and concerns because it is the only table where we do have a seat to discuss our concerns about this merger.

In the very near term, we are very worried that 9,000 Northwest airlines flight attendants who have had the benefit of collective bargaining rights for more than 60 years are in danger of losing those rights. We are also skeptical of the CEO promises of no job losses and no hub closures and the resulting financial burden on the workers.

In the wider view, we remain concerned that in the absence of a sound national aviation policy, our national aviation system continues to flounder in search of an effective business plan in a deregulated environment.

This merger between Northwest and Delta has drawn significant attention from the media, communities served by both carriers and here on Capitol Hill. The attention being paid to what will create the largest airline in the world is appropriate and necessary.

While we are confident that many are looking out for the interests of the communities served and for the interest of those who rely on air transportation, there are virtually no protections for airline workers in this or any other merger. Very little attention is being paid to the upheaval that mergers create for the thousands of airline employees who find themselves unemployed or whose lives are disrupted.

We have heard the guarantees from the two CEOs about no furloughs and no hub closures, but each guarantee is qualified with references to the current environment.

As we look for solutions to cushion the enormous negative impact this latest merger could have on workers at Northwest and Delta and the potential for a wave of airline mergers, it is time to revisit the concept of employee protection from the deregulation act. As part of this and any airline merger plan, money must be set aside to protect the financial security of the employees.

There were many important protections in place for airline workers prior to the Airline Deregulation Act but no real protections exist today. After deregulation, employers successfully lobbied for an end to the labor protective provisions because, as they argued at the time, these matters are better left to the collective bargaining process.

Union contracts do provide a level of protection for those employees covered by a contract, but there is no protection for nonunion airline employees. The majority of the Delta employees have no collective bargaining agreement. This merger seriously jeopardizes the existing collective bargaining rights of all the Northwest employees who have fought for and won the legal right to have union representation.

It is true that today the nearly 14,000 Delta flight attendants are the closest to securing their future by forming a union through AFA-CWA as they are currently engaged in a representation election.

But the management of Delta Airlines has declared that the current Delta, essentially a nonunion company, when it becomes the new Delta will also be a nonunion company. They have launched the largest, most vicious anti-union and voter suppression campaign I have witnessed in my 40 years in this industry. Whatever else this merger is permitted to be, it must not be permitted to become a vehicle for union busting.

The selection among the Delta flight attendants is not just an opportunity for them to gain a voice on the job and a seat at the table, it is the first line of defense to protect the over 60 years of collective bargaining rights for the Northwest flight attendants. The airline executives have realized the opportunity this merger presents for them, and it is not just a chance to prevent thousands of nonunion employees from gaining a union. It is a chance to eliminate the unions that already provided protection for their members at Northwest.

Using this merger as an opportunity to destroy unions provides these airlines and all who would follow with an opportunity to drive down wages, work rules and benefits for all airline employees. It excuses them from any responsibility for the workers' lives destroyed and disrupted by their plans. It sets the stage for them to set industry standards back to levels we have not seen in decades.

If the new Delta is a nonunion carrier as well as the largest carrier, they will be poised to set in motion an unprecedented remaking of the entire airline industry that will destroy forever airline jobs as a stable and secure middle class career.

I urge the Members of this Committee to send a strong and clear signal to Northwest, but more especially to the Delta executives, that they must not use this merger as a means to destroy the collective bargaining rights of the employees.

While much will be made over the coming months about the impact of this merger on consumers and communities, I urge you to remember that 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.

It may be the Department of Justice and the Department of Transportation that will ultimately decide whether this megamerger is approved and in what form, but you have the ability to stand up for the workers caught in the middle, restore the financial protections lost through the deregulation of the industry and stand up for the rights of those workers to freely choose to form a union without the influence and interference of their employer.

Without our unions and our collective bargaining rights, we have no protection. Please don't let them, with their high-flying grandiose plans, destroy the one thing we have protecting us, our unions.

Federal regulators will look carefully at the impact this merger and others will have on the consumers and communities. We hope that this Committee and other congressional committees will continue to exercise vigorous oversight responsibilities as well.

Thank you again for this opportunity, and I look forward to your questions.

Mr. COSTELLO. [Presiding.] The Chair thanks you for your testimony and now recognizes Mr. Roach.

Mr. ROACH. Thank you, Mr. Chairman and the Members of the Subcommittee for the opportunity to speak to you on behalf of airline workers throughout the United States.

My name is Robert Roach, Jr. I am General Vice President of the International Association of Machinists which is the largest airline union in North America. I appear here on behalf of International President R. Thomas Buffenbarger and the more than 160,000 active and retired airline workers in every job classification including flight attendants, ramp service workers, mechanics, customer service agents, reservation agents and office employees.

It is my firm belief and the belief of many others that some airline executives are using a crisis of their own making to justify the establishment of what can only be called a monopoly. Some airlines are consistently asking the Government for relief, begging the courts to abrogate labor contracts and forcing the Government to absorb its pension obligations.

History has shown that poorly managed airlines cannot operate without Government assistance. These airlines repeatedly appeal to the Government for bailouts. They abuse the bankruptcy laws to decimate shareholder values or pay millions of dollars in professional fees. This is tantamount to killing the patient, so the undertaker can make money and then having a rebirth and killing the patient all over again.

Hundreds of millions of dollars were spent in the last several years in airline bankruptcies for professionals, for lawyers, for economists while the airline employees lost hundreds of millions of dollars in benefits, wages and health insurance.

Airline executives continually argue that they must consolidate and reduce air miles, air seat miles. Well, Mr. Chairman and other Members of the Committee, Pan American is gone. TWA is gone. People's Express came and left. Ozark is gone. Braniff is gone. Still, they beg for more consolidation in the industry.

We have put together a committee of airline professionals, lawyers and economists, and we have determined that the merger of Northwest Airlines and Delta Airlines would not be in the best interest of the flying public, the cities or States that they serve or the employees that work at these airlines or the airline support employees.

We have determined that, based on published reports, United Airlines is working very closely with U.S. Airways and will probably announce a merger in the next couple of weeks.

Continental Airlines has been talked about here by airline executives who have said they want to stand alone. Published reports indicate they are in the process of forming an alliance with American Airlines which will mean, as many of you have stated, three megacarriers in this Country, running the smaller carriers out of business.

As you have seen, they talk about the airlines that no longer exist or recently filed for Chapter 11. These are the smaller carriers that are unable to compete because all the industry consolidation has already taken place.

They indicate the high oil prices are the reason for this merger. If, as they say, we are going to have an end to end merger and all the hubs and all the buildings and all the people are going to stay, then the high oil prices are not going to come down. They are only going to double.

I would like to remind this Committee that it was the Congress that provided the Pension Protection Act for Delta Airlines and for Northwest Airlines which means they have $7.5 billion combined under-funded pension liabilities and an elongated period of time to pay off these liabilities.

As Congressman Holmes indicated, if this massive airline is put together takes, it three to five years to put a maintenance program together. There are massive problems in integrating an airline.

I, myself, come from TWA. Again, I have lost my pension, and my fellow coworkers lost their pensions. They lost their health insurance, and they lost their jobs based on promises, as you indicated, Mr. Chairman, that were made in this very same room.

If this massive airline, we are talking about an airline that would have 40 billion in debt, inclusive of that $7.5 billion of pension obligations. Those pension obligations, if that mega-airline were to go into Chapter 11, would fall to the Pension Protection Guarantee Corporation which would mean that the people of the United States would either have to fund this under-funded PBGC to the tune of $7.5 billion in addition to the under-funding that is already there from United Airlines and U.S. Airways that have already dumped their pensions onto the quasi-Federal Government agency.

If they were unable to pay that through the PBGC, then the cities and States of the United States, the citizens, would have to pay to put people on welfare because that is where people will go without their pensions, without their health insurance.

So this is another Government bail-out. This is just killing the patient again in order to line the pockets of executives to the tune of 15 to 30 million dollars in addition to all the other executives from the major carriers that will soon announce, as published reports, additional airline mergers.

We believe, as we have urged since 9/11, that we need a format. We need an airline summit. We have requested that from the airline management. We think we need labor, management and Government to sit in a room with the Department of Transportation, if you will, and come up with a real plan to fix the problems in the industry.

You must remember that Southwest Airlines, Continental Airlines and American Airlines, they are now operating under the same situation as the other carriers, but they have not come here looking for merger relief. They are looking for the bailout that Northwest and Delta are looking for. If that is approved, then the others must follow.

As Chairman Oberstar indicated, you must look at this process as the entire industry. You cannot look at it, as one of the witnesses, in isolation because it is already publicly reported what is going to happen in the industry. It is not a secret, and it will happen very quickly.

Again, it will be detrimental to the industry because it will take a very long time to put this process together and a lot of things can happen in the interim period.

So, in sum, we urge the Congress and we thank the Congress for voting to stop putting oil into the strategic oil reserves. We ask you to go further and ask President Bush to turn the spigot on and reduce the cost of oil to all of America. We ask for a moratorium on all airline mergers until such time as we can sit down—management, labor and Government—sit down in a format that we can resolve the industry problems.

We are talking to many people. We are talking to the former CEO of American Airlines, Robert Crandall. We don't agree with everything he says, but in a newspaper editorial he clearly stated this merger is not going to fix the problem.

The only thing that may fix the problem is some small, slight re-regulation because you cannot continue to sell seats for less than what it costs to produce that seat and intend to stay in business.

Thank you, Mr. Chairman. I will be here to answer any questions that you may have.

Mr. COSTELLO. Mr. Roach, thank you for your testimony. I share many of the concerns that you just expressed, concerning not only front line employees but a number of other issues that you touched on.

Captain Stevens, you mentioned in your testimony that much of the synergy and the economic benefits that management is indicating that they will achieve through this merger will not be there unless there is a common contract that includes Northwest Airlines. I wonder if you might elaborate on that.

Mr. STEVENS. I thought it was interesting that Mr. Anderson mentioned six different synergies, all of them under $200 million.

Mr. Steenland mentioned the biggest item being cross-fleeting. You will remember earlier in their testimony, they referenced $2 billion in savings. Well, if you take those six out, there's about a billion left over. Somewhere in that billion is where they are expecting in their business plan to achieve much of their efficiency, and that would be the cross-fleeting.

In the original contract that was negotiated between the Delta pilots and the Northwest pilots, that was accomplished in a joint contract that was achieved in February. Now they recognize that by only having one of the partners, they can only achieve in the cross-fleeting perhaps a quarter to a third of what they could do in a joint contract.

So, if this is the direction that the management chooses to go, we feel that in all likelihood costs are going to be higher than they expect, and so they should take advantage of every possibility to generate greater revenue to have the greatest possibility for this merger to succeed. The best way to accomplish that would be with a joint contract between the Delta and the Northwest pilots and Delta management.

Mr. COSTELLO. Ms. Friend, you referred in your testimony to efforts by Northwest management to outsource flight attendants' jobs to foreign nationals. I want to ask you to talk a little bit about that and also some of the concerns that you raise associated with the organizing drive for representation by Delta flight attendants, which Mr. Lipinski raised earlier. He raised it just prior to me having the opportunity to raise it.

So I wonder if you would comment on both.

Ms. FRIEND. Right. Well, obviously, the outsourcing issue is a big concern and becomes a greater concern if we are looking at the possibility of this combined group of flight attendants having no collective bargaining rights.

During the bankruptcy, during the Northwest bankruptcy, when we were negotiating with Northwest management for the concessionaire agreement, one of the things that they put on the table was the ability to staff all of their international flights with non-U.S. citizens. Their proposal was that the existing Northwest workforce would retain domestic flying, only point to point within the United States, and anything that left the United States and returned would be staffed by non-U.S. citizens.

We have some experience with that in some of our flight attendant contracts, and we know what they do there. We have isolated usage of what we refer to as foreign nationals in specific parts of the world, particularly in the Pacific but nothing that ever touches the U.S.

We know what they do. They chase, obviously, the cheapest labor that they can find. So I mean that just adds to our urgency of this group of flight attendance retaining a collective bargaining agreement so that we can preserve those jobs.

When we filed for the election under the National Mediation Board rules for an election, the day we filed, Delta management put up in their offices, their in-flight offices where the flight attendants have to go to check in before their flight. They practically wallpapered these areas with anti-AFA, anti-union posters.

As Mr. Lipinski referred to it, under the Mediation Board Rules, if you don't cast a ballot, it is a no vote. In order for these flight attendants to form a union, 50 percent plus 1 of them have to actually cast a vote.

So the management campaign is when you get your ballot, don't vote. Rip it up because then that becomes a no vote. So that is the theme of their campaign. As I said, they practically wallpapered their in-flight offices with this message.

They produced a DVD video from Mr. Anderson. That is what Mr. Lipinski has a copy. That is what he referred to, where Mr. Anderson talks about all the bad things that will happen to you if you should join a union. It will completely destroy Delta Airlines. He actually repeats falsehoods about his interaction with the flight attendant union at Northwest Airlines for the period that he alleges he was there.

Because they give lip service to this idea that the flight attendants who are supporting forming a union are supposed to have equal access to talk to their coworkers, they have isolated them into what they define as the non-work area.

Now, the non-work area continues to shrink. In our estimation, our workplace is the aircraft, but they have defined the work area as every place except a kitchen area that is attached to some of these in-flight areas. Even if our flight attendant supporters are in this very narrow area and they happen to be wearing a tee-shirt because our slogan for this campaign is Pro-Delta, Pro-AFA.

So if the flight attendant supporter is wearing a Pro-Delta, Pro-AFA tee-shirt, they are not allowed to leave this narrowly defined non-work area, wearing that tee-shirt in spite of the fact that the rest of the area is plastered with these anti-union don't vote. It is massive voter suppression. It is.

We were told when this merger was first announced. Our Northwest leadership contacted Northwest management and said we need to sit down and talk about this merger. We were told by Northwest management, there is no place for you to discuss this merger because it is the intent of the people who will manage the new Delta Airlines that when the dust settles you will have no union.

They are true to their word. They are going to try to stop it here. Then if we have to go through the second phase with the combined group, it will be just more of the same.

Rather disingenuously, Mr. Anderson answers the questions about the DVD, saying, well, we have a lot of passionate flight attendants on both sides.

I find it really very difficult to believe that these so-called passionate flight attendants who are anti-union were allowed to use his name and his photograph without his permission.

Mr. COSTELLO. The Chair thanks you and now recognizes the Ranking Member, Mr. Petri.

Mr. PETRI. Thank you.

We apologize a little bit for the length of the hearing, but it is an important subject, and we appreciate your taking the effort to stay and participate and for the statements that you and your organizations prepared for this occasion.

I just want to say as a member of the traveling public, I appreciate the dedication and seriousness with which nearly all of your members take their jobs. I know there has been a lot of stress, and it has been difficult work for a whole variety of reasons, and people are sometimes cranky, but my own experience has been actually getting top-flight service.

I just wonder if you could answer two questions. One, there have been articles about whether the merger would succeed or not based on and doubting that it would because of what were described as quite different employee cultures between the two organizations.

All of you probably have been through various mergers. There have been a lot in the airline industry. If you have been with either of your companies for any number of years, you have experienced some. Would you care to comment on that?

Is it possible that will be an impediment or is it something that is a concern but can be overcome?

The second one is I think the chief executives testified that they were hoping after the merger to unite the pay schedules and benefits at the higher of the two levels—at least that is what I heard—between Delta and Northwest.

Obviously, the airline pilots and probably the mechanics, you have union discussions to figure out how you are going to be working on that as well as dealing with the companies, but I wonder if you could comment on that as well. That sounded like a pretty good outreach to me.

Mr. MOAK. Congressman Petri, I would like to start with that. I believe that this merger is going to be very successful and, not only that, I believe it must be successful and that we are going to have to work together. We are going to have to all come together and say, what can we do to make this work?

You hit the nail on the head early on when you said nine airlines have gone into bankruptcy or liquidated over the last few months. Those airlines, those employees of those airlines are not going to get a hearing here in order to talk about a potential merger. They have lost their jobs. They will not be here.

I, myself, have an interesting experience as a Delta employee because I was up here last year in January, leading an effort to fight the hostile takeover by U.S. Airways of Delta Airlines. That was a Wall Street transaction, and they had no shame. They came out of the gate and what they said to the Delta employees is 10,000 Delta employees would be on the street and 1,000 pilots would lose their jobs.

At that hearing, I agreed with Mr. Roach. That was the wrong merger at the wrong time.

But right now, we are faced with all the different events we have talked about, whether it is oil, the economy or competing with flag carriers in Europe. Lufthansa alone is worth more. The German-flag carrier is worth more than all the legacy airlines put together.

So, not only are we going to make this work, we must make it work or we won't be at another hearing ever again.

As far as Captain Stevens and the Northwest pilots, we were working together. We met today. We will be meeting after this hearing is over, and we will get this done because our members demand it and it is important for the airline as we move forward.

The U.S. Air merger, one more time in contrast, at that time, when they were trying to do the hostile takeover of Delta Airlines, they had not completed that merger. They have still not completed that merger today.

So it may be a little contentious right now, okay, but the merger was just announced three weeks ago. We have been working three months on it, and I am confident we are going to get the job done because we need to get it done. Culture aside, we will get it done.

Mr. ROACH. Can I comment on that?

I respect the captain and what he said. I have been in this industry 33 years. I have never seen an airline merger work yet.

History tells us what is going to happen here. Northwest and Republic, big culture clash, okay. Very recently, U.S. Airways and America West, they are still fighting down there. It has gotten to the point where employees couldn't even get along with each, that they left the union of their own accord.

These are serious problems. You just can't put two airlines together. They have two different cultures. They have two different ways of working.

We work on different aircraft. We service the passengers different, and there are different types of management. There is a whole history and culture of working with a company or an industry.

It takes, in the best of conditions, three to five years to put an airline merger together because you have a maintenance program, you have aircraft that you have to either get rid of or downsize, retrain pilots, retrain mechanics. It is a whole host of things that happen.

With all the good intentions, we were at the Senate hearing, and Mr. Anderson and Mr. Steenland admitted that all these guarantees don't mean anything because they are not likely to happen.

If somebody asks, could you put that in writing, you never got an answer to that because they said it is not going to happen. That is what they told the Senate side. It is not going to happen because we can't guarantee anything because anything is liable to happen.

So all these promises that are being made and how wonderful everybody wants to do this and I am quite sure with all good intentions. But, Congressman Petri, you are right. There is a cultural difference.

There is a cultural difference, and U.S. Airways and America West have been at it for over two and a half years. There are lots of internal problems. There are internal problems with employees, internal problems with meshing as to flight schedules. They are still operating as two separate airlines. So it is a problem.

To diminish the problems that are going to happen would seriously take away from the process. There is going to be problems. People can work as hard as they want. I don't think people are not. There are going to be problems.

Our view of the world is this is not in the best interest of the American people, period. End of story.

Mr. COSTELLO. The Chair thanks you, Mr. Roach.

Let me announce that we have a series of three votes going on the floor. We have about three minutes to get over for the first vote, two five-minute votes after that. So I would ask the panel to return, and we will recess.

Mr. PETRI. Mr. Chairman?

Mr. COSTELLO. Yes, Mr. Petri.

Mr. PETRI. One of the additional witnesses was hoping to say something. If they do it when they come back, would that be possible?

Mr. COSTELLO. On this panel?

Mr. PETRI. Are we done with this panel?

Mr. COSTELLO. No.

Mr. PETRI. Yes. I think Captain Stevens has something.

Mr. COSTELLO. Quickly, if you will add what you need to add.

Mr. STEVENS. Yes, Mr. Chairman.

Unfortunately, because of the airline industry, I did participate on the unsecured creditors committee from 2006 through 2007, attending all those meetings and seeing the challenges faced by all the different groups that Captain Moak also referenced in this challenging environment.

I also was of the belief and again expressing it to my executive board of the benefits of a cooperative merger starting last December. I do find it somewhat ironic that also suggested for all employees at Northwest that they emerge similar to management with an equity program to get everybody pulling in the same direction starting in February of 2007.

Fortunately, it is now I have the irony of seeing in the announcement statement for the merger with Delta, the only group that is excluded from equity being contemplated are the Northwest pilots. I find that frustrating along with the——

Mr. COSTELLO. I hate to interrupt you, but we have a minute and 50 seconds to get over to the floor.

Mr. STEVENS. I have a final point, and I am done.

Mr. COSTELLO. I will ask the panel to come back and be ready to answer questions at 7:15. So the Subcommittee will recess and ask you to be back at 7:15. Thank you.

[Recess.]

Mr. COSTELLO. The Subcommittee will come to order.

The Chair, at this time, will recognize the gentleman from Wisconsin, Mr. Kagen.

Mr. KAGEN. Thank you, Mr. Chairman, for holding this Committee hearing and thank you to everyone for appearing. I don't know how many hours ago you began to be involved in this Committee, but this is part of the listening process and part of oversight and asking questions.

So my question has to do with the three things having to do with the overhead of the companies that you are employed by. As I understand the transportation industry with regard to Delta and Northwest, they have some major areas of cost involved in people/employees, their fuel costs and their equipment. So, of these three categories, as they seek to consolidate and merge their organizations, which of these three do you think that they can control?

Can they control their fuel cost? Unlikely.

Will the merger in some fashion lower their fuel cost? I think not.

Will it lower their cost for their equipment? I doubt it, not for their acquisition cost of new planes and new engines and new equipment that goes onboard.

So the only area left to really cut costs is going to be for the employees and the people, and that is really where the economy of scale comes in, in my mind.

When I first began to take lessons in business, it was when I was a little kid watching television on Saturday night. There was Gussman Presents. It was a movie. He would present different movies. Mr. Gussman, he sold automobiles, and he said there is quality, price and service.

On these three aspects of quality, price and service, the question I have for all of you is I would like you to address the areas that you believe the merger will improve upon efficiency of scale either by lowering the cost of the fuel, the equipment or the cost for employees and also what effects this merger will have on the quality of the service that you are able to offer.

Ms. FRIEND. I will go first because I think my answer will probably be the briefest since we are essentially locked out of this process.

Our Delta flight attendants have no union representation, and our Northwest flight attendants, whom we represent, have been denied access to any information or any discussions about the merger because, as I said in my testimony, it is the intention of the management of the new Delta that when the merger is complete the flight attendants will have no union. So we don't have, other than what we hear them say publicly, which we are extremely skeptical of.

I will say in response to the question that was asked just before the last recess that, yes, however this comes together, whether it comes together with both flight attendants having a voice through their union or with the flight attendants having no voice, there will be cultural differences to work through. I believe that they can be worked through under normal circumstances.

But I have to say that if you rip away the collective bargaining rights of 9,000 of those flight attendants that they have had for more than 60 years. These are flight attendants who have never, ever worked without a collective bargaining agreement. The concept is completely foreign to them.

If you rip up their contract in front of them and say now, go and be nice to the Delta flight attendants, I think that is going to be an extremely protracted integration process. It will be extraordinarily difficult.

Mr. ROACH. It is employees. Clearly, putting these two airlines together, the purpose is to reduce the overhead, the labor costs.

They have admitted on CNBC, and they admitted last week at the Senate that the reservation agents will be reduced. They didn't say that today, but they have said that before. They consider them back room, those 1,000 employees, office and clerical people who will be reduced.

I don't know how, what the work rules are for flight attendants and pilots, but obviously there is some issue with seniority.

Regardless of what they say and we have heard from industry analyst, Mr. Nadelle, last week, there is only one way for this to cut costs, and that is to reduce employees. That will reduce service because both of these airlines have cut employees to the bone.

You go there and you see a machine, and there is not enough people to work it, not enough people to load the planes, not enough people taking reservations. It is bad for the employees which will be bad for customer service, but fuel is not going to go down and putting these two airlines together is not going to make it any cheaper to operate.

Fares need to be what they need to be. That is the real issue.

Mr. MOAK. I say this is good for employees. It is good for our communities, and it is good for the traveling public.

I do understand the cultural issues slightly. I believe airline employees, mechanics, flight attendants, gate agents, reservation people, on and on and on, are all required to work together to make an airline work. An airline is a very complicated and complex operation, and I believe that these people are intelligent, and they are going to be able to work together.

At Delta, we have a long, proud history of being formed by four mergers. We had the CNS. We had the Northeast merger of 1972.

We had the Western merger of 1987, I believe. We had the Pan Am merger of 1990.

In every one of those mergers, we took care of our people. We moved forward, okay, and we need to move forward because customer service in the operation is what is going to make the airline profitable.

Mr. KAGEN. So, if I understand you, Captain, you are saying that by reducing the number of employees, that makes life better for the consumer and that by reducing the pay and the negotiation ability of the employees, somehow that makes life better for them.

Isn't it really the history of the labor movement, that the labor movement by collective bargaining, by having effective collective bargaining, didn't that raise the vote of everybody? Didn't it give us the middle class?

Mr. MOAK. Well, Congressman, I beg to differ. That is not what I said.

What I am saying is this: I am not going to jump on the management bandwagon or apologize for things that other managements have done. But if you are going to vilify every single management team, eventually you are going to have a management team that arrives that is trying to work through the problems. This is a difficult time, difficult problems.

Now through the collective bargaining process, okay, the Delta pilots modified their contract. However, we worked together with the Northwest pilots over the last three months in what was a first ever attempt to negotiate a contract before a merger was announced. We weren't successful, but we are not giving up.

We are years ahead of everybody else. We will get it done. I am confident of it.

We raised the bar for the Delta pilots over the next few years. It is approximately a 20 percent pay raise. It increases the retirement for the Delta pilots, for the Northwest pilots, and I am confident we will get it done.

I will say it time and time again. I am working with Captain Stevens. We welcome them, and we are going to get it done.

But for some of his equipment, some of his pilots, it will be a 35 percent pay raise over the life of the agreement. That is the right thing to do.

As far as equity, there is equity for all the employees. I know we haven't completed the negotiation with Captain Stevens and the Delta management, but I am going to stand here. I am sitting here, telling you that I believe there is equity for the Northwest pilots also. There has to be to make this work.

So I think the collective bargaining process. You are seeing it work. We are working together. We are going to get it done.

Mr. KAGEN. What I haven't seen is it work for the consumer today as they get bumped off of one flight because of maybe overweight or the seats just aren't available or the seat is double-booked. They have squeezed down the number of seats available for the existing clientele that they have. I haven't seen it work.

You get to see it from the cockpit. I get to see it from coming in off the chairs and from people that talk to me.

Mr. COSTELLO. The Chair thanks the gentleman from Wisconsin and let me comment, if I can.

Captain Moak, you indicated that you are going to vilify every management team. I don't think it is anyone's intent to vilify a management team here. It is our intent to recognize the facts, and the fact is that when you look at the Federal budget and you try and balance the Federal budget or do something about it, the lion's share of the outlays are for entitlement programs.

When you look at the aviation industry and you look at Delta Airlines or Northwest Airlines or any legacy carrier or, for that matter, Southwest or JetBlue, the vast majority of the outlays are in fuel and in labor. We heard testimony today, and everyone recognizes that there is not much that management can do about the price of barrel of oil or jet fuel. It is probably going to continue to increase.

So where do you get your cost savings? It is in labor. I think Mr. Roach has indicated that the history of mergers in the past paints a pretty skeptical picture.

I think you or anyone else would have to say you probably have reason to be skeptical when we have heard time and time again that we are going to keep the employees, we are going to maintain our hubs, people are going to be able to keep their pensions when, in fact, that has not been the case. So, just an observation and a comment.

With that, the Chair would recognize the Chairman of the Full Committee, Chairman Oberstar.

Mr. OBERSTAR. I can only say amen to your observations, Mr. Chairman.

Captain Moak, Captain Stevens, do you know whether the merger application has been filed with the Department of Justice yet?

Mr. STEVENS. I believe it has, Mr. Chairman.

Mr. OBERSTAR. You believe it has?

Mr. STEVENS. Yes.

Mr. OBERSTAR. Do you know, Captain Moak, whether it has been?

Mr. MOAK. I also believe it has.

Mr. OBERSTAR. The Justice Department, under their rules, has been saying to us that they are not at liberty to divulge whether that has occurred or not. It is important to know where all these things stand.

Do you think, Captain Moak, Captain Stevens, that Northwest and Delta squeezed out all the excess cost that was reasonable to squeeze out during bankruptcy?

Mr. MOAK. Chairman Oberstar, it hasn't really been brought up today, but both of us were involved in our bankruptcies. We both went into bankruptcy at the same time, same day, same court in Manhattan.

Through efforts by you and many people up here, the pensions were preserved of the employees of Northwest and of Delta except for one group, the Delta pilots. I believe everything has been squeezed out of the Northwest employees and the Delta employees.

As we move forward, which I guess is more than you are asking me, I truly believe that this is a one plus one equals three merger.

Mr. OBERSTAR. At any time during the bankruptcy proceedings, was there any suggestion, any hint of a merger with another carrier?

Mr. STEVENS. Mr. Chairman, I think there were some considerations, and I do feel during the bankruptcy, to your original question, it was more than what was necessary was squeezed out of all of the Northwest employees. It was a very frustrating experience to be part of. I attended all of the meetings after my election. It has been over a year.

I also testified in bankruptcy court. I also appealed to Mr. Steenland at the end of 2006 that he had gotten more than he needed and he needed to remotivate the employees and appealed on behalf of the flight attendants.

I then, in February, also asked him, besides a management equity plan that was grossly outsized, to have an employee equity to motivate and to reward employees. That fell on deaf ears in February of 2007.

We then came out of bankruptcy, and now we face quite a challenge.

It is true what Captain Moak says, that we did work hard here to try to come to a conclusion of a cooperative merger. It seems to be, though, that Mr. Anderson has brought the style that was learned at Northwest Airlines, and now we are omitted from equity. With great irony, we are the proponents of equity for all employees. We are left out.

Also now, Mr. Anderson has taken on a strategy of reaching pay parity for the Northwest pilots over a multi-year period. We do have the support of the Delta pilots in opposing that as they published, but the idea that that strategy going forward is some inclination of perhaps how they think it will answer.

I think to answer the other Congressman's question, that creates the question of increasing costs. Costs will go up, and they do need to have a joint contract in order to have all the synergies. The top line has to increase. Costs have to go down if you are going to have an airline that works. It is basic economics as we both learned, apparently.

Mr. OBERSTAR. Are your respective pension plans the same before the Northwest plan was frozen at the same period of time as the Delta plan?

Were those contributory pensions or are they 100 percent company contributed pensions?

Mr. STEVENS. We still have our DB plan, a traditional pension plan.

Mr. OBERSTAR. Defined benefit.

Mr. STEVENS. Defined benefit frozen, and then we also have a smaller defined contribution than Delta does.

Mr. OBERSTAR. Yes, going forward. Does Delta have the same structure?

Mr. MOAK. No. We had a defined benefit plan going into bankruptcy.

Mr. OBERSTAR. Was that 100 percent company contributed?

Mr. MOAK. Absolutely.

Mr. OBERSTAR. Yes, okay.

Now do you know what happens in the event of a liquidation bankruptcy?

Mr. MOAK. Absolutely.

Mr. OBERSTAR. What is your standing?

Mr. MOAK. With PBGC?

Mr. OBERSTAR. Yes.

Mr. MOAK. We have been meeting with the PBGC to get a valuation on our pension.

Mr. OBERSTAR. I will answer my own question. You are unsecured creditors.

Mr. MOAK. Absolutely.

Mr. OBERSTAR. Unsecured creditors, so with the machinists, so with the flight attendants. We have been through that with the steel industry and been through that in other sectors as well where there are 100 percent company contributed pensions.

In the event of a bigger bankruptcy, you get nothing except that little bit that is left on the table. So, think very carefully about where you are headed with this proposition.

Now let me ask Captain Moak first. How many aircraft do you think or might you speculate that are likely to be retired in the new Delta?

Mr. MOAK. Chairman Oberstar, I believe like I said earlier, that although there are announced domestic capacity drawdowns related to the price of fuel, in the press announcement of the new global Delta, there are 20 additional wide body planes that will be coming and there are many markets that will be added. I believe that.

Mr. OBERSTAR. Captain, if you believe that, then I have a bridge I would like you to buy, if you believe a press release issued by your company. They can't tell you on their sacred oath and word and trust, and you have to read it in press release.

Mr. MOAK. Sir, that is all I can.

Mr. OBERSTAR. Captain Stevens, let me ask you what you think is likely to happen. How many aircraft?

They aren't going to continue with this fleet as it stands. How many DC-9s? How many 737s? How many?

Go deeper into your regional carrier fleet. How many of those below 50 passenger capacity aircraft are likely to be retired?

Mr. STEVENS. Below 50, they will be gone.

The aircraft larger is a more difficult question. It depends on the routing and what the yields are because, for example, our DC-9s don't have any current lease payments. So it will be very dependent.

If fuel continues to rise, where no business plan works, clearly many of them will be parked. In the other scenario, if fuel moderates, there is a future for the 9.

My bigger frustration is that Mr. Steenland didn't follow our advice not today but over a year ago in putting in a risk management policy for the price of fuel. Everybody argues that the cost of fuel is extremely expensive to hedge when, in fact, by using a method of collars, it is a very inexpensive insurance process. It would be like not having health insurance for any of us, and that is by far the greater problem that we have.

If you look at Mr. Kelly's success at Southwest, it isn't great management of the airline. It isn't a single airplane. It is that over 50 percent of the fuel is hedged at half the price the legacy carriers are paying.

Mr. OBERSTAR. Well, it is surprising he didn't take that advice because when Mr. Anderson was at Northwest, he and Mr. Steenland both combined on a hedge proposition that made $200 million profit for the airline.

Captain Moak, have you had a little time to think about that question of retiring of aircraft?

Mr. MOAK. Absolutely, sir. That was a public announcement. As you know, I am under a confidentiality agreement. I can't talk about private matters.

Mr. OBERSTAR. I am asking you to speculate.

Mr. MOAK. Well, I speculate that the answer to the question is fuel. The current fuel hedge program at Delta is worth $800 million. They have 25 percent of their fuel hedged.

However, like you said and you have been very clear with this, if fuel goes up, there is a real risk of planes being parked, but that is whether you are merged or you are a standalone carrier. The same thing would happen.

Mr. OBERSTAR. I would suspect that in the larger carriers, you have at least 100, maybe more, aircraft parked.

You are not going to continue flying the DC-9 fuel-eaters. You are not going to continue, in the regionals, the smaller capacity aircraft. I don't know what the age of the 737 fleet at Delta is. At least, I don't remember it, but the older versions will be phased out. That is about 1,000 jobs.

Now, before I go to Mr. Roach and Ms. Friend, do the contracts with Delta's and Northwest's regional carrier pilots differ from those with the network carrier? Are those different tier contracts?

Mr. STEVENS. If I understand the question correctly, yes, the main line.

Mr. OBERSTAR. Pay scales?

Mr. STEVENS. The pay scale is higher on the main line, and we have a very good relationship with Compass, Mesaba and Pinnacle, and we have flow-through agreements both with Compass and Mesaba because they aspire to join the main line at Northwest.

Mr. OBERSTAR. Can those pilots migrate up the line?

Mr. STEVENS. Yes, sir, they can contractually.

Mr. OBERSTAR. What about Delta?

Mr. MOAK. At Delta, we don't have a flow-through, but in the last year we have hired 650 pilots. We just stopped hiring.

Mr. OBERSTAR. But the seniority lists are very different between Northwest and Delta, are they not?

Mr. STEVENS. Because of the bankruptcy and we are in a unique circumstance, the pilots at Northwest are older than the pilots at Delta.

Mr. OBERSTAR. More senior, don't say older.

Mr. STEVENS. Well, I have debate on that from my counterpart, whereas many Delta pilots chose early retirement to get part of their DB plan, so they didn't become unsecured creditors as you pointed out.

Mr. OBERSTAR. Mr. Roach, with the outsourced maintenance that is rampant within the industry except for American Airlines which still does their maintenance in-house, how do you see the playing out of the conduct of maintenance of aircraft in a merged carrier, a vastly larger carrier, against the backdrop of the hearings this Committee held just a couple of weeks ago?

Mr. ROACH. Well, Northwest subcontracts the majority of their maintenance work, a lot of it overseas, and I believe Delta subcontracts a good portion of their work. You can see, based on saving money, that a great deal more work will be subcontracted out. Probably they will send planes to Singapore and all over the world to be maintained.

On the Northwest side, which they have an independent organization, they really have no restriction on this, and there is no restrictions on Delta sending this work out. So you can see a lot more work being subcontracted out.

Mr. OBERSTAR. Would there be conflicts with the multiplicity of providers? There are a number of maintenance providers, MROs, in the U.S. for these carriers.

Mr. ROACH. Right. The problem is when you start talking about a merger. You have to integrate a maintenance plan. They have two different maintenance plans. They have two sets of aircraft, two different aircraft, types of aircraft.

So the FAA, they have to go in and reorganize an entire maintenance plan and put that plan together. Until that is done, the mechanics from one carrier can't work on the planes from another carrier. They have to redo the maintenance manuals. This is a three to five-year process.

These planes have to be maintained separately or maintained by somebody who has been trained on that particular plane. DC-9 aircraft is about as old as I am, and they require a lot of maintenance. These older aircraft require a lot of maintenance.

I would just like to answer one question you said before to the pilots. You said, were there discussion during the bankruptcy about this merger. There were discussions.

I think I have some documents—these weren't in confidential meetings—that I would like to give to the Chairman, that there were some discussions about Northwest and Delta merging during the bankruptcy.

It was a Mr. Checchi who was a former executive of Northwest. He was going around with a current member of the board of directors of Delta Airlines, Mickey Foret, trying to sell this Northwest-Delta deal. We didn't want anything to do with Mr. Checchi or Mr. Foret or anybody else, and that is what we told them, but this was shopped before.

I am not sure if they should have discussed this with the bankruptcy court. These two companies were in bankruptcy, talking about mergers, and the board of directors of Northwest Airlines sanctioned these discussions.

If I have those documents, I will make sure that you get them.

Mr. OBERSTAR. I invite you to submit those documents to the Committee. It is vitally important.

I asked the question for that very specific reason. I knew of contacts during that period of time, and they were not made public. I had no documentation about it.

Mr. ROACH. I believe I still have those documents. We will check tomorrow and, if I do, we will give them to you.

Mr. MOAK. Chairman Oberstar, can I weigh in on that also?

Mr. OBERSTAR. Of course.

Mr. MOAK. During bankruptcy, as I said a little bit earlier, Delta was in bankruptcy when a hostile takeover was made by U.S. Air of Delta Airlines. It was a very public and a very painful process.

At the end of the day, $10.7 billion was offered to the creditors committee. The creditors committee ultimately turned that down because they didn't think they would get their money in a timely fashion. If that would have happened, Delta, I believe, would have still been in bankruptcy today. That fell apart January 30th of 2006.

Mr. OBERSTAR. Well, Ms. Friend, the merger of flight attendant lists would be a nightmare, wouldn't it?

Ms. FRIEND. No. I guess it depends on whether or not the Delta flight attendants are successful in forming a union. If they are successful in this process that they are engaged in right now, and we will know that on the 28th of this month, then they will become members of AFA.

Our AFA policy is when two AFA-represented airlines merge, we put those seniority lists together by date of hire. There is no conflict. It is done, and we hold the seniority list until we have a single contract.

Mr. OBERSTAR. But absent that, absent a successful vote?

Ms. FRIEND. If they are not successful, then we are going to rely on the new legislation that Senator McCaskill helped us with in the Senate and that you were helpful with here which says that if the two groups of flight attendants—in this case, workers—but two groups of flight attendants can agree on how to merge and to integrate their seniority lists, then it will be subject to arbitration.

I can pretty much guarantee you that if the Delta flight attendants are still represented by their management, our Northwest flight attendants will come to the bargaining table and propose date of hire. I don't know what the Delta flight attendants, through their management, will propose, but it won't be date of hire. And so, we will end up with an arbitrated list.

Mr. OBERSTAR. Chairmen and panelists, the information that you have provided us and the testimony is not going to be considered by the Justice Department in reviewing a merger proposal. That is why we have you at the table. That is why we have your testimony here.

We will see to it, though, that the Justice Department has this information as a matter of record.

Thank you for your testimony.

Mr. COSTELLO. Thank you, Mr. Chairman.

Let me again thank our panelists for being here today. It has been a long day. We appreciate your patience and your contribution to this hearing. So, thank you.

I would ask the last panel, the fourth panel and final panel to please come forward, and I will introduce you as you are coming up to the witness table.

Mr. Kevin Mitchell, who is the Chairman of the Business Travel Coalition; Dr. Aaron Gellman who is a Professor at the Transportation Center, Northwest University; Mr. Hubert Horan, an Aviation Analyst and Consultant; Mr. Albert Foer, President, the American Antitrust Institute; Mr. Philip Baggaley, Managing Director, Corporate and Government Ratings, Standard and Poor's Rating Services; and Mr. Raymond Neidl who is an Analyst with Calyon Securities. So, if you will please take your seat at the witness table.

The witnesses should be aware that your entire statement will appear in the record. We would ask you to summarize your statement, and we will begin with Mr. Mitchell. If you are prepared to proceed, we will begin with you.

**TESTIMONY OF KEVIN MITCHELL, CHAIRMAN, BUSINESS TRAVEL COALITION; AARON J. GELLMAN, PH.D., PROFESSOR, TRANSPORTATION CENTER, NORTHWESTERN UNIVERSITY; HUBERT HORAN, AVIATION ANALYST AND CONSULTANT; ALBERT A. FOER, PRESIDENT, THE AMERICAN ANTITRUST INSTITUTE; PHILIP BAGGALEY, MANAGING DIRECTOR, CORPORATE AND GOVERNMENT RATINGS, STANDARD AND POOR'S RATING SERVICES; RAYMOND NEIDL, ANALYST, CALYON SECURITIES**

Mr. MITCHELL. Thank you. Thank you, Mr. Chairman and Members of the Committee for requesting the Business Travel Coalition to appear before you today.

Delta and Northwest are playing the fuel card and suggesting that their merger is an inevitable response to high fuel costs, but does the Delta-Northwest merger math make any sense?

Even if we give them the undeserved benefit of the doubt that they will achieve $1 billion in annualized synergies, many analysts believe 75 percent of that would be captured by a new and well-deserved pilot agreement, leaving just $250 million. The project pro forma fuel bill for the combined carriers for 2008 will be $12 billion.

So how is it possible that $250 million will materially help with fuel costs especially given the $1 billion in projected up-front integration costs? The math simply does not work.

What is more, these mergers were planned when fuel prices were less than half of today's level. The idea that they are a necessary response to $125 fuel is absurd.

Importantly, many energy experts predict that oil prices will retreat to the $50 to $75 range in a relative near term especially against a global economic slowdown. Building an irreversible national aviation policy around the current price of oil makes no sense.

Delta and Northwest would have you focus on just 12 overlapping nonstop markets when the real story, as far as domestic U.S. competition is concerned, is the 550 nonstop and one-stop markets where the combined carrier would have 50 percent market share or higher. In 139 one-stop markets, the market shares soar past 70 percent. These are the small and mid-size communities where capacity will surely be ripped out and fares increased.

However, there are many not so small communities that will be seriously harmed as well, like Nashville and Baltimore, where in numerous city pair markets the standard DOJ measure for competitive concentration, HHI, the index is off the charts.

DOJ merger guidelines say that 100 HHI points increase in highly concentrated markets, characterized as those market with a score of 1,800 or more, establishes the presumption that the merger is likely to create or enhance market power or facilitate its exercise. In Nashville, for example, there are numerous city pair markets where the HHI skyrockets to 8,000, 9,000 and nearly 10,000. Make no mistake, these are the markets that matter.

Delta and Northwest don't want you to focus on these. All their promises about no layoffs, no hub closures, no service degradations will fly out the window faster than Ferris Bueller with a stomachache on a sunny, spring school day or evening as it were.

Delta, however, realizes HHI is the valid trip wire. In its own presentations to Congress last year, rebuking U.S. Airways overture with assistance from BTC, the carrier stated, "Capacity reductions and fare increases cannot justify mergers," and quoted the DOJ merger guidelines as follows: "Cognizable efficiencies do not arise from anti-competitive reductions in output or service."

Delta now claims that the circumstances have changed. That was then and this is now. Inevitable hub closures last year are inevitable no more. But, in truth, Delta's strong reaction to the unsolicited U.S. Airways merger that Delta found so abhorrent and anti-competitive is a polygraph test for Congress and regulators to study in connection with Delta-Northwest.

Despite the Delta-Northwest spin machine, there are scenarios for airlines other than ill-considered mergers, and some could produce far better results. If the Delta-Northwest merger is the proverbial canary in the coal mine, as time passes, the canary is inhaling gas and gasping for air. It is time for policy-makers, regulators and airlines to look for alternatives to avert disaster.

What are the choices?

Status quo: In this scenario, airlines accelerate their own unilateral reductions of uneconomic capacity and continue to address cost and efficiency issues.

Robust recovery: If oil prices should fall back to $80 as many predict, because of the cost-cutting initiatives of the past few years, the major network carriers could come out on the other side of the current U.S. economic slowdown and experience a robust airlines sector recovery.

Liquidations: If the proponents of the let the market work its will truly believe what they say, then let major carriers fail instead of propping them up with Government-sanctioned anti-competitive combinations. Antitrust law is not meant to be sympathetic to industries that cannot solve their own problems.

Perhaps the most authoritative voice about airline options, however, comes from Delta itself. I quote from an Associated Press story on February 29th: "If Delta's consolidation talks with Northwest fall apart, the airline isn't committed to finding a replacement deal, said Chief Financial Officer, Ed Bastian. When asked if Delta had a Plan B ready if the Northwest deal fails, Bastian said, it is not a Plan B. It is a Plan A. That is our standalone plan. Bastian said, the company expects solid growth for the year, that the airline has a great, great standalone plan."

As you can see, this merger proposal will neither help consumers nor the competitive structure of the airline industry, and there are options.

Thank you.

Mr. COSTELLO. The Chair thanks you.

Professor Gellman, I would like to thank you. I know that you had a flight out this evening to try and get back, but we appreciate your staying here and offering your testimony. Thank you, Dr. Gellman.

Mr. GELLMAN. Chairman Costello, Chairman Oberstar, I am indebted to Captain Moak, who left, because he kept saying "we will get it done." The only thing we are going to get done is this hearing and soon.

I am Aaron Gellman, Professor at the Transportation Center at Northwestern.

There are five reasons most often given these days for seeking to become a single airline through merger or acquisition:

Economies of scale which leads to reduction of costs;

Economies of scope where there will be more single-line service to more places especially internationally;

A varied fleet that can be deployed to meet more precisely the needs of each city-pair market;

High and mounting fuel costs; and,

Reduction in the rate of growth of the U.S. economy.

I will consider each of these reasons in turn, but before doing so I need to state that the views I express today are my own and do not necessarily reflect those of the university, its faculty and staff, nor of the Transportation Center at Northwestern with which I am principally associated.

I should also make it clear that I am not categorically against mergers between airlines. There are amalgamations that make economic and public policy sense. But, as I hope to demonstrate, this is not one of them.

Let's consider economies of scale, reduction of costs. I should not be surprised if certain non-flying jobs would be eliminated at Northwest and Delta if they were to marry. Some functions are surely duplicated in the two carriers, and not all the associated people will be needed in the future if they merge.

The challenge for a new management team is to assure that the best, most productive persons are retained while the others, sadly but necessarily, pay the price of displacement. But the history of mergers generally, in this as well as other industries, gives little comfort that this will be the case, thus decreasing the prospective cost savings.

It is very hard to believe that surviving will be only the best. If they are at Northwest, they are already handicapped because there is a cost to move them. Indeed, many of them may not want to leave the Twin Cities despite their winters.

As for other cost-related issues, there would be some benefit from geographically broader, more efficient advertising and marketing programs, but airport space rental and maintenance costs are unlikely to be much reduced, given the representations of the prospective partners not to close hubs or cut services significantly.

The prospects regarding the pilots of the two carriers suggest either a minimal beneficial effect on costs or a substantial increase in costs. In the former case, it will require the two carriers to continue operating essentially as two airlines much as U.S. Airways has now had to do all these many, many months since US Air and America West got married. Many economies of scale would be sacrificed in the process while costs attributable to pilots may well not change much.

On the other hand, in order to achieve real and full integration of the two airlines, it will be necessary to bring the pilot corps together through a merger of the two seniority lists on a basis that is acceptable to both pilot groups. This is something that U.S. Air has still not been able to accomplish, and this is likely to be a far greater issue with Delta and Northwest.

Assuming the new Delta can do it, this will mean a substantial additional cost burden for some time as seniority number rather than pilot age or experience will determine what equipment the pilot can bid for. Given the great and perhaps unprecedented disparity of the two airline fleets, this will take a considerable period to implement with attendant training and logistics costs all along the way.

Turning now to economies of scope, there are economies of scope to be exploited in a combined carrier. Perhaps this is why there is the pledge in this instance to retain all the hubs now in the system. But how the economies work out from greater scope and the value of such economies is not clear except for the advertising and cost savings previously cited.

It should also be noted that one of the principal reasons given for international alliances in which both carriers already participate is that they enable airlines to gain many economic and marketing benefits without the need to merge. In any case, the greater profitability now to be found in the intercontinental markets is not immutable.

Low cost carriers will enter the markets and some very soon. Look who has ordered 787s. There are some carriers, a few, that were charter airlines in Europe. They are not going to use those for charters. They are going to use them to enter the transatlantic market as low cost competitors.

One of the most amazing claims that has been made in my view has to do with the varied fleet of aircraft that the two airlines will present. A disparate fleet of aircraft is not usually productive of economic benefits.

To be sure, a variety of aircraft is required to carry out the wide range of missions of Delta and of Northwest either individually or combined, but the number of aircraft types must be constrained if all the benefits of economies of scale are to be realized. This means in the present instance that either one of the carriers has to substantially re-fleet, which will be exceptionally costly and take considerable time or that, again, the two carriers be operated separately with all that entails.

Note that at present the only aircraft type flown by both carriers is the 757-200 with Pratt and Whitney power. Otherwise, Northwest is oriented to Airbus and Delta is exclusively Boeing in its main line fleet.

In any case, presently each airline alone appears to have a fleet varied enough to assign aircraft types to the markets best suited to them. Also, each carrier has regional jet and turbo prop operations either through subsidiaries such as Comair or through contracts, and these provide each with even greater flexibility. Therefore, to make a virtue of an exceptionally diversified combined fleet seems more of an excuse than a reason to merge.

Now, let's consider, finally, high and mounting fuel costs and a slowing economy. First, again, we have excuses being offered as reasons. Regarding fuel, with very limited exceptions, all U.S. airlines are faced with the same conditions. Of course, the major exception is Southwest hedging.

Moreover, how can the combination of these two airlines influence either condition, either fuel price or the slowdown of the economy? Only by reducing service can fuel costs be lowered in the short run, and there is the representation that this will not be pursued to any significant degree if these carriers combine.

It is true this may have changed. Mr. Anderson earlier stated here today that service will be reduced if fuel cost continues to increase regardless of whether the merger is completed or not, and that is a direct quote.

But a larger issue must be faced: When fuel prices decline and economic growth is restored, both of which I truly believe will happen, what of these "reasons" then?

You will not be able to unscramble the egg. If these were not valid bases for consolidation, how much will the public suffer in future because of higher fares and reduced services as a result of the merger having taken place?

I would like to conclude with four general observations. First, the recent withdrawal of Continental Airlines from negotiations with United is of considerable importance in the present context. Note that Mr. Kellner, Continental's CEO, prominently cited cultural differences as a reason for not going forward.

One has to admire Mr. Kellner for his candor which is of benefit to you and indeed to all of us because cultural differences do matter in mergers between firms, and we know that from the history of mergers in all kinds of industries. It is especially true that culture matters where the companies that are merging serve the public with a "soft" personal product like transportation.

Second, what, if any, has been the role of the hedge funds in the present urge to merge of several airlines?

After all, how can this question be ignored when a fund named Pardus, out of whole cloth, announced to the world some months ago that Delta and United were negotiating after which both carriers quickly and firmly denied it?

Was this an attempt to manipulate the share prices of one or both companies?

Shouldn't the SEC be alert to the possibility, even probability, that this is an emerging pattern?

Third, the Civil Aeronautics Act of 1938 was bottomed on the stated premise that airlines are "vested with the public interest." Although this language no longer is present in governing legislation, the airlines are no less so vested.

I, in no way, want to see re-regulation. At the same time, I believe we must be careful, and we must take a long-term view of this industry. Congress can show the way in doing this.

Finally, there is the issue of how do you hold a merged airline to the representations made in order to gain approval to join? Will the system be maintained as promised? If not, what can be done?

I don't have an answer. I certainly hope that you do.

Thank you for your attention and the opportunity to appear before you.

Mr. COSTELLO. Thank you, Professor.

The Chair now recognizes Mr. Foer.

Mr. FOER. Thank you, Mr. Chairman.

I am Albert A. Foer, President of the American Antitrust Institute which is a 10 year old, independent nonprofit education, research and advocacy organization.

The essential points of our written statement are three. First, air transportation is an industry in which there are substantial network effects, but the incremental costs of expanding an already large network may offset the benefits.

Second, the industry is already moderately concentrated on a national basis, but this generalization underestimates the market power that is present at most hubs and on most routes including the transatlantic routes where three alliances behave increasingly like three global companies operating through a variety of branded subsidiaries.

And, third, a merger of this magnitude will, in all probability, lead to at least one more merger of similar size such that it is imperative to look at the forest and not merely the trees, by which we mean the DOJ must not only apply to the Delta-Northwest merger the standard antitrust analysis that requires the divestiture of overlapping city pairs in concentrated markets, but it must also pay attention to systems competition and ask the difficult question of whether the five or possibly four or even three national networks that will emerge from this process are sufficient to provide a satisfactory range of choice in service and sufficient competition to keep prices close to costs.

While it is unlikely that the non-system airlines, the LCCs and connectors, will emerge in the next few years as competitive network carriers, they might very well benefit from a raised price umbrella if a less competitive network strategic segment is more easily able to raise its prices. The public would pay more, not only because of fuel costs, which is legitimate, but because of increased market power which is not legitimate.

In most circumstances, a particular travel experience may be accommodated by only one or two systems. Reducing the number of systems could only be justified if there are substantial economies of scale and scope that a competitive industry will assure gets passed on in substantial part to consumers.

If there is one thing that we have learned from the long history of antitrust, it is that efficiencies are easy to assert, difficult to achieve and rarely of the magnitude that the parties predict. In this regard, it appears that a system which relies heavily on hubs is expensive to operate compared to a point to point system, and there may be limits to the efficiency gains achievable through already large networks.

For example, bigger networks create peak load problems at an airport with all the planes arriving at the same time and departing at the same time. Such a system is also fragile and particularly so with all the outsourcing that we now see.

A delay in a plane's arrival at a hub can quickly metastasize through the system. As networks grow and the number of alternative systems decreases, minor inconveniences become major national inconveniences, if not emergencies. This is an external cost that is not calculated in the antitrust analysis.

Allowing additional market power to the airlines that survive the proposed mergers will obviously not reduce the price of fuel.

The question is whether the inevitable downsizing needs to be handled through cartelization of the industry or by individual decisions by the incumbent airlines. It is our commitment to competition in the airline industry, as opposed to regulation, that is fundamentally at stake here.

Now the ultimate question is whether the public will be satisfied with four domestic and three global air transportation systems.

There is little, if any, empirical knowledge that says how many systems are needed to provide a workable degree of inter-system competition.

There is substantial data, however, both empirical and theoretical that suggest that competitive problems increase as a market becomes highly concentrated. There is substantial experience with domestic air mergers that suggest how difficult they are to execute successfully, how few efficiencies have resulted from big carrier mergers and how slow entry has been at the network level.

We suggest that the magnitude and certainty of the proclaimed efficiencies in this case should be analyzed with great skepticism and must be weighed against inefficiencies due to other dis-economies of scale and scope, the cost of consummating the merger and the reduction in competition arising from the merger.

Thank you very much.

Mr. COSTELLO. The Chair thanks you and now recognizes Mr. Horan.

Mr. HORAN. Mr. Chairman, the Delta-Northwest merger is part of a well-planned, organized movement toward extreme consolidation of large intercontinental airlines. The most important immediate goal of these mega-mergers is permanent elimination of market competition on the North Atlantic.

My belief that mega-mergers will be bad for consumers and bad for the future economic efficiency of the industry is based on 25 years of experience as to how these airlines actually compete and how these types of mergers actually work.

Mr. Chairman, these mergers can only be financially justified by artificial profits from anti-competitive behavior. Every comparable U.S. airline merger since deregulation has been a dismal financial failure. They all underestimated implementation costs and wildly overestimated synergies.

The profit from anti-competitive behavior in these mega-mergers will occur in two stages. In the first stage, the Delta and prospective United mergers complete this five-year process of eliminating competition between the United States and continental Europe, a highly profitable strongly growing market of over 30 million passengers that never needed any mergers.

As I will show you on the next slide, the Delta and United mergers entrench a permanent duopoly controlling 90 percent of this market. This duopoly, which is the two collusive alliances led by

Delta's and United's partners, Air France and Lufthansa, have full immunity to collude on prices, capacity and service with huge entry barriers protecting them from future competition. With market dominance of this magnitude, 90 percent, and high entry barriers, the U.S.-Europe duopoly will be able to raise prices at will.

You will quickly see an application from British Airways, American and possibly Continental to form a third collusive alliance that would have similar dominance and pricing power in the U.S.-U.K. market.

These anti-competitive gains from gouging consumers will create an ongoing stream of what economists call artificial supernormal profits. All of the claimed synergies you have been hearing about today are just a smoke screen. The gain from anti-competitive pricing will be large enough to totally justify all the complex costs and risks of these mergers.

The second stage of the anti-competitive threat is that the megacarriers will be able to use the artificial profits from gouging North Atlantic consumers to badly distort domestic U.S. competition including every domestic market where they compete with airlines that don't serve overseas markets. A prime example, Delta can use North Atlantic profits to block AirTran's ability to profitably grow in Atlanta, completely undermining the way competitive airline markets are supposed to work.

Domestic concentration would also undermine basic free market dynamics because you create three big inefficient airlines that were too big to fail. The mega-mergers would create a situation where these three or four companies control 80 percent of the total U.S. airline revenue base, which is how you ought to look at it, and 100 percent of many important sectors in the market where low cost carriers do not compete including all mid-sized and smaller cities and all the large fortress hubs.

This table, I hope you can see it and it is in the testimony, shows several traditional measures of market concentration in the U.S.-continental Europe market over recent periods of time.

The U.S.-Europe market enjoyed vibrant profitable competition with low levels of concentration until very recently. The increases in top line concentration that you see going from, say, 38 percent in 1995 to 55 percent in 2003 reflected the normal workings of a dynamic market that was just going through a period of deregulation and posed no threat to consumers.

The shift to extreme consolidation, going from 55 to 75 and soon in the nineties, was completely driven by mergers starting with the Air France-KLM merger in 2004 and has absolutely nothing to do with normal, healthy market competition.

Transatlantic competition ends for good with these mergers, with the establishment of a collusive alliance between America and the U.K. and Continental's final decision. Does it join and collude with the United-Lufthansa group or does it go with the British Airways-American group?

These three competitors will control 95 percent of the entire North Atlantic, and no market or regulatory forces will be able to stop them from gouging consumers for years to come.

There are two critical pieces of evidence that you need to focus on: one, the hard data of the concentration of this huge market that you see before you and the evidence that this extreme concentration was not driven by market forces over the last five years. It has all been part of a concerted, well-organized plan to eliminate competition on the North Atlantic.

This slide just lists a few of these artificial events:

Policy shifts at the European Union away from letting the market decide to deliberate government intervention to drive intercontinental mergers; the mergers that occurred within Europe; the huge industry consolidation press campaign that has been going on in the United States for the last four years led by United Chairman Glenn Tilton; the Air France and Lufthansa's drive to encourage the two mergers that are before us this week; and, the long delay over a new Open Skies Treaty while the Europeans didn't only want the right for the collusive alliances but wanted the right to control their U.S. partners.

Here is a snapshot of the end results. This is the North Atlantic five years ago. The two separate European and U.K. markets with lots of competition and low concentration will have been completely eliminated.

You will have three competitors, 93 percent of the entire market, two controlling Europe, one dominating the U.K., and they will have the ability to raise prices at will, and you won't be able to do anything about it.

These mergers fail every important antitrust test. The concentration is increasing markets with very high entry barriers. It is not increasing because of marketplace success or economic efficiency.

There is no way regulators can rely on market forces. These transatlantic markets are not in any way, shape or form contestable.

The small, wildly overstated, as you have heard, claims of efficiency gains can't possibly justify the risks to consumers. There are no offsetting benefits to consumers in terms of clearly lower prices, rapid growth in new service.

It is not helping a shakeout of uncompetitive industry capacity. It is not improving the allocation of capital across the industry. In fact, it is going to make that problem worse.

Mr. COSTELLO. The Chair thanks you and now recognizes Mr. Baggaley.

Mr. BAGGALEY. Thank you. Good evening.

Mr. OBERSTAR. Mr. Chairman I would just like to welcome Phil Baggaley once again. Over many years, 20 some, he has been a constant and consistent contributor to the work of this Committee.

Mr. BAGGALEY. Thank you very much, Mr. Congressman.

I do feel a bit of a sense of deja vu. Once again, the airline industry is facing a financial crisis, in this case caused by very high jet fuel prices and a weak economy.

The managements of Delta and Northwest suggest that a merger will help them survive these challenges. My testimony will address the magnitude of the financial problem, how the proposed merger seeks to address that and what broader effects the merger and others that may follow would have on the industry.

The industry faces a huge increase in jet fuel prices, potentially 15 to 20 billion dollars higher this year, which is more than triple their pre-tax profits last year.

The airlines' choices of how to respond are limited: cut non-fuel costs and raise revenues. Unfortunately, having squeezed costs for years, airlines are running out of places to cut. The other choice, increasing revenues, means filling more seats on already crowded planes and raising fares in a weak economy.

Would merging Delta and Northwest help? The companies forecast at least $1 billion of revenue and cost synergies annually by 2012.

We would agree that a larger combined route network should allow them to capture market share from competitors and boost revenues by reallocating planes and flights throughout the enlarged system. As for costs, combining any two companies provides an opportunity to cut overhead, and we believe this is no exception.

However, we also see significant risks. Combining the two airlines will require a one-time investment of up to $1 billion to integrate aircraft fleets, information systems and for other merger-related expenses. Depending on the timing of the merger investments and the benefits, cash outlays could actually exceed benefits in the first year.

Perhaps, more important, we believe airline mergers have a checkered track record, rarely delivering on expected gains and usually creating labor unrest and service disruption.

In the case of Delta and Northwest, our main concern is the cost of new labor contracts. Employees at both airlines made deep sacrifices in bankruptcy and will want better compensation and new contracts. Therefore, the actual net merger benefits may be less than forecast, though still positive.

We also think that the labor unrest and service problems that plagued other airline mergers are a risk here as well.

What about the effect on air fares? An understandable concern is that a big merger could create market domination. On this point, the merger of Delta and Northwest appears less problematic than some other possible combinations because there is little direct route overlap.

That said, this merger and further consolidation could cause some increased fares. With fewer airlines, some hubs would no longer compete against each other for connecting traffic, for example, Detroit and Cincinnati.

Another reason for potentially higher fares is that any general price increase can succeed only if all the major airlines go along. If there are fewer big airlines that have to agree, there is probably a better chance that a fare increase will stick. Even so, we believe that economic conditions and competition from low cost carriers would continue to serve as somewhat of a check on fare increases, even in a more consolidated industry.

Also, bear in mind that airlines need higher revenues to offset higher fuel prices. This could occur in at least three possible ways:

Airlines could manage to raise fares still further and fill more seats. This is getting harder, given the state of the economy.

Airlines could fail to do so, forcing some to file for bankruptcy or even shut down. That would reduce the supply of seats and make it easier for the survivors to raise fares.

Or, airlines could find it easier to raise fares in a more consolidated industry.

Most likely, there will be some combination of these three. In any case, revenues need to increase if the industry is to remain solvent. If this were a regulated utility, airlines would be applying for rate increases based on higher input costs.

To sum up, we believe there are three key points. First, the U.S. airline industry faces a potential financial crisis if it cannot offset much higher fuel costs.

Second, the proposed merger of Delta and Northwest offers potential financial gains but also material risks. Overall, it is probably neither as beneficial as supporters promise nor as dire as its critics suggest.

Lastly, one way or another, ticket prices are likely to rise if fuel prices remain high.

Thank you for your attention.

Mr. COSTELLO. We thank you, and the Chair now recognizes Mr. Neidl.

Mr. NEIDL. Good evening. I want to thank the Committee for inviting me to present today.

Representative Oberstar, it is good seeing you again. Thank you for having me.

Being that I am the last presenter, I will keep it brief.

I come from a family, a long line of family that has been involved with transportation, the rails. I have a love for the industry. I have been brought up in the industry.

I saw the passenger railroad industry die as a child. It broke my heart, so I got into airlines, thinking I would get into the wave of the future. I love the industry also. I worked for American Airlines.

I worked for a creditor agency. I worked as a bond analyst. Now I am a stock analyst. So I have seen this industry, financially speaking, from all sides.

I try and put my emotions aside of the love of the industry when I try and analyze it, and usually I get criticism from everybody: labor unions, politicians, management. So I will just go ahead and speak my mind here again tonight.

Now I have never been a big fan of airline mergers. I have been through the cycle a number of times, and I have seen a lot of them really struggle the first couple of years as they try and integrate the systems, the aircraft types and, most importantly, the work groups. I know we have heard a lot of this all day during the testimony. I was listening to it, but I agree with a lot of what I have heard.

However, we are in an environment that I have never seen before, even after 9/11. I was here after 9/11, testifying. I am more scared now than I was even after 9/11 for the industry. With oil at $120 a barrel and people saying it is going to go even higher on a permanent basis, we have to look at this industry differently than we did when oil was at $20.

Now I followed Delta. I followed Northwest. I have been through a number of airline bankruptcies. I used to also follow casinos, so I have been through a number of Donald Trump bankruptcies as well. It is a little different in the airline business.

But looking at the Delta and Northwest bankruptcies, at least in my opinion, they did it the right way. They squeezed just about everything they could. They got their balance sheet deleveraged. They got the unit cost structure down.

They squeezed their employees. They squeezed their creditors. They squeezed everybody. I couldn't think of another thing they could do.

In fact, if Delta or Northwest were to go into bankruptcy again tomorrow, it would be Chapter 7 because there is nothing else they can do in bankruptcy. They really did work hard at that.

I am going to say something that you are not going to want to hear. I don't want to hear it, but it is the truth. With oil prices shooting up over $100 a barrel, we, the traveling public, had not been paying our way.

It is like telling a gas station, oil prices are up, but you only can charge a dollar a gallon. How long would they stay in business? That is what is happening with the airlines right now.

In my opinion, airline management has been too weak over the past two years in putting through further price increases. Now they are afraid of the low cost carriers. They are afraid of the elasticity of demand. Nobody really knew what that was.

But we are seeing that the market is supporting price increases. People are still traveling even with the weaker economy. The question is how much more can they put through?

My opinion is they may be running up against barriers. If that is the case, a lot of capacity has to come out of the system which is going to drive out the marginal traveler.

In other words, I won't be able to do my weekend trip to Florida anymore because the price will be going up. I will have to do it every other week or something, but I mean those are the facts of life. That is my broad prospectus of where I come from.

Now to address mergers, again like I say, in the past, I have never been a real fan of mergers, but the industry right now is changing. It is becoming more global.

Since 9/11, we have low cost carriers that are actually succeeding. Before 9/11, I think it was Southwest. Now we have a number of them. Some of them are failing, but they have a big part of the market, probably over 30 percent of the domestic market. So, in my opinion, the industry is too fragmented.

Mergers wouldn't hurt. If we did have a couple of the big carriers getting together, it would give them some ability to raise ticket prices more than they have. Like I say, I think airline management has been too weak on raising ticket prices in light of the increased costs. So this would give them a little bit more ability to raise prices.

Certain mergers do make sense like the Delta fighting off U.S. Airways' proposal. I thought they did a good job. I like the management of U.S. Airways, but I just thought there was too much overlap there. As an outsider, I never thought the Department of Justice would approve that because there was just too much overlap.

If you look at Delta-Northwest, there is not a lot of overlap there.

Who knows? Maybe you are getting an airline that is too big, as some of the former speakers said, but I think this would give them worldwide mass market, a better ability to compete with the giants that are emerging in Europe: Air France, KLM, British Airways, Lufthansa.

So when you do an end on end merger, if it is done right, I think you have a more powerful competitor.

My main problem is I am not sure where the cost-cutting is going to come from if they are not going to cut costs. With high fuel costs, that is something that is going to have to be done.

Again, I get back to capacity is going to have to be reduced. It will drive out the marginal traveler, at least in the short term, until new low cost carriers emerge.

New low cost carriers will emerge. We have seen them coming. We have seen a lot of them go. We see a lot of them staying and gaining market share, and that will happen in the future.

I mean the old joke is how do you become a millionaire very fast? You start with $10 million and start an airline.

I think I am running out of time, so basically let me just wind this up by saying airline mergers are time-consuming. They are risky if they are not done right. You do have to have the employees onboard. But if it is an end on end merger where they can look at cost-cutting, I think it is something that is worthwhile looking at.

Thank you.

Mr. COSTELLO. Mr. Neidl, thank you for your testimony.

The Chair now recognizes the gentleman from Wisconsin, Mr. Kagen.

Mr. KAGEN. Well, before I begin, I might ask for a little bit more than five minutes because a lot of data have been presented here.

Let me just start with the last. Mr. Neidl, thank you for your testimony, but I couldn't disagree with you more with regard to the greater concentration within an industry.

In the medical field, when you get less choice, you get higher prices. Instead of having maybe 100 different doctors to call in a city, you might get 2 big and bigger clinics. So I don't know how that a greater concentration in the marketplace of air travel can lead to a better choice.

Mr. Horan, I really appreciate your point of view, and it raises this question. It is a question I have been asking myself and my constituents for a number of months and years. Whose side is this Administration on?

You say in your testimony, @@But it could never have happened without the full support of the European Union and the United States Department of Transportation.''

I would like you to amplify. Whose side is this Administration on? Whose side is the Department of Justice on and the Department of Transportation?

Mr. HORAN. I would actually give some credit to the European Union for honesty. They have come out explicitly—DG Comp, the agency in Brussels is doing that—and said, we don't care about the good of European consumers. We care about mergers that would involve the owners of two companies, wealthier.

They are having the same problem in Europe that we will soon see in America—the artificial profits for Air France and Lufthansa are turning around and hurting consumers and the owners of Ryanair, Air Berlin, Vueling and EasyJet who are more efficient.

The DOT has been silent. There is no policy discussion. There is no congressional oversight. But if you look at the recent decisions up to and including the tentative review of the Air France-Delta-Northwest-KLM four-way merger, they simply ignore all the data.

Oh, there used to be 55 percent concentration with 6 very reasonable healthy competitors, and tomorrow there will be none. Well, we didn't look at that. But the DOT continues to insist that there is no problem for consumers.

Mr. KAGEN. But if you have greater concentration and these hubs are also concentrated and controlled by larger companies, how does a $10 million startup airline get access to that hub?

They don't have the gates. They don't have the marketing muscle. They don't have the ability to sell tickets. So how does a small company?

Mr. HORAN. Where you get the ability, where your constituents are going to get gouged first and hardest is markets where they have the highest concentration, where the market is not contestable.

Southwest or JetBlue or AirTran or Ryanair cannot become a competitor on the North Atlantic. It would take them billions and billions of dollars to acquire of intercontinental airplanes. They have never flown them before. They wouldn't be available until 2016, and there is no way to serve markets like Kennedy, Newark, Philadelphia, Chicago, London, Paris, Frankfurt.

Mr. KAGEN. Mr. Foer, would you join in on this, answering this question? Whose side are they on?

Mr. FOER. The problem with the antitrust analysis is one that goes back 20 to 30 years. Analysis that focuses on narrowly defined markets, which is what the Chicago School revolution led us to under President Reagan and has pretty much continued ever since, takes us down to this point where the only thing they really care about is overlapping city pairs.

If that is the only thing that is going to be applied here, this merger goes through, at least with the Justice Department. DOT could, in theory, rule differently based on its public interest jurisdiction.

But, if I made a prediction, my prediction is the Justice Department will take this narrow view. Remember, they didn't want to get pinned down on the question of whether they would look at two more or less simultaneous mergers. They won't, at least not outwardly.

But if we have two or more clearly contemplated, I think that one thing this Committee could do is to find out what the other airlines really are planning and thinking. They have plans. They know what they are going to do. We don't know, but we have speculation.

So, to answer your question, we have locked ourselves into a way of thinking that is simply too narrow and isn't going to get us the solutions that are necessary to serve the public interest.

Mr. KAGEN. Professor?

Mr. GELLMAN. Well, this is a little hard to say here. When you put your reliance and trust in the Justice Department, as long as they are trained to look back, at most they are trained to look at now. What we are mostly talking of here is what the future effect of all this is.

Somehow, we need to discipline those people who hold sway over this to look at the dynamics of it going forward, and I don't know how you get that done the way the antitrust laws are dealt with at the DOJ. I think it has always been a problem. I believe that in many industries, many companies and the country have suffered because of it.

But I can't think of a case or a situation, timing either, where it is more important to make sure the dynamics of the future. If this happens, then that. There has never been a time like this where that is so important.

I don't know how you get the Justice Department disciplined enough to do that. I would hope that you can, but I can't tell you how to do it because I am not a lawyer.

Mr. KAGEN. Mr. Horan?

Mr. HORAN. Just to respond to a question that several Members of the Committee have been posing all day long. There is no plausible antitrust logic, whether liberal or conservative, anywhere where you could say yes, this Delta-Northwest merger is kosher, but the next one is not. That is key to this well-orchestrated plan. It has always been the plan for Delta-Northwest because of superficial appearances to go first.

If that is done, there is no way you can turn down any merger that United Airlines wants to do, or any request to expand the collusive alliances to Europe.

British Airways, American and Continental will say, well, how can you turn us down? The answer is you can't.

Mr. KAGEN. So the precedent is rather important.

Mr. HORAN. Precedent is everything. It has been planned. All of these lawyers and PR people have been working on this. They are not stupid.

Mr. KAGEN. Mr. Mitchell?

Mr. MITCHELL. Yes. The DOJ, from my investigation of the last few weeks, has the ability and, in some cases, the obligation to look at mergers at the industry level. They have even gone so far as to call for a timeout in certain industries.

So I think some of the answers today were just by the book from the DOJ. I think there is opportunity to ensure that they look at this at the largest possible picture level.

The second thing I would say is that there are a number of people here today saying the same thing in different ways in the sense that Mr. Roach said we need a summit. Ms. Friend said we need something to get at a national air transportation policy. Bob Crandall, the former Chairman of American, said the same thing in a New York Times editorial within the past few weeks.

I think whether it is the recent problems with the FAA or the situation we find now. We deregulated the industry, but we never had a debate, the debate on who is it supposed to serve, what are the priorities, et cetera. We don't have a framework and, consequently, we have a lot of knee jerk reacting within the industry.

I think, if anything, this should be a wake-up call to slow the process down, take a step back and impanel the right people to get that part of the job done.

Mr. KAGEN. I thank you for your testimony.

I think you will find I will be a very strong advocate for greater choices. The more choices we have, the more competition will exist.

If the competitive marketplace really existed, these two airlines could raise their rates and increase their profits and their survivability. If they can't raise their rates, it is because it is not competitively to their advantage.

So I yield back my time and thank you for the extension.

Mr. COSTELLO. The Chair thanks the gentleman.

This has been very interesting. It is unfortunate that Mr. Anderson and Mr. Steenland are not here to hear the testimony and attempt to refute some of it.

The Chair now recognizes the Chairman of the Full Committee, Chairman Oberstar.

Mr. OBERSTAR. Mr. Chairman, you are very generous to forego your questioning.

Goodness, it is almost 9:00. This is getting to be a record hearing. Again, we thank you for your patience and want each of you to know how vitally important your testimony is to the work of this Committee, to the air traveling public, to the communities served by these airlines because you have made an enormous contribution.

My wish is that we had you on earlier so Justice and DOT would have been here to hear your testimony in addition to Steenland and Anderson.

Now where to begin. Mr. Mitchell, you talked about 550 markets in which Delta and Northwest have roughly a 80 percent market share. You know we heard earlier in the day these dark references to European carriers and Pacific Rim carriers who are dominating the international trade market.

Time out. Lufthansa doesn't have a domestic network to serve. Air France doesn't have a domestic network to serve. British Airways doesn't have a domestic network to serve.

They have TGV/Talgo and the ICE in Germany. They have high-speed intercity rail service. Between Brussels and Paris, there is no air service today, no passenger air service, but there is a TGV or a Thalys leaving every 3 minutes with 1,100 passengers aboard from 6:00 a.m. to midnight at 184 miles an hour, going from Brussels to Paris in 80 minutes, a trip that when I went to graduate school in Europe took 6 hours.

Well, we don't have, several of you referred, a plan or a national policy, but the Europeans do. They have a plan. Anything over 1,000 kilometers gets air service preference. Between 750 and 1,000 kilometers, there is a competition between rail and air service. Below 750, it is preference for high-speed passenger rail.

Actually, they are now getting to a point where 1,000 kilometers is preference for high-speed rail because they are increasing their speeds to well over 200 miles an hour.

So, if you have long-haul air service as your principal operation, it is highly profitable compared to short-haul service, less than two-hour air service. Of course, it is.

I just dismiss this argument about well, we have to compete with Lufthansa, so need a different model. Baloney. We have a different structure.

Mr. Foer, you said incremental costs could well offset benefits. You talked about the market power of hubs will lead to at least one more merger and to look at systems competition.

I was trying to get the Justice Department folks to talk about the merger behind the merger. They don't want to address that, but at least they said they would consider it. Do you think that is enough of an opening?

Mr. FOER. I understand their problem. If they have to go to court, they have to go to a conservative court, and the courts have not been very favorably disposed toward antitrust lately.

The question is when do you take a risk as a law enforcer to serve the public interest and possibly lose a case or possibly have more leverage to negotiate a proper outcome?

Mr. OBERSTAR. That is a good point, Mr. Foer.

Mr. FOER. I don't think that this Department of Justice has the backbone to do that based on recent experience.

Mr. OBERSTAR. Does it strike any of you in this panel as odd that there is more scrutiny given to a simple request for antitrust immunity for an alliance than there is for a merger?

Mr. Mitchell?

Mr. MITCHELL. That is a very interesting observation. It seems that the applications for antitrust immunity, there are reams and reams and reams of data that are validated, verified by independent experts, and when it comes to mergers a lot seems to be taken at face value.

Mr. OBERSTAR. It is narrowed down. The scope is so narrowed down to just this particular merger and its anti-competitive effects whereas the alliance, as you said, they looked at reams of paper, documents, what the effect was going to be on the international trade in the North Atlantic when they were considering the Northwest-Air France.

Mr. Horan?

Mr. HORAN. Mr. Chairman, if I may disagree with the point to say that if you look at the recent review, the tentative decision on merging the two alliances, they didn't do any analysis whatsoever. You are giving them way too much credit.

Remember, I was involved with the original KLM-Northwest alliance back in 1993. I was the one who developed that joint network. I am very familiar with that. I recall the level of antitrust scrutiny that was required.

Quite properly, an alliance is, from an antitrust standpoint, the same as a merger. You are eliminating competition.

Mr. OBERSTAR. That is right.

Mr. HORAN. There is full collusion. That is why I am careful to call them collusive alliances to distinguish them from frequent flyer programs and things like that.

But if you look, they simply ignored. They pulled out an OAG and counted some departures, ignoring the fundamental basis that these are network airlines. They had no evidence of the trend towards high levels of concentration over time.

When American Airlines actually put evidence saying, well, wait a minute, but prices are going up and service is going down, they said, we are going to ignore that because you haven't proved it, but we are going to accept all of the claims of the billions in savings with no evidence.

That is a core factual question here, and they are not doing any of objective independent analysis.

Mr. OBERSTAR. Professor Gellman?

Mr. GELLMAN. From the very beginning, I felt that it was not proper to grant antitrust immunity to any alliance. I doubt there is an alliance that would not have happened without it. I don't think it was a necessary condition for very many alliances, if any.

Look what we gave up in the very first one. The very first antitrust immunity was Northwest-KLM. We got access, grandly so, to Schiphol Airport in Amsterdam. There is no other airport in the Netherlands that we could serve, and there isn't today, whereas KLM got all of the United States.

Mr. OBERSTAR. I asked that same question at the time that was being proposed.

Mr. GELLMAN. So did I.

Mr. OBERSTAR. So we get access to the Netherlands, wonderful, wonderful. We have some ore carriers in the Great Lakes that are wider than the Pays-Bas as they call the Netherlands. Come on. They get access to our whole market.

The answer was oh, no, but you get access to Europe through Schiphol.

Mr. GELLMAN. What I was told by one of the two people who made the decision to grant antitrust immunity was that they wanted the alliance and it wouldn't have been entered into without it. I don't believe that.

Subsequently, some years later, I had the opportunity to talk very frankly with the CEO of another airline, a large European one, that was in an alliance. He assured me that antitrust immunity was not a necessary condition for the alliance he was in.

I just think that that was a path we should never have gone down because we see now that antitrust immunity adds a layer of anti-competitive behavior to something that is at least mildly anti-competitive from the beginning. I think the alliance is not a bad idea per se, but to layer antitrust immunity was a terrible public policy mistake.

Mr. OBERSTAR. I am not sure that we really get the competition effects with alliances that you do with head to head competition. If our carriers had to buy aircraft, provide crews, provide ground service and all the rest, set up a real competition, you might get a better result for the consumer, not such a good deal for the airline but a better result for the consumer.

Mr. Mitchell, you had your hand up.

Mr. MITCHELL. Yes. I just wanted to add that if Delta-Northwest were to go through or any of these other mergers that have been proposed or talked about, they are going to have, according to their own press releases, such grand reach and scope and scale that I would think that the DOJ would consider as a remedy in all of this to reverse the policy of antitrust immunity and code sharing. If they are that big with that much reach, why do they need it today?

Mr. OBERSTAR. That is right.

How do you hold the airlines to pre-merger promises was a question raised by the panel. Here is a good example. Chairman

Costello has already cited the effect on St. Louis with the American Airlines saying in testimony in our Committee room, we will maintain the hub but, poof, it was gone within a couple of years.

In Minnesota, the Metropolitan Airports Commission gave a loan to Northwest to bail them out of their high cost short-term debt, $380 million. It is paid down to $245 million.

How long do you think it will take the new Delta to buy out that loan and throw the hub overboard, throw the Northwest headquarters overboard and throw the personnel under the bus? In a heartbeat.

A question and then I have to close. In a mega-carrier era, will the U.S. ownership law have any relevance in a real world?

Mr. Baggaley?

Mr. BAGGALEY. Well, the ownership law is actually still quite important which is one reason why the E.U. is pressing to change it so much.

Mr. OBERSTAR. Right, are desperately trying to change it.

Mr. BAGGALEY. Certainly, antitrust immune alliances allow a greater level of cooperation than otherwise, but I think the ownership law still represents a large, large barrier.

I mean we don't take positions on public policy. I am not saying that is good or bad, but I think it is a significant factor.

Mr. OBERSTAR. But does it have any real world application, Mr. Horan and Mr. Foer?

Mr. HORAN. One of the intellectually dishonest things of the industry consolidation discussion out of the E.U. is in all of the negotiation over Open Skies and can we control U.S. airlines is, oh, we need to break down artificial barriers. Why are airlines different from Coca-Cola? Why do we have national barriers? It leads to efficiency.

The flaw with that argument, it is absolutely true if you look at airlines in Southeast Asia. Why do we have to have separate Cambodian and Vietnamese and Thai airlines? They have six airplanes, and they have three and they have 14, and it might be very efficient.

If you have a home market the scale of the United States, the European Union or maybe the People's Republic of China, getting rid of the ownership achieves nothing from a pure economist academic efficiency standpoint. You are already there.

So, to answer your question, no. It would actually make it harder. With megacarriers, you need to keep the ownership law there

Mr. OBERSTAR. Mr. Foer?

Mr. FOER. I think I would disagree with that. It seems to me that as we achieve this very high level of concentration domestically and we have financially weak airlines, that allowing foreign ownership is the way out to generate competition domestically. But at the same time I think you have to take away the antitrust immunity from the alliances.

I was told by the general counsel from Northwest that when Northwest and KLM got their antitrust immunity, they became a single company for transatlantic purposes. That is why, in my testimony, I talked about three global companies.

We have to worry about that too. The whole globe has to worry about that because three global companies operating airline transportation worldwide, that is sinful.

Mr. OBERSTAR. In the testimony, I don't remember whose testimony it was, but I think it was Mr. Neidl who said that the next stop for these two carriers in a financial crisis was Chapter 7 and that Government ownership of carriers is not realistic.

The reverse side of that coin is in Europe if any one of their carriers, if Lufthansa were on the verge, Air France on the verge or look at Alitalia. Berlusconi pulled Alitalia out of the Air France merger as soon as he was sworn in as president. They are not going to let their flag carrier go down the drain.

They were owned by the national government before the E.U. If there is any risk of losing their flag carrier, they will pull them back into national flag ownership again.

Well, Mr. Chairman, I have been berating this thing. This is like a seminar. It has just been wonderful.

Mr. COSTELLO. I think Professor Gellman has something.

Mr. GELLMAN. I just had one point that I think we sort of glossed over. If we are going to talk about alliances, we need to think about the code sharing aspect of alliances.

Mr. OBERSTAR. Yes.

Mr. GELLMAN. There was a time when I was on the fence about code sharing in alliances. I am not talking about domestic code sharing. I am talking about intercontinental.

I had an opportunity to spend quite a lot of time with the senior management of Lufthansa, and I was attacking the idea of code sharing. The route that they wanted to focus on was a route between South America and Germany. They pointed out the value of code sharing which was drawn primarily from the fact that both Varig—now you know the country—and they were each flying very low load factor flights every day between the two points. So they wanted to code share, in order to do things more efficiently.

That seemed reasonable. When I came back to the States, I got to thinking about it, and it occurred to me that, first, put a time limit on a code share arrangement. Preventing an alliance to code share for more than, pick a number, five years sounds about right to me.

Then reexamine it. If, in fact, the code share is leading to less service, less profitable service for the two airlines than there would be without it, then you don't let it continue. If it needs to continue because it is pro-efficiency, you do that.

The other aspect is that alliances have many more benefits for alliance partners than just code-sharing. There are myriad other benefits. I think we ought to recognize that some of those benefits accrue to the public, but not all of them.

I think the alliances need to be structured in a way that is not anti-competitive any more than they have to be to get whatever net benefits flow from them. So the net benefits should be there even though there are some social costs to be paid that are less than the net benefits.

Thank you.

Mr. OBERSTAR. Mr. Chairman, I just looked at a note I made for myself.

In a mega-carrier era, would the domestic airline service return to a pre-deregulation model where you have a domestic feeder network to these international carriers? What happens to the airline service model?

Mr. Horan is saying no.

Mr. GELLMAN. I happen to think we need to watch carefully at what evolves in the relationship between JetBlue and Lufthansa. As you know, JetBlue has sold about 20 percent of its equity to Lufthansa.

Now Lufthansa has some difficulty, I am sure, in transferring passengers to or from JetBlue if they are front-end passengers; but still that is the best case now before us to understand whether the answer to your question is yes or no.

Mr. OBERSTAR. Mr. Horan?

Mr. HORAN. With the mega-mergers, if we are down to three or four legacy carriers, they have 80 percent of the entire U.S. revenue base. The entire LCC group—Southwest plus JetBlue plus AirTran plus Hawaiian and Alaskan have the other 20. They are in narrow niches.

Of the legacy megacarriers, they are going to look just like they do today: more service if fuel costs get better, less service if fuel costs don't.

The problem with the whole theory of airline competition without Government interference is you want carriers who are better run with better service and more efficient operations to be able to grow and the ones that have lousy service, bad management, et cetera, to shrink and go away.

In the mega-carrier world, that breaks down. You have three big carriers who can be just as arrogant as Pan American was 27 years ago: Well, what do we care about this stuff?

To answer your narrow question, you are going to freeze in today's route structure. You are not going to see a change back to the pre-deregulation. The problem is the efficient carriers in the markets like Southwest and JetBlue are not going to be able to grow, and that is an efficiency question.

It is not just come help our loyal shareholders and employees. You have to hurt the loyal shareholders and employees and customers of these other companies that are actually more efficient.

Mr. COSTELLO. The Chair thanks you.

Mr. Mitchell, a final comment and then we will close the hearing.

Mr. MITCHELL. Yes, thank you, a quick comment.

Last week, someone I work with was sitting at breakfast at a hotel here in Washington, listening to one of the two airline teams that are proposing this merger plan for their day on the Hill. They said three things. Number one, the fleet integration is going to be a disaster. Number two, the reservation systems are a nice match. Number three, one hub is closing and another hub is going to be significantly downsized.

So a remedy perhaps could be that for a period of five years they have to maintain seat capacity at all their major hubs.

Mr. COSTELLO. Very good. This has been an excellent hearing, and we deeply appreciate the contributions that each of you have made. It has been a long day for all of you, and we appreciate your patience and your contribution.

With that, the Chair will close the hearing, and Mr. Gellman, we are actually going to close the hearing now.

The Subcommittee stands adjourned.

[Whereupon, at 9:15 p.m., the Subcommittee was adjourned.]

BRUCE L. BRALEY
1st District, Iowa

TRANSPORTATION AND INFRASTRUCTURE COMMITTEE
Vice-Chairman, Highways and Transit Subcommittee

OVERSIGHT AND GOVERNMENT REFORM COMMITTEE

SMALL BUSINESS COMMITTEE
Chairman, Contracting and Technology Subcommittee

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Bruce L Braley

May 14, 2008

Rep. Bruce Braley
Statement for the Record
Subcommittee on Aviation Hearing: *"Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines"*

Thank you, Mr. Chairman, for holding this hearing on the impact of consolidation in the aviation industry. This is an important issue, and one that can have substantial impacts on the economic well-being of many communities.

Iowa has eight commercial service airports and 103 general aviation airports. The majority of our airports serve small cities and towns, and the presence of air service in and out of these rural areas is essential to business, tourism, and travel opportunities for residents. Many of these communities rely on air service in Iowa, and I view part of my role on the Aviation Subcommittee as helping to maintain and expand air service in Iowa.

This is why I have serious concerns with any merger that has the potential to result in cuts in service to rural areas. In the most recent proposed merger of Delta and Northwest airlines, executives of the merging carriers have promised not to close airport hubs, reduce air service, or fire large numbers of employees. They are also indicating that the merger would reduce the firms' operating costs by up to $1 billion from the costs that would be incurred by the two firms as separate entities.

I find it hard to understand how such cost-savings can be recognized without closing hubs, reducing air service, or firing employees. While I appreciate all of these commitments, I am curious as to the business plan that saves $1 billion without making these cuts. Furthermore, Northwest Airlines is one of Iowa's main carriers, and I would be particularly perturbed if some Northwest routes were the first to go in efforts to find cost-savings.

I will have a hard time supporting this proposed merger until I see irrefutable evidence that air service in Iowa will not suffer as a result. I understand times are tough in the airline industry, and that spikes in gas prices have caused a lot of harm, and that is why I believe we can find solutions that incentivize small community air service and make these routes profitable. There are viable solutions out there to the problems in the airline industry that will not result in cuts to service in Iowa. I look forward to continuing to work towards these types of solutions that are good for both urban and rural America.

**OPENING STATEMENT OF**
**THE HONORABLE RUSS CARNAHAN (MO-3)**
**HOUSE TRANSPORTATION AND INFRASTRCUTURE COMMITTEE**
**AVIATION SUBCOMMITTEE**

**Hearing on**
Impact of Consolidation on the Aviation Industry, with Focus on the Proposed Merger Between Delta Airlines and Northwest Airlines

**Wednesday, May 14, 2008**
**2167 Rayburn House Office Building**

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Chairman Costello and Ranking Member Petri, thank you for holding this important hearing on the proposed merger of Delta Airlines and Northwest Airlines.

I have grave concerns about the effect this merger will have on airline employees at both Delta Airlines and Northwest Airlines. If recent mergers are any evidence of what can be expected these employees could potentially lose their job as a result. In my home state of Missouri, as a result of the 2001 American Airlines merger with TWA thousands of Missourians lost their jobs when TWA's Missouri headquarters were closed, the hub at Lambert-St. Louis International Airport was eliminated, and the Kansas City maintenance facility was closed.

Additionally, I believe much must be done to improve workforce integration in the event of airline mergers and acquisitions. When American Airlines and TWA merged, TWA employees lost decades of seniority because they were unfairly integrated into American Airlines workforce. The unfortunate consequence was that many of these employees were the first to be laid off and placed on a recall list later although they may have had years more actual seniority.

For this reason I was happy to see the manager's amendment to the FAA Reauthorization bill passed by the House last year included language I proposed to ensure minimum protections for airline employees in the event of a merger or acquisition to assure they are treated fairly. Specifically, the manager's amendment included language at my request to provide for the integration of carriers' seniority lists in a fair and equitable manner. I was happy to see this included in the omnibus appropriations bill passed by Congress last year and will continue to fight for this to become law.

In closing, I want to thank all our witnesses for joining us today and look forward to hearing from them.

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**OPENING STATEMENT OF REP. STEVE COHEN**

Transportation and Infrastructure Subcommittee on Aviation

"Hearing on the Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines"

May 14, 2008

Memphis International is the fastest airline connecting hub in America for both domestic and international connections. It is located centrally in the lower 48 states and is within 60 miles of the population center of the lower 48 states making Memphis a perfect location for a transfer hub. The airport has one of the lowest percentages of cancelled flights of any airport in the nation. It is known for its moderate weather with few snow and ice events that can cause operating problems for airlines and their passengers.

Northwest Airlines operates its third largest hub in Memphis. Northwest's daily non-stop service between Memphis and Amsterdam is the area's only direct service to Europe. Last summer, I spearheaded a letter to DOT, supporting Northwest Airlines' application for new nonstop transatlantic service from Memphis to Europe. I supported a similar letter in support of Northwest's application to operate nonstop service between Detroit and China. These new rights would both serve to greatly strengthen Northwest as the only hub carrier in Tennessee.

As the only carrier with a hub in Tennessee, the service provided by Northwest is important in linking our state with the global economy. Expansion of international service at Memphis in particular stands to greatly benefit the economy of Tennessee and the MidSouth at large.

I have heard from representatives of Northwest and Delta as well as a wide array of stakeholders from my district that have given me their assurances that Memphis will lose neither jobs nor flights. Nonetheless, I have heard concerns from unions and employees of Northwest and Delta relating to the loss of jobs and certain benefits.

The International Association of Machinists Union contends that Delta has yet to guarantee that IAM members at Northwest Airlines will not lose the security of a defined benefit pension plan. There also remain concerns over the prospect of future hub closures where it is alleged that blame for the closures will strategically be placed not on the merger itself, but on some current or unforeseen crisis such as oil costs or economic recession.

On May 6, 2007, I joined Judiciary Committee Chairman John Conyers in sending a letter to our two Panel I witnesses today, Delta Air Lines CEO Richard H. Anderson and Northwest Airlines, CEO Douglas M. Steenland, requesting that employees and union representatives of the two airlines be included in all future airline discussions between the two airlines.

As a member of both this subcommittee and the Antitrust Task Force of the House Judiciary Committee, I am uniquely positioned to oversee this proposed merger and will be constantly looking to ensure all affected Memphians have a continual voice in this matter.

Memphis International Airport is one of the biggest reasons that Memphis has been able to attract businesses and investment over the past decades and I will do everything in my power to ensure that Memphis remains the world's distribution center for the foreseeable future.

SENIOR DEMOCRATIC WHIP

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
*CHAIRWOMAN*, SUBCOMMITTEE ON WATER RESOURCES & ENVIRONMENT
SUBCOMMITTEE ON AVIATION
SUBCOMMITTEE ON RAILROADS

COMMITTEE ON SCIENCE AND TECHNOLOGY
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SUBCOMMITTEE ON INVESTIGATION AND OVERSIGHT

CHAIR, TEXAS DEMOCRATIC DELEGATION

CONGRESSIONAL BLACK CAUCUS
CHAIR, 107TH CONGRESS

*Eddie Bernice Johnson*
**Congress of the United States**
30th District, Texas

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**Opening Statement for the Honorable Eddie Bernice Johnson**
**Aviation Subcommittee Hearing on the Proposed Merger between Delta Airlines & Northwest Airlines**
**Wednesday, May 14, 2008– 2167 RHOB**

**Thank you Mr. Chairman.**

**I want to thank you and Ranking Member Petri for holding this important hearing on the issue of the proposed Delta – Northwest merger.**

**Mr. Chairman, since the announcement of the Delta-Northwest merger on April 15th of this year, executives of both airlines have touted this proposed union as "a different kind of merger".**

From their vantage point, the new Delta-Northwest merger will provide synergies that are expected to reduce the entities costs by up to $1 billion dollars.

In realizing these savings the management of both carriers indicate that there will be no hub closures—all hubs will be maintained; there will be no furloughing of frontline employees; existing pension plans for both companies' employees will be protected; and frontline employees of both carriers will be provided seniority protection through a fair integration process.

While I would like to believe such a rosy scenario is possible, I am also a realist, and I find it very difficult to believe that hubs, service, competition, and most importantly the jobs of hardworking men and women who have devoted their entire lives to these carriers will not be adversely

**impacted if the proposed merger is approved by the Department of Justice.**

**In reviewing the respective testimonies of Mr. Anderson and Mr. Steenland, I was struck by the lack of elaboration devoted to the issue of employee integration and retention.**

**Moreover, on the issue of whether or not union representation will be made manifest within the various crafts and classes, I found a mere paragraph which was ambiguous at best.**

**Mr. Chairman, I predict the Bush Administration will ultimately rubber stamp this proposed merger, as I do not foresee the Administration deviating far from its anti-labor and anti-consumer ideology. The Bush Administration has proven, time after time, that they place very little weight on the views of labor and working people.**

While I understand that the authority to approve this particular merger rests squarely on the shoulders of the Bush Administration's Justice Department, it is my hope that this Committee is able to utilize every tool at its disposal to ensure that the 75,000-plus employees that stand to be impacted by this proposed merger have a seat at the table and that they are treated equitably.

I want to thank our witnesses that have come before us to testify this afternoon. I look forward to receiving an honest accounting of what this proposed merger will mean for the hardworking men and women of these respective air carriers.

Thank you Mr. Chairman and I yield back the balance of my time.

Harry E. Mitchell

Statement of Rep. Harry Mitchell
House Committee on Transportation and Infrastructure
Subcommittee on Aviation
5/14/08

**--Thank you Mr. Chairman.**

**--Airline passengers have had a rough go of it lately. They've endured crowded planes, crowded skies, and record delays. Many are now facing surcharges for things that used to be free.**

**--As we contemplate consolidation in the airline industry, I think we need to ask: is this good for the passenger?**

**--Will all these mergers result in more convenience and lower fares?**

**--I know that much of our discussion today will focus on the proposed merger between Delta and Northwest Airlines, but I hope we might also be able to shed some light on the potential merger between US Airways and United.**

**--US Airways is the largest carrier at Sky Harbor.**

**--Headquartered in Tempe, it employs thousands in the Phoenix metropolitan area.**

**--A merger could have significant implications for our local economy, as well as our national aviation system.**

**--I look forward to hearing from our witnesses.**

**--At this time, I yield back.**

OPENING STATEMENT
THE HONORABLE JAMES L. OBERSTAR
SUBCOMMITTEE ON AVIATION
IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES
MAY 14, 2008

Today, we begin hearings on a proposal that could do more to determine the future of the airline industry than anything that has happened in the 29 years since deregulation: the proposed merger between Delta Air Lines and Northwest Airlines.

I have serious concerns about the consequences of this merger as a single, stand-alone transaction and also because I think it would be likely to lead to other mergers among our largest carriers. The end result could be an industry of three major carriers, with much less competition, higher fares, worse service to the public, and financial problems that could lead to failure in an economic downturn. In short, the pending merger places at risk the consumer benefits of airline deregulation.

There are only a few of us left, Mr. Chairman, who voted in this Committee room in 1978 on deregulation. I know that when I cast my vote I expected the antitrust laws to be vigorously enforced, as did others. Most of us would never have voted for deregulation if we thought it would mean only three major carriers.

That is why the government has to view this merger holistically, with great weight given to the potential "downstream" effects; that is, the possibility that if this merger is approved, other carriers will be forced to merge to stay competitive. To ignore the "downstream" effects of the proposed merger would be to ignore reality. As soon as the Delta-Northwest merger was proposed, other major carriers began their own merger discussions. In fact, it is rumored that United and US Airways are currently in merger discussions.

Reducing the airline sector to three major carriers would substantially reduce competition and raise fares. The way airline competition works today, when established carriers control markets, the tendency is for the carriers to follow each other's fare changes so that the fares are identical, and passenger choice is limited. These tendencies would be magnified if there were only a few major airlines. There would be enormous incentives for each carrier to avoid competing with the others at their strong hubs and routes. This strategy would likely lead to the greatest mutual profitability, while strong competition across the board could prove suicidal. As the Department of Transportation (DOT) aptly stated, "[e]conomic theory teaches that the competitive outcome of a duopoly is indeterminate: the result could be either intense rivalry or comfortable accommodation, if not collusion, between the duopolists."

I am particularly concerned about the effects of mergers in discouraging competition at major hubs dominated by a single carrier. The Government Accountability Office has found that fares at concentrated hubs are already higher than fares elsewhere. Those differences are likely to increase if there are only a few carriers, and a hub carrier has the ability to retaliate throughout the country against a challenge to its hub.

Delta and Northwest claim the merger is pro-consumer because they will provide single carrier service in many new markets, but will not reduce service elsewhere. It is hard to see how they can do this. Both carriers are already flying with 85% of their seats filled. How can they provide new service without reducing service somewhere else? Similarly, the carriers suggest that they will increase revenues without raising fares by selling more seats in international markets with higher fares. But if they fill seats with international passengers there are going to be fewer seats for passengers paying lower domestic fares.

A merger of dominant U.S. air carriers would also have a significant impact on international competition. The U.S.-European market is already dominated by three alliances of U.S. and European carriers. Members of these alliances have, or are about to receive, antitrust immunity to coordinate schedules and prices, and operate as though they were one carrier. Two of these groupings would control over 80 percent of the traffic between the U.S. and Continental Europe. Mergers between major U.S. carriers will lead to even less competition within and between the three alliances.

Moreover, the impact on fares goes deeper than having only three major competitors. Government studies have found that in markets where the merging carriers now compete, fares are likely to rise after a merger.

Delta and Northwest argue that the growth of low cost carriers has created new competition that would offset historical regulatory concerns with mergers. I caution against an over-reliance on low cost carriers. Low cost carriers do not serve many of the same markets that the large network carriers serve. In addition, for some traffic, low cost carriers may be non-competitive because they do not offer the same benefits as network carriers, such as frequent flier benefits to foreign destinations. Moreover, many low cost carriers are struggling financially, with several going out of business or having filed for bankruptcy. In the last few weeks, Aloha and ATA, have ceased operations, and Frontier Airlines has filed for bankruptcy. Faced with competition from larger network carriers, some low cost carriers may be driven out of the industry or into a merger with a network carrier.

Northwest and Delta also cite fuel as a reason for consummating this merger. Fuel prices have hit unexpectedly high levels and this added expense has impacted the cost of airline operations. I am doubtful that this merger will help with fuel costs. The carriers acknowledge that they will not be able to purchase fuel more cheaply. Moreover, much of the increase in fuel costs can be passed on to consumers. Just last week, both Delta and Northwest levied a $20 per round trip fuel surcharge on passenger tickets – the 11th fare increase since December 2007.

Experience tells me that mergers will likely add to the difficulties we already face. Historically, most airline mergers have created problems for consumers. Consumer service generally falls by the wayside while management grapples with merging two proud cultures, and dealing with employee unrest over potential closing of facilities and the integration of seniority lists. I have experienced these problems first-hand in my area of the country -- the Northwest-Republic merger led to major service difficulties that lasted for years. Following their merger over three years ago, US Airways and America West have had considerable hurdles to overcome including pilot unrest over seniority integration that has yet to be resolved.

As the *Weekly Standard*, a supporter of free markets and limited government regulation, recently opined:

> History is on the side of the pessimists. In the period immediately following every airline merger, chaos is the order of the day – or year. Pilots find that the control panels on the merged carriers differ; baggage losses mount, as they did when Northwest acquired Republic Airlines in 1986; the merging of reservation systems causes kiosks and websites to malfunction, as US Airways and America West discovered; strikes occur as disgruntled employees find the new

> pension package inferior to the old one. All of these are in the new Delta's future . . . .

In sum, the inescapable lesson of 29 years of deregulation is that mergers and a reduction in competition are likely to lead to higher fares, a deterioration in service, and financially weakened survivors.

As we listen to the testimony of our witnesses today, we should be guided by the words of George Santayana: "Those who cannot remember the past are condemned to repeat it." We should take heed of the lessons of history, and do everything possible to ensure that the public continues to receive the airline service it needs and deserves.

John T. Salazar

Opening Statement
Congressman John T. Salazar
T&I Aviation Subcommittee Hearing
Impact of Consolidation on the Aviation Industry
May 14, 2008

**Thank you, Mr. Chairman, for calling this hearing.**

**We've heard rumors about possible mergers between major airlines in recent months.**

**Today we are looking at the proposed merger between Delta and Northwest Airlines.**

**I'm looking forward to today's testimony, and to hearing from all sides of the issue.**

**The high price of fuel is hurting everyone right now, but it's severely affecting the airline industry.**

**And with higher costs, businesses are facing difficult choices in order to survive.**

**As a small businessman, I understand that.**

**But I also understand the impact that a merger will have on the employees—specifically layoffs, seniority integration, and pensions.**

**I want to ensure that those affected by a merger are given every opportunity to voice their concerns and have their questions answered.**

**I hope today's hearing provides a chance to do that.**

**Thank you, Mr. Chairman.**

Remarks for Congressman David Wu of Oregon
for the Aviation Subcommittee hearing on May 14, 2008

I thank the Chairman for allowing me to join the subcommittee today to speak on this important issue and to ask questions.

I have deep concerns about the potential ramifications of the proposed merger between Northwest and Delta.

I strongly value the current Northwest Airlines transpacific air service between Portland and Asia and am concerned that the merger may adversely affect this crucial service.

From my perspective, airline mergers should only go forward if they benefit the markets and customers served. Oregonians rely on airlines to be responsive to their business and personal travel needs.

Oregon, through no fault of its own, has had intermittent international air service at Portland International Airport.

After many years of community effort, the Port of Portland established its first nonstop international flight to Tokyo in 1983 with United Airlines. This route immediately opened valuable business and cultural opportunities and increased investment on both continents.

Although Oregon and its business leaders worked extremely hard to establish this route, our community suffered when United chose to move its transpacific service to Seattle.

Business, community, and government leaders in Oregon acted promptly to establish a Delta nonstop route between Portland and Tokyo in 1987.

Unfortunately after Delta's acquisition of Western Airlines, Inc., Delta wound down and eventually discontinued its Portland-based transpacific service. This was despite what we understand were continuously profitable operations that included flights from Portland to Tokyo, Seoul, Nagoya, Bangkok, Taipei, and Fukuoka.

After many years of strenuous efforts by the Port of Portland and Oregon leaders, Portland again regained transpacific service when Northwest established a route between PDX and Tokyo in 2004. This existing Northwest service provides Oregonians with vital opportunities for business, personal, and cultural travel.

We are understandably sensitive to the potential repercussions of the proposed merger between Delta and Northwest because of our history of repeatedly losing transpacific air service despite Oregonians' best efforts.

In a letter to both Delta and Northwest, I requested that, should this merger proceed, any post-merger entity make a binding commitment to continuing air service between Oregon and Asia. I would like to acknowledge that Mssrs. Steenland and Anderson did send a written response to my concern, however they made no solid commitments to continue this service. I know that Oregonians will continue to rely on this essential service, and are eager to hear from Mssrs. Steenland and Anderson.

Thank you again Mr. Chairman for your work, and for your generosity in giving me this opportunity.

**STATEMENT OF RICHARD H. ANDERSON, CEO**
**DELTA AIR LINES, INC.**
**BEFORE THE**
**HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE**
**SUBCOMMITTEE ON AVIATION**

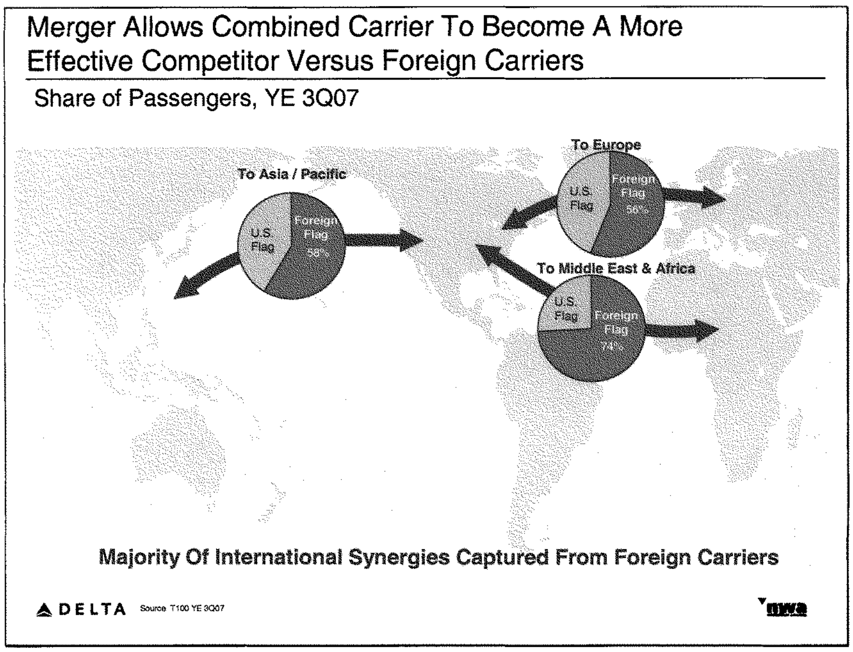
**"IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES"**

**MAY 14, 2008**

**STATEMENT OF RICHARD H. ANDERSON, CEO**
**DELTA AIR LINES, INC.**
HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE
SUBCOMMITTEE ON AVIATION
"IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES"
MAY 14, 2008

## INTRODUCTION

Mr. Chairman and members of the Subcommittee, I want to thank you for providing me with the opportunity to discuss a topic that is critical to the future of every employee of Delta Air Lines and Northwest Airlines. On April 14 we announced the merger of Delta and Northwest; a transaction that will create America's premiere global airline. This transaction comes at a unique and important time in the history of the airline industry and our two companies. The world is changing rapidly; business is conducted across all parts of the globe and people around the world have unprecedented freedom and opportunity to travel abroad. The question facing the domestic airline industry is whether we will have companies with the global network and financial stability to compete in this new world against foreign carriers. Make no mistake about it; we face formidable competitors from overseas. Today foreign flag carriers carry more passengers to and from the U.S., Europe and Asia than U.S. flag carriers. They are frequently funded by their governments and benefit from regulatory policies that promote consolidation into a handful of strong competitors. The Open Skies agreements that recently have gone into effect offer domestic carriers excellent opportunities and daunting challenges as transatlantic competition will increase dramatically. The current order book for wide body Boeing and Airbus aircraft shows that U.S. carriers make up only about 5% of the buyers. We do not come here today looking for financial support, but we are looking for an opportunity to build a more financially stable U.S. airline with the global presence to compete with foreign carriers.




Our ability to remain strong financially and to compete internationally is severely impacted by the unprecedented rise in the price of oil. Continued prices of $115-$120 per barrel of oil will result in bankruptcy for some carriers and deny even the most financially sound carriers of profitability. In the last few weeks alone we have seen five U.S. carriers go into bankruptcy directly as a result of fuel prices, with four of them shutting down completely. Passenger airlines reported first quarter results and the industry reported a $1.74 Billion loss for the quarter compared to profits for the first quarter of 2007, with the swing almost exclusively the result of increased fuel costs. We have seen the impact of bankruptcies on airline employees and customers. Since 2001, U.S. network carriers have shed more than 150,000 jobs and lost more than $29 billion. The management of Delta and Northwest believe that this merger will create a financially stronger airline, with a broad and diversified global route network that will help it weather the impact of fuel prices and the volatility of the domestic and world economies.

## THE DELTA-NORTHWEST COMBINATION WILL BE A STRONG, U.S. BASED GLOBAL COMPETITOR

The combination of Delta and Northwest will create a stronger company with route systems that complement each other and will provide an opportunity to offer travelers a global network that neither airline independently could offer. Northwest for decades has been America's premiere carrier to Asia; in fact it is the only U.S. carrier with a hub in Japan that provides a convenient point to connect to the most important destinations in Asia. As a result of restrictions in bi-lateral agreements between the U.S. and Japan, there is little chance that Delta would ever be able to offer comparable service. Conversely, Delta has invested substantially in building the leading service to Europe, the Middle East and Africa from the U.S., as well as a strong presence in Latin America. It is virtually impossible for Northwest to devote the capital necessary to acquire the planes to build such a franchise. As I indicated, the recent Open Skies agreements will permit any U.S. or European Union carrier to fly between the U.S. and the 27 EU member states. Already, British Airways, Virgin Atlantic and Ryanair have indicated that they will add or start new service between the U.S. and Europe, and Lufthansa is a growing presence in the U.S. The combined Delta/Northwest will generate approximately $ 1 billion a year in synergies and will have about $7 billion of liquidity together with the global route network that will allow us to compete in this new environment.

**<u>THE MERGER HAS BEEN STRUCTURED TO PROVIDE STABILITY AND BENEFITS FOR EMPLOYEES</u>**

Delta has a uniquely cooperative relationship with its employees, and in planning this merger the impact on employees was uppermost in our minds. I have worked at many companies, in many different jobs, in both the public and private sectors and I have never seen an employer that respects and cares about its employees more than Delta Air Lines. Delta historically has had a culture that always tries to do what is best for its people. That is particularly important in view of the immense challenges that Delta and the rest of the airline industry have faced in recent years. Given these industry challenges, I believe it is even more important that we work collaboratively with all of our people so that we can fight and overcome them together. As we are beginning to see, companies and employees that fail to work together are at greater risk of failure. We believe it is important that any transaction we undertake will benefit the people of both companies, together with our customers and other stakeholders. We believe that if we take care of our people, they will take care of our customers, and we will all benefit.

Here are just some examples of how this merger will benefit our people:

a. We will set aside sufficient equity so that all employees can have an unprecedented equity stake in the merged company.

b. We will move all employees, over time, up to industry standard pay and benefits.

c. We will honor our commitment to all U.S.-based, frontline employees to provide a process for the integration of seniority in a fair and equitable manner.

d. We will maintain the existing pension plans of both companies, both for current employees and for those already retired.

e. We will maintain our top tier profit-sharing plan and operational rewards program.

f. We have assured our frontline people that there will not be any involuntary furloughs as a consequence of the merger.

g. And particularly important in view of the impact on our industry of record fuel prices and economic uncertainty, we will strengthen our airline financially and provide opportunities for our people to benefit from our planned growth and future success.

With respect to whether there will be union representation in the various crafts or classes of employees after the merger of Delta and Northwest, we have pledged to respect our employees' preferences on that issue. The Railway Labor Act, as administered by the

National Mediation Board, provides a time-tested process for determining employee choices regarding representation following an airline merger. We of course will respect that process and those choices. In the meantime, we have provided a written commitment to honor the existing Northwest collective bargaining agreements until any post-merger representation issues are resolved.

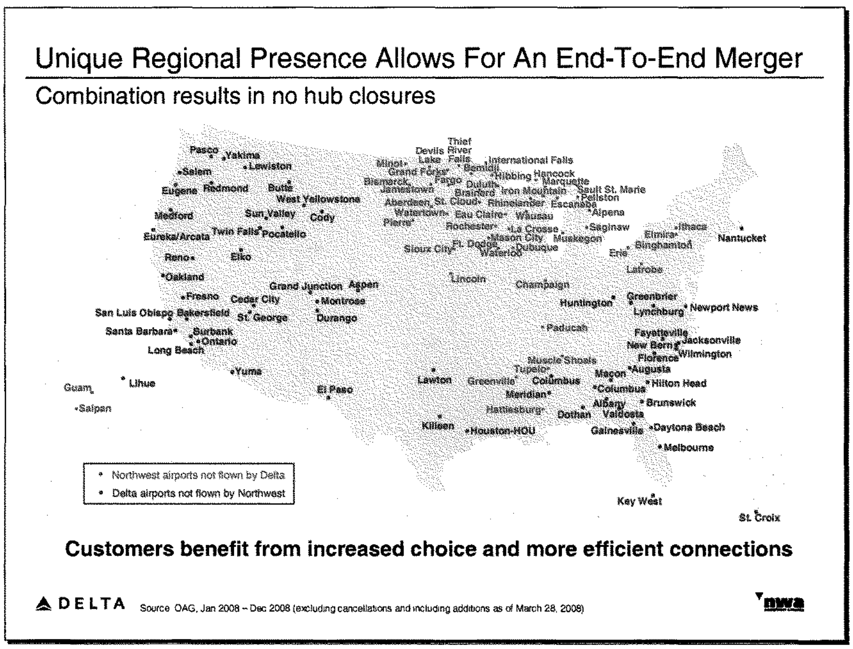
Regarding seniority protection for the frontline employees of Delta and Northwest, Delta took the initiative last year when our Board of Directors adopted a policy to provide a process for fair and equitable seniority integration for employees of both companies in any Delta merger. We pledged to use the seniority integration provisions from the former Civil Aeronautics Board's ruling in the Allegheny-Mohawk merger. Delta and many other carriers have used the Allegheny-Mohawk provisions in prior mergers, and they are also provided for in many collective bargaining agreements in the industry. Last December, Congress passed legislation that required the use of the Allegheny-Mohawk seniority integration provisions in airline mergers. Delta successfully fought to assure that the law as passed protected all employees, whether union or non-union. We carried these principles through our negotiations with Northwest and have provisions in our merger agreement that provide for seniority protection.

## SMALL COMMUNITIES WILL BENEFIT FROM THE MERGER

I would like to address another issue that I know is very important to this Committee and our customers: service to small communities.

Both Delta and Northwest are very proud of their long history of serving small communities. Northwest has often been the only way for people in small towns in the upper mid-west to connect with the rest of the country and the world. Similarly, Delta was founded in a small southern city and for years its focus was serving small southern communities. We know and understand the importance of air service to the economic health of these communities. The phenomenal growth of Atlanta and the southeast in general is directly related to the superior service offered from Hartsfield Jackson Airport in Atlanta, largely by Delta. We intend to continue with these traditions and to remain the airline providing the most service to small communities from strategically located hubs in Atlanta, Minneapolis, Detroit, New York, Memphis, Cincinnati and Salt Lake City. This is not just customer service, it is good business—we have committed publicly that we will not close any hub as a result of this merger. To keep these hubs profitable, we need the traffic from small communities around the country. A robust hub system is critical to the services desired by small communities. It is the most effective model to serve these communities since it allows us to use smaller aircraft to bring passengers from many small communities to the hub and offer broad connecting opportunities for these passengers. The combined Delta/Northwest will serve over 140 small communities, nearly twice the number served by our next closest competitor. The merged airline will offer new service to nearly 3,000 domestic origin and destination markets and over 6,000 new international markets, greatly expanding the ability of customers from small communities to reach every part of the country and the world on one airline.

As the economies of the world become linked more closely, we recognize the importance of air travel to the ability of small communities to compete and thrive in a world economy. This merger will open up a new range of options for our customers in small communities and it will bring them in closer contact with the rest of the world. For example, the combined Delta/Northwest will provide customers in 48 small communities served by Northwest better access to 83 additional international destinations served by Delta today, while passengers in 51 small communities served by Delta will gain greater access to 20 Northwest international destinations.



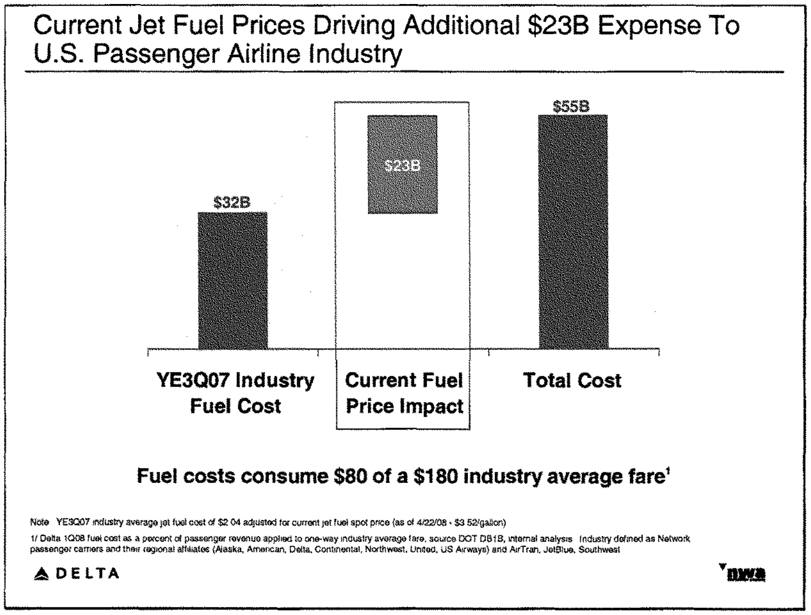
The combined airline will offer passengers over 390 global destinations on a single airline up from 250 on Northwest alone and 327 on Delta alone. Customers in small towns in the south will be able to fly to Japan and much of Asia with one easy connection on the same airline. That is not the case today. Similarly, customers in the upper mid-west will have many more options to fly on one airline network to more destinations in Europe and Latin American than they do today. Since Delta and Northwest have focused their attention on different regions, there are few overlap routes and customers will gain the benefits of a larger combined network without any material reduction in services. However, providing service to any city, whether small or large, must make economic sense and the high cost of fuel for Delta and Northwest is far more likely to result in a reduction or elimination of service than this merger.

**THE UNPRECEDENTED RISE IN THE PRICE OF FUEL HAS CREATED SERIOUS RISKS FOR THE AIRLINE INDUSTRY**

No discussion about the current state of the airline industry would be complete without mentioning the devastating impact of the unprecedented rise in the price of oil. Every day we read that the price of a barrel of oil has hit new records. Over the last five years we have experienced a 28% annualized increase in oil prices and in the last 12 months alone, the price of a barrel has nearly doubled. Most analysts do not foresee the price of a barrel of oil going below $100 any time in the near future. What is less widely publicized is the equally dramatic rise in the cost of jet fuel extracted from oil. Since 2001, the cost of a gallon of jet fuel has increased over 500% and nearly doubled since December of 2006.

The airline industry is somewhat unique. When the price of oil rises and you go to fill your car up with gasoline, you pay more at the pump; there is little choice. In the airline industry, we are lucky if we can recover through fare increases even 50% of fuel price increases. The costs have to be made up somewhere else. Despite becoming more and more fuel efficient and obtaining more and more productivity from our employees and operations - Delta and Northwest have two of the lowest cost structures of the mainline carriers - the impact is dramatic. In 2003 fuel costs consumed 17¢ of every dollar of passenger revenue we received; in 2008 that number will be 43¢. Every $1 increase in the price of a barrel of oil costs Delta about $60 million. The increase from $110 to $115 per barrel in the last couple of weeks alone will cost Delta over $300 million on an annual basis. As a result, there are fewer dollars left to improve passenger amenities, acquire new aircraft and provide better compensation and benefits to employees.

The employees in this industry have sacrificed time and time again. The dramatic rise in fuel costs has resulted in much of the cost savings our employees have generated through productivity and benefit losses being used to pay for fuel rather than to improve the product. In effect, it has eroded most of the sacrifices they have made to make their company viable and sustainable in the future. Merging Delta and Northwest will create a much more financially stable company with approximately $7 billion in liquidity and $1 billion in annual synergies. The combined airline will be able to withstand an 80% greater increase in fuel price than either airline standing alone, and still maintain profitability. This financial strength and flexibility, much greater than either airline standing alone, will provide additional resources to help weather this unprecedented fuel cost environment and a softening domestic market.




**THIS MERGER WILL BE BENEFICIAL TO CUSTOMERS**

I have already touched on some of the key benefits our customers can expect such as a significant expansion in the number of domestic and foreign locations that will be available from the merged airline. There will be other benefits such as a common frequent flyer program that will provide more opportunities to earn miles, more schedule options, and more efficient routes for connecting passengers as we optimize the combined hub structure. Of equal importance, the financial stability and flexibility of the combined carrier will allow us to re-invest in our products such as planes, in-flight services and reservation systems. For example, we have publicly stated our intention to exercise options to purchase up to 20 new wide body jets between 2010 and 2013 to upgrade our fleet for international flying.

We are mindful of the difficulties in combining the complex operations of two airlines and that other airline mergers have encountered problems that have inconvenienced customers. Delta and Northwest are committed to making this merger seamless and trouble free for our passengers. Both Delta and Northwest are members of the SkyTeam alliance and have gained experience in working cooperatively on passenger service issues. Our frequent flyer programs, customer lounges and IT systems are already partially integrated. In addition, we will be able to build on the decades long partnership between Northwest and KLM (now a part of Air France) and the long standing relationship between Delta and Air France. All of these factors will help smooth the integration process for our customers.

## THE MERGER DOES NOT HARM COMPETITION

Doug Steenland's written submission will deal extensively with the pro-competitive impact of this proposed merger and I will not repeat all of those points. I will simply say that these two airlines have complementary networks; Delta's domestic focus is in the east and mountain west while Northwest focuses on the upper mid-west. There are only twelve domestic nonstop overlapping markets. Even these nonstop overlaps do not cause competitive problems, as Doug's statement indicates. Similarly, on connecting route overlaps, potential competitive effects are mitigated by the presence of low cost carriers, the relatively small market shares of Delta and Northwest, the availability of alternative airports and the likelihood that legacy carriers will expand into these markets. In addition, the transaction will generate significant efficiencies through such factors as more efficient matching of aircraft to routes that will enable the combined carrier to be financially stable and to offer a better product to customers, such as a broad global network and enhanced airport presence.

**CONCLUSION**

In closing, I would like to acknowledge the support we have received from Delta people throughout the company. It has been three weeks since we announced the merger. We have been traveling our system from Atlanta to Cincinnati to New York to Salt Lake City and I am happy to say that Delta people are very excited about what this means to them. I believe that Doug will report the same about Northwest's employees.

Two weeks ago we had a meeting in Atlanta attended by almost 2000 employees. Some of our people have traveled here today to show their support. Our people appreciate the fact that we are taking proactive steps to provide a more secure, financially stronger company in these times of increased foreign competition, record-setting fuel prices and a weakening economy. They do not want us standing still. We look forward to welcoming Northwest employees to join with their Delta counterparts to create and enjoy the benefits of being part of America's premier global airline.

# U.S. House of Representatives
## Committee on Transportation and Infrastructure
Washington, DC 20515

James L. Oberstar
Chairman

David Heymsfeld, Chief of Staff
Ward W. McCarragher, Chief Counsel

John L. Mica
Ranking Republican Member

James W. Coon II, Republican Chief of Staff

May 29, 2008

Mr. Richard Anderson
Chief Executive Officer
Delta Air Lines
1275 K Street, N.W., Suite 200
Washington, D.C. 20005

Dear Mr. Anderson:

On May 14, 2008, the Subcommittee on Aviation held a hearing on the "**Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger between Delta Air Lines and Northwest Airlines.**"

Attached are questions to answer for the record submitted by Rep. Daniel Lipinski. I would appreciate receiving your written response to these questions within 14 days so that they may be made a part of the hearing record.

Sincerely,

Jerry F. Costello
Chairman
Subcommittee on Aviation

JFC:pk
Attachment

**MAY 14, 2008**
**SUBCOMMITTEE ON AVIATION**
**HEARING ON**

**IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES**

**QUESTIONS FOR THE RECORD**
**TO:**

**MR. RICHARD ANDERSON**
**CHIEF EXECUTIVE OFFICER**
**DELTA AIR LINES**

Mr. Anderson, thank you for your participation in the House Subcommittee on Aviation's hearing examining the impact of consolidation in the aviation industry. I appreciate you taking the time to respond to the following questions:

1. It has been widely reported in the media, and discussed at the hearing, that attempts were made to reach seniority and contract agreements with both pilot groups prior to the merger announcement. Were similar efforts made with the four other unions representing Delta and Northwest employees? If not, why, and what are the plans for working with these groups if the merger moves forward?

2. How does Delta plan to go about a fair and equitable integration of seniority lists?

3. At the hearing, I believe you stated that no hubs would be closed as a result of the merger. However, hub operations at Memphis largely duplicate those at Atlanta, and hub operations in Cincinnati duplicate those in Detroit. If these hubs are to remain fully operational, how can this merger result in cost savings?

4. Finally, the workers at Northwest airlines have a secure defined benefit pension plan. What will happen to their pension if Northwest merges with Delta Airlines?

**MAY 14, 2009**
**SUBCOMMITTEE ON AVIATION**
**HEARING ON**

**IMPACT OF CONSOLIDATION IN THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES**

**QUESTIONS FOR THE RECORD**
**TO:**
**MR. RICHARD ANDERSON**
**CHIEF EXECUTIVE OFFICER**
**DELTA AIR LINES**

1. It has been widely reported in the media, and discussed at the hearing that attempts were made to reach seniority and contract agreements with both pilot groups prior to the merger announcement. Were similar efforts made with the four other unions representing Delta and Northwest employees? If not, why, and what are the plans for working with these groups if the merger moves forward?

    A: The vast majority of Delta's employees have chosen through the years not to elect to have union representation, with the result that there are only two unionized workgroups at Delta – approximately 7000 pilots and 120 flight dispatchers out of a total workforce of nearly 50,000. Because the pilots will have a greater effect than other groups on the timing of our obtaining a single operating certificate from the FAA, as well as on related operational integration factors, Delta and Northwest took the unprecedented step early on in our merger discussions of asking the two pilot groups, who were represented by the same union, to try to reach agreement on a common contract and operational integration plan before the merger transaction was completed. We did not ask other workgroups to reach agreement on a common contract because the question of whether the rest of the new merged workforce will have union representation involves legal requirements that will remain open until after the transaction is completed. Upon completion of the merger, the status of the union representation of the various Delta work groups, along with the status of the various Northwest groups, will be resolved through a fair and equitable process under procedures administered by the National Mediation Board based on the requirements of the Railway Labor Act. As a result, it is not possible to do with the other groups what we negotiated with our pilots.

2. How does Delta plan to go about a fair and equitable integration of seniority lists?

    Regarding seniority protection for the frontline employees of Delta and Northwest, Delta took the initiative last year when our Board of Directors adopted a policy to provide a process for fair and equitable seniority integration for employees of both companies in any Delta merger. We pledged to use the seniority integration provisions from the former Civil Aeronautics Board's ruling in the Allegheny-Mohawk merger – specifically sections 3 and 13. As it turned out, in December the Congress enacted into law the same procedures that Delta had adopted as it own policy. The historical practice under Sections 3 and 13 has been to define a "fair and equitable" integration as one that seeks to protect the pre-merger circumstances and expectations of each group. Section 13 permits any affected party to submit a dispute over the integration of seniority to binding arbitration by a neutral arbitrator. Employee representatives from both DL and NW will directly participate on the seniority integration committee and will recommend a "fair and equitable" integration method. Delta will provide outside professional support as appropriate, and a neutral arbitrator will be available in the event the committees cannot reach agreement on an integration method.

3. At the hearing, I believe you stated that no hubs would be closed as a result of the merger. However, hub operations at Memphis largely duplicate those at Atlanta, and hub operations in Cincinnati duplicate those in Detroit. If these hubs are to remain fully operational, how can this merger result in cost savings?

   The Delta/Northwest network formed by our seven geographically balanced U.S. hubs is the combined carrier's greatest asset. We have no intention of dismantling any hubs, and have committed to maintaining Atlanta, Cincinnati, Detroit, Memphis, Minneapolis/St. Paul, New York-JFK, and Salt Lake City. These hubs exist because there was a strong local market that justified the development of hub service, and an air carrier with the resources to develop it. Delta and Northwest made different – but sound – business decisions in developing hubs in the cities where they exist today. Furthermore, each hub has unique service points, which add value to the hub and to the network. The merger provides the opportunity for Delta and Northwest to make better use of their hub infrastructure investments by generating additional traffic flows throughout the broader combined network. Because this is an end-to-end merger and because sound economics underlie our hub operations today, there is no need for hub closures. Memphis will continue to play an important role for the combined carrier, as will both the Cincinnati-Northern Kentucky International and Detroit Airports.

4. Finally, the workers at Northwest airlines have a secure defined benefit pension plan. What will happen to their pension if Northwest merges with Delta Air Lines?

   A: Delta's non-pilot employees also have a secure defined benefit pension plan. The existing pension plans for both companies' employees will be protected

# U.S. House of Representatives
## Committee on Transportation and Infrastructure
Washington, DC 20515

James L. Oberstar
Chairman

David Heymsfeld, Chief of Staff
Ward W. McCarragher, Chief Counsel

John L. Mica
Ranking Republican Member

James W. Coon II, Republican Chief of Staff

May 19, 2008

Mr. Richard Anderson
Chief Executive Officer
Delta Air Lines
1275 K Street, N.W., Suite 200
Washington, D.C. 20005

Dear Mr. Anderson:

On May 14, 2008, the Subcommittee on Aviation held a hearing on the "**Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines.**"

Attached are questions to answer for the record submitted by Rep. David Wu. I would appreciate receiving your written response to these questions within 14 days so that they may be made a part of the hearing record.

Sincerely,

Jerry F. Costello
Chairman
Subcommittee on Aviation

JFC:pk
Attachment

MAY 14, 2008
SUBCOMMITTEE ON AVIATION
HEARING ON
"IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY,
WITH A FOCUS ON THE PROPOSED MERGER BETWEEN
DELTA AIR LINES AND NORTHWEST AIRLINES"

QUESTIONS FOR THE RECORD
TO:

**Mr. Richard Anderson**
**Chief Executive Officer**
**Delta Air Lines**

1. Given your expressed interest in maintaining transpacific service for your Oregon customers, are you aware of the extreme importance of transpacific air service to the economy of Oregon? And are you aware of the history of intermittent international air service the state has had? Does the surviving company plan to maintain transpacific air service from Portland International Airport? Is the surviving company willing to make a binding commitment to continue transpacific services from Portland for a meaningful, post-merger period of time?

2. Just this spring Northwest Airlines started nonstop service to Amsterdam, Holland. Considering the importance of this flight to Oregonians who need to travel Europe, would the surviving company from this proposed merger be willing to make a binding commitment to maintaining this service for a meaningful period of time?

3. I would like to reiterate the request of the Port of Portland that representatives of the merging companies travel to Portland and talk to their customers about their concerns. Do members of your companies plan on visiting Portland for this purpose?

DELTA

**D. Scott Yohe**
**Senior Vice President**
**Government Affairs**

May 20, 2008

The Honorable Jerry F. Costello
Chairman, Subcommittee on Aviation
Committee on Transportation and Infrastructure
2251 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Costello,

Thank you for providing us with the opportunity to respond to Congressman Wu's questions for the record from the May 14, 2008 hearing on the proposed merger between Delta Air Lines and Northwest Airlines.

Please find the attached letter from Delta and Northwest's CEOs, Richard Anderson and Doug Steenland to Congressman Wu, dated April 22, 2008. Delta respectfully submits this letter for inclusion in the hearing record in response to Congressman Wu's submitted questions.

Please do not hesitate to let me know if you have any questions.

Sincerely,

D. Scott Yohe

April 22, 2008

The Honorable David Wu
United States House of Representatives
Washington, DC 20515

Dear Congressman Wu:

Thank you for your letter of 15 April communicating your concerns about the potential impact of a Delta-Northwest merger on transpacific service currently operated by Northwest.

We certainly appreciate your concern about the preservation of this service given the efforts of PDX, and local business, community and government leaders to secure and preserve service to Asia. We both recognize that this support has been crucial to the ability of two companies to begin and provide transpacific service. In addition, we fully understand the importance of that service to the valuable economic and trade investments that have been made in the Portland region.

We expect the communities we serve to be among the primary beneficiaries of the merger. By combining our complementary networks we believe we will be better able to support existing routes, and develop new ones, serving important markets such as Portland. Certainly, Northwest's Tokyo hub and services to Asia is an extremely important part of the overall network. Not only will it provide potential growth opportunities but the existing services such as the Portland flight to Tokyo are valuable contributors to the existing Northwest network. The merger does not change the plan to continue this service after the merger and we also plan to maintain the Portland-Amsterdam flight. We are sure you can appreciate, however, that we cannot make commitments about any of the services either carrier provides today because of the extremely volatile and difficult economic environment created by the rapid recent explosive increase in the price of jet fuel.

We, too, look forward to meeting and working with you and PDX in the coming months to ensure that we obtain the community and customer benefits that this merger will provide to all our constituencies.

With warm regards,

Richard Anderson Douglas M. Steenland

Richard H. Anderson
CEO
Delta Air Lines

Douglas M. Steenland
President and CEO
Northwest Airlines

www.newglobalairline.com

# Testimony before the Subcommittee on Aviation
# U.S. House of Representatives
# Committee on Transportation and Infrastructure

# "Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines"

May 14, 2008

Philip Baggaley
Managing Director
Standard & Poor's Ratings Services
*A Division of the McGraw-Hill Companies, Inc.*

Good afternoon, Mr. Chairman, members of the Subcommittee, ladies and gentlemen; thank you for the opportunity to testify today.

The U.S. airline industry once again faces a financial crisis, this time caused mostly by very high jet fuel prices and a weak economy. The managements of Delta Air Lines and Northwest Airlines suggest that the proposed merger of their companies will help them survive these challenges. My testimony will address:

- The magnitude of the financial problem facing U.S. airlines;
- How the proposed merger seeks to address that; and
- What broader effects this transaction (and others that may follow) may have on the rest of the airline industry, its employees, and the traveling public.

In 2007, the ten U.S. airlines rated by Standard & Poor's spent over $30 billion on jet fuel, higher than the previous year and more than triple the level in 2002. Yet, they reported their best profits since 1999. How was this possible? They cut non-fuel costs, including painful restructuring in bankruptcy for many, and they were able to raise fares and fill more seats. This year, their progress is in danger of being wiped out by a further surge in jet fuel prices. The Energy Information Administration's recent forecast of $136 per barrel jet fuel in 2008 is 50% higher than last year. That means that the ten rated airlines could face $15 billion higher fuel costs in 2008. That is triple the $5 billion of pretax profits they earned last year. Absent any other changes (such as higher revenues), this fuel price shock could bring many of them close to bankruptcy by early next year.

My first slide shows our current long-term corporate credit ratings on U.S. airlines, all of which are rated in speculative grade, except for Southwest Airlines, which is rated investment grade. The second slide shows a simplified example of the financial pressures facing the airlines. I start with the unrestricted cash and bank line availability at the end of last year for the nine airlines we rate in speculative grade. I add operating cash flow, assuming for the moment that the airlines repeat in 2008 what they generated last year. I then subtract the approximate damage from 50% higher fuel costs. I also deduct debt payments due this year and commitments for capital expenditures on new aircraft. The result of this scenario is that, by the end of the year, the airlines' cash would be slightly below what we would judge to be a safe minimum level of cash on hand. In other words, in this simplified example, the airlines, as a group, would be at risk of bankruptcy. I should emphasize that this is not our forecast for these airlines, but rather a simplified example that shows how serious a threat they face if they cannot offset the higher fuel prices through higher revenues or cost reductions.

The airlines' choices of how to respond are limited. One method that airlines have used to cut fuel expense is to ground the least fuel efficient planes. That helps only if the airlines can also cut other operating expenses (like labor and overhead costs) proportionately and if the revenues foregone by not flying are less than the cost savings. Delta and Northwest have announced plans to ground some older planes used in the domestic market later this year. Beyond this, the airlines' choices are to try to cut their total non-fuel expenses and to try to raise revenues—the same strategies they used before. Unfortunately, there are problems with each choice. Having squeezed expenses (including labor compensation) for years, airlines are, in our view, running out of places to cut costs. The other strategy, increasing revenues, means filling more seats on already crowded planes and raising fares in the midst of a weak economy.

Would merging Delta and Northwest help them respond to this situation? The companies suggest that the combination would generate at least $1 billion of revenue and cost synergies annually by 2012. Most of this would be in the form of higher revenues, as shown in my third slide. We agree that the more complete route network created by combining these two airlines should allow the combined airline to compete more effectively and capture some market share from competitors. It is also plausible that reallocating planes and flights throughout the enlarged system will create some revenue gains. I will address later whether we think this implies higher fares for passengers. On the cost side, the combination of any two airlines provides an opportunity to cut overhead costs somewhat, and this case is no exception in our view.

However, we also see significant risks in this proposed transaction. The managements acknowledge that combining the two airlines will require a one-time investment of up to $1 billion to integrate information systems, fleets, and for other merger-related expenses. Although this transaction, as an all-stock merger, does not require adding acquisition debt, it also does not provide for any new equity investment to cover the merger costs. In our view, depending on the timing of the up-to-$1 billion one-time investment for merger integration, and the timing of the ramp-up of merger benefits, cash outlays could exceed benefits in the first year of the merger.

Perhaps more important in our view, airline mergers have a checkered track record, rarely delivering on expected gains and usually creating labor unrest and service disruption. US Airways, the product of a 2005 merger with America West, is still trying to overcome these kinds of problems. In the case of Delta and Northwest, our main concern is that the cost of new labor contracts could offset merger synergies to a greater extent than management forecasts. Labor groups at both airlines made deep sacrifices in bankruptcy, and will want better compensation in their new contracts. Therefore, we expect that the actual synergies may be less than Delta and Northwest forecast. However, bear in mind that not meeting projected financial benefits is not the same thing as not providing any benefits at all. In the case of US Airways and America West, despite their labor troubles, the combination did generate higher revenues and probably saved US Airways from liquidation. For Delta and Northwest, we expect that a merger would, over time, be a net financial positive for the combined company, but perhaps not to the extent currently expected by management. We also think that the labor unrest and service problems that plagued other airline mergers remain a risk here, as well.

What about the effect on air fares? One understandable concern is that a merger could create market domination sufficient to allow big fare increases. On this point, the merger of Delta and Northwest appears less problematic than other possible combinations, as the two airlines have very little direct route overlap. That is not to say that this merger, and any that follow, would not have any effect on fares. First, airline hubs often compete against each other indirectly, even where there is no direct overlap. To the extent that passengers today have a choice of connecting through, say, Delta's hub in Cincinnati or Northwest's in Detroit, they would presumably see less price competition between those two hubs following a merger. However, connecting flights often have more than two alternatives, such as Continental's hub in Cleveland or United's in Chicago. For that reason, connecting traffic is often very low priced and unprofitable for airlines.

Another way in which airline industry consolidation could affect pricing is by changing the likelihood of general fare increases and decreases. We think that a U.S. airline industry with fewer large participants would be more stable and, on average, charge somewhat higher prices. That is because a successful fare increase requires that all major airlines participate, while any single large airline can set off a general fare cut. Fewer major airlines, each of which would have substantial, defensible competitive positions, would make a proposed fare increase more likely to succeed.

That conclusion may cause concern, but needs to be put it in perspective. First, the ability of the large, so-called "legacy carriers" to charge higher fares would likely be limited by general economic conditions and by competition from low-cost carriers. Southwest and the other low-cost airlines have penetrated almost all domestic markets and generally serve as a check on how high fares can go. Even though they, too, have been raising fares recently, prices remain well below the levels of the late 1990's.

The second issue to bear in mind is the airline industry's fuel price problem I described earlier. With opportunities for cutting non-fuel prices limited, airlines' best hope lies in generating higher revenues. If these companies were carrying freight, instead of passengers, the means to do so would already be in place. Freight carriers, such as railroads, trucking lines, and package express, have contracts with their corporate customers that usually include fuel surcharges. When an index tied to diesel fuel or some other benchmark rises above a certain point, the surcharges typically take effect automatically. Airlines, by contrast, mostly sell their tickets one at a time to individual passengers, and there is no automatic increase for higher fuel prices. They have to try to raise fares or other fees, instead.

The magnitude of the potential increase in fuel prices this year means that air fares will almost certainly increase. This could occur in a combination of at least three possible ways, as shown in my next slide:

- Airlines might raise fares and pack more passengers into planes sufficient to cover higher fuel costs, as they did during 2007. This looks increasingly unlikely, given the state of the economy and the scale of the higher fuel costs.
- Airlines might fail to increase revenues sufficiently, forcing some to file for bankruptcy or even shut down. That would reduce the supply of seats and make it easier for the survivors to raise fares.

- Or, airlines might find it somewhat easier to raise fares in a consolidated industry.

Most likely, there will be some combination of these three outcomes. However, the important point is that revenues, and thus air fares, will likely have to increase if the industry is to remain solvent. There is likely no other way to make the numbers add up, in our view. If this were a regulated utility, the companies would be applying for rate increases based on higher input costs. However, the percentage increase in revenues does not have to equal the percentage increase in fuel prices. The $15 billion higher fuel expense I mentioned earlier is equal to about 13% of 2007 revenues for the ten rated airlines.

To sum up, there are three key points to bear in mind:

- The U.S. airline industry faces a potential financial crisis if it cannot offset the dramatic increase in fuel prices;
- The proposed merger of Delta and Northwest offers potential financial gains in our view, but also material risks; overall, it is probably neither as beneficial as its supporters promise, nor as dire as its critics suggest; and
- One way or another ticket prices are likely to rise if fuel prices stay close to current levels or increase further.

Thank you for your attention. I will be happy to address questions you may have on my testimony.

Note: Standard & Poor's Ratings Services does not take positions on matters of public policy. This testimony addresses the credit implications of airline mergers and certain industry risk factors, such as higher fuel prices.

STANDARD
&POOR'S

# Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines

*Testimony before the Subcommittee on Aviation,*
*U.S. House of Representatives Committee on Transportation and Infrastructure, May 14, 2008*

Philip Baggaley, Managing Director, Standard & Poor's Ratings Services



The McGraw-Hill Companies

## S&P Long-Term Corporate Credit Ratings on U.S. Airlines*

| | |
|---|---|
| *Investment Grade* | |
| **Southwest Airlines Co.** | **A- / Stable** |
| *Speculative Grade* | |
| **Alaska Air Group Inc.** | **B+ / Stable** |
| **Northwest Airlines Corp.** | **B+ / CreditWatch Negative** |
| **Delta Air Lines Inc.** | **B / CreditWatch Positive** |
| **Continental Airlines Inc.** | **B / Negative** |
| **AMR Corp.** | **B / Negative** |
| **UAL Corp.** | **B / Negative** |
| **US Airways Group Inc.** | **B- / Stable** |
| **JetBlue Airways Corp.** | **B- / Stable** |
| **AirTran Holdings Inc.** | **B- / Negative** |

* As of May 7, 2008. Rating and outlook on that rating.





STANDARD &POOR'S

## Example of Impact of Higher Fuel Prices on Airlines*

| | |
|---|---|
| **Unrestricted Cash & Bank Lines** (Dec. 31, 2007) | $ 22.4 bil. |
| **Cash from Operations** (assumes 2007 level) | + 9.4 |
| **Less: 50% Higher Fuel Costs** | - 14.2 |
| **Less: 2008 Debt Payments due** | - 4.9 |
| **Less: 2008 Capital Expenditure commitments** | - 3.0 |
| **Equals: Cash & Bank Lines** (Dec. 31, 2008) | = $ 9.7 bil. |
| | |
| **Minimum Cash Levels** (= 1 month expenses) | $ 10.0 bil. |

*U.S. airlines rated in speculative grade, added together. This is an example that makes certain simplified assumptions, and is not a Standard & Poor's Ratings Services' forecast for these airlines.

STANDARD & POOR'S

## Synergies Claimed for Delta-Northwest Merger

| | |
|---|---|
| **Network Synergies** | |
| **Fleet Optimization** | **$0.4 bil. - $0.5 bil.** |
| **Network Presence** | **$0.2 bil. - $0.3 bil.** |
| **Total Revenue Synergies** | **$0.7 bil. - $0.8 bil.** |
| **Cost Synergies** | |
| **Gross Cost Synergies** | **$0.6 bil. - $0.7 bil.** |
| **Less: Higher Labor Costs** | **$0.3 bil.** |
| **Net Cost Synergies** | **$0.3 bil. - $0.4 bil.** |
| **Total Synergies by 2012** | **$1.0 bil. - $1.2 bil. annually** |

Note: Does not include one-time integration costs of up to $1 bil.





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## Potential Causes of Higher Air Fares

In our view, fares are very likely to rise because of:

Fare increases attempting to offset higher fuel costs; and/or

Bankruptcy and possibly liquidation of some airlines, allowing survivors to charge more; and/or

- Consolidation, which makes it somewhat easier for airlines to raise fares





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## Conclusions

**Airlines face a potential financial crisis if fuel prices remain high and they cannot offset that by higher air fares;**

**The Delta-Northwest merger has the potential to provide financial benefits, but also carries material risks; and**

**Air fares are likely to rise, one way or another, if fuel prices remain high**

Note: Standard & Poor's Ratings Services does not take positions on matters of public policy. This testimony addresses the potential credit implications of airline mergers and of certain industry risk factors such as higher fuel prices.





STANDARD &POOR'S

# TESTIMONY OF THE AMERICAN ANTITRUST INSTITUTE
# BEFORE THE US. HOUSE OF REPRESENTATIVES
# COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
# ON THE IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY

ALBERT A. FOER[1]

WEDNESDAY, MAY 14, 2008

## Introduction

I am Albert A. Foer, President of the American Antitrust Institute. The AAI is a ten year old independent non-profit education, research, and advocacy organization. We operate as a network of approximately 100 antitrust experts, including men and women trained and experienced in law, economics, and business. The AAI believes that the vigorous enforcement of the antitrust laws is the best way to protect consumers, innovation, and the economy as a whole from anticompetitive corporate behavior, and in this way ensure that competition will be both aggressive and fair. For further background, visit www.antitrustinstitute.org. We are currently working on a white paper on competition in the airline industry.

## 1. Getting the Perspective Right

Although this testimony focuses primarily on the proposed merger of Delta and Northwest, it is critical to place this merger into context. The essential points are that: (1) this is an industry in which there are substantial network effects, but the incremental costs of expanding an already large network may offset the network benefits; (2) the industry is already moderately concentrated on a national basis, but this generalization underestimates the market power that is present at most hubs and on most routes; and (3) a merger of this magnitude will in all probability lead to at least one more merger of similar size. These three considerations require us to consider whether the five or possibly four national networks that will emerge from this process are sufficient to provide a satisfactory range of choice and service and sufficient competition to keep prices close to costs.

---

[1] Mailing Address: 2919 Ellicott Street, NW, Washington, DC 20008

Telephone: 202-276-6002

The airlines predictably assert that merger brings efficiency benefits from economies of scale and scope, but these must be weighed against inefficiencies due to other diseconomies of scale and scope, the cost of consummating the merger, and the reduction in competition arising from the merger. For consumers not to be harmed, the benefits of the merger must outweigh the costs *and* at least some of these net benefits must be passed on to consumers in the form of lower prices and improved service.

**2. The Limits of Standard Antitrust Analysis**

Standard antitrust analysis focuses on horizontal overlaps between city pairs. If an origin and destination route is served by only a few airlines and the merger will leave the particular market highly concentrated, the DOJ will likely—and properly—require a divestiture or some other arrangement with respect to that route, as a condition of approving the transaction. I will not address this further, but I would note that this conventional approach tends to downplay the important role of potential competition in airline markets. Airlines not presently serving a route but which can fairly readily enter, serve to constrain pricing, so that mergers that eliminate such a constraint may be anticompetitive just like mergers between airlines that currently do serve the market.

Standard overlap analysis is necessary but it should not be considered sufficient, because it captures only one part of the competition picture. The observer's lens needs to be adjusted in order to look not only at the trees but also at the forest. A more complete analysis must answer these questions: how many systems are enough to guarantee the kind of pricing, service, and convenience that the American public desires from its air transportation industry? How many are enough to provide the current competition or potential entry that can serve as a constraint on higher prices by other systems?

**3. Three Business Models**

The airline industry in the U.S. consists of carriers following three principal business models or strategic segments: network, point-to-point, and hybrid. There are six major network carriers, all of roughly the same size (American, United, Northwest, Delta, Continental, and US Airways, although by some measures American, United and Delta are substantially larger than the other three). Other carriers, including those that are categorized as "low cost carriers" and "connectors" either operate point-to-point or, as is the case of Southwest, have begun to move to a combination of point-to-point and hub-oriented service.

It is possible that one day Southwest will become a national network carrier, but that remains to be seen. As things stand today, with Delta and Northwest saying that they do not intend to close any hubs, it seems unlikely that Southwest would evolve into an additional network system within the two years required for "easy entry" under the current federal Horizontal Merger Guidelines. There are disadvantages as well as advantages to a network strategy, which will be discussed below.

The non-network carriers do play a role as competitors to the networks. In terms of planes in the fleet, Southwest, the only airline projected to be profitable in 2008, comes just behind American and United; and SkyWest, a holding company with two hubs and several connector airlines whose code-sharing agreements with Delta, Continental and United limit its incentives to compete with any of them for fear of losing the interline traffic, has more planes than Continental or USAirways. Southwest clearly influences prices wherever it competes (often causing fares to fall substantially), and even when it is perceived as a potential competitor. But Southwest and the other low cost carriers have found their success by competing indirectly rather than directly with the networks.

### 4. The Importance of Systems on the Demand Side

There is some question as to whether the DOJ considers networks relevant from the demand side. Airline passengers benefit through demand-side economies known as network effects. When an airline adds service between its hub and a new location to accommodate passengers at that location, it also creates new service offerings between that location and other locations that can be reached through its hub. Code-sharing arrangements between airlines and other alliance functions can also facilitate network effects to the extent they promote coordination of schedules, route expansion, and the appearance of increased flight frequency.

From the perspective of the individual non-business air traveler, whether or not a carrier is part of a network may or may not be important, depending on what service is available from the origin to the destination. The benefit of a larger network is that it enables a consumer at any given city to reach more cities on the same airline, although most if not all of the additional choices involve changing planes. (The enhanced ability of a consumer to fly non-stop rather than via multiple legs would be an important consumer benefit.) If the traveler has frequent flier miles, he or she may be biased to stay within a particular system, and indeed this may be a factor that makes new entry more difficult.

From the perspective of businesses that negotiate the purchase of large amounts of travel service requiring specific scheduling, there is an advantage in that a single negotiation can cover a larger fraction of potential destinations and origins of flights.

If two airlines merge, both business and non-business customers receive a convenience benefit only if the average number of hops to reach all destinations goes down. For this to be a non-trivial effect, there must be significant cities that are not served by one of these carriers. Otherwise, one can get to any other city in one or two hops on either carrier.

Although networks bring important consumer benefits as they grow, the incremental network benefits may decline as carriers get larger. Expanding a network by merger may add city-pair routes to those offered by the merged entity, but it does not create an in-system benefit to any given consumer if both carriers serve all major airports through each hub. Because low cost carriers compete only on certain non-stop routes, they provide at best only a limited discipline on a system-wide basis.

Networks therefore should be taken into account in antitrust analysis from the demand side.

**5. The Value of Considering the Systems Competition**

Each network can also be thought of as a "system," and we can say that for many purposes and for many travelers, a particular travel experience can usually be accommodated by only one or two systems. Price competition on overlapping point-to-point routes is not the only dimension of rivalry under a systems view of airline competition. Travelers also look to the ease of connections, arrival and departure times, airport amenities, seamless baggage transfers, frequent flyer programs, etc. in making their airline choices. But airlines tend to think of their seats as a commodity, such that the systems carriers usually do not want to go head-to-head against each other in circumstances where price would be the only differentiating factor-- which results in relatively few choices of airline for most non-stop flights..

**6. The Role of Entry**

What barriers constrain entry in the form of route expansion? With a number of important exceptions, gates are not constrained, although dominant airlines have succeeded in deterring entry at their hubs through predatory strategies which neither antitrust nor regulation has been unable to stop. To a large degree, it is a matter of strategic decision for the larger airlines whether they want to compete on certain routes. Why cannot Delta and Northwest independently expand routes to gain network effects? Why is it more costly for Delta to add service rather than to buy the service from Northwest, which is the practical effect of this merger? Overarching may be the efficiency question of why the most successful airlines are smaller, if network effects are the dominant factor in airline success?

Whether non-system airlines such as Southwest, AirTran, Jet Blue and Frontier will become more like the system airlines is not clear and their potential entry as systems should therefore not be counted on in our current analysis of the industry. If two or more mergers of systems carriers occurs, Southwest and other non-system carriers may have the opportunity to pick up additional routes and perhaps even hubs, if hubs are abandoned – a possibility that should not be taken for granted. Moreover, the non-network carriers might benefit from a raised price umbrella if a less competitive network strategic segment is able to raise its prices. The public would pay more to fly.

Entry is particularly difficult in several well-known airports. Government policies could make entry for low cost carriers easier, which would improve the competitive situation in those airports. But such other factors as corporate contracts between businesses and systems airlines, frequent flier lock-in, and the difficulty of obtaining financial capital, availability of planes, and the FAA requirements for operating cash on hand are among the reasons why the public cannot count on low cost carriers to discipline post-merger price increases.

### 7. **Using Caution in Considering the Parties' Efficiency Claims**

If there is one thing that we have learned from the long history of antitrust, it is that efficiencies are easy to assert, difficult to achieve, and rarely of the magnitude that the parties–in their self-interest–claim.

The principal efficiency claims being put forward in justification of this merger are economies of scale and scope on the supply side and rationalization of the use of planes to "right-fit" them to their routes.

The network airlines initially obtained large supply-side cost economies through the hub and spoke system resulting from increased traffic density, particularly as they induced increased passenger volumes on hub-to-hub flight segments.

However, it appears that a system which relies too heavily on hubs is expensive to operate compared to a point-to-point system, and that there may be limits to the efficiency gains achievable through networks. For example, bigger networks create peak-load problems at an airport. The basic idea of a network is that all planes arrive at an airport at about the same time, the through-passengers then reassemble on different planes, and the planes depart at about the same time. This increases the disparity during the day in the number of arrivals and departures, and so creates problems for efficient staffing of gate, ticket, and maintenance personnel. By contrast, back-and-forth non-stops and multistep puddle jumps do not create as much of a peak-load problem.

The just-in-time structure of the networks means that if weather or a mechanical problem causes a delay in the arrival of a plane at a hub, the problem quickly metasticizes throughout the system, as each delay causes a multitude of other delays. As networks grow, therefore, minor inconveniences become major national inconveniences, if not emergencies.

It is an empirical, not theoretical, issue to identify the point at which an airline begins to experience diseconomies of scale and scope. For mergers among big carriers, no one has found a significant net benefit. As such, many of the efficiency claims by the parties should be viewed with some skepticism.

For example, Delta and Northwest say they anticipate large savings because they operate different types of aircraft and, if merged, the new company can "right-size" by flying more small or large planes on short or long routes. A proper analysis will ask the following questions and answer them with the help of experts not employed by the companies: (1) To what extent can these changes be made internally over time? (2) Why can't Delta and Northwest simply swap some assets to accomplish these changes, which would be in each airline's interests. (3) Given that many planes are leased, why is a merger the only way to right-fit planes to their routes? In any event, the projected savings from this type of efficiency need to be scrutinized route by route and plane by plane.

## 8. Strategies and Counter-Strategies

Delta and Northwest justify their merger in terms of the desirability of increased scope – which they refer to as "presence" – and scale. They argue that the savings they can attain will help them survive the current fuel crisis and economic downturn.

Northwest says that the very same motivations are likely to lead to at least one additional systems merger in the near term, probably between United and USAirways. They reason that the other systems carriers will see that the new largest carrier has unit cost advantages deriving from the economies and will have no choice but to quickly emulate the size of Delta via the only possible method, which is merger. Presumably the remaining two airlines would also have to find a way to bulk up. Thus, if Delta and Northwest are right, the merger wave that this one will kick off will not stop here.

On the other hand, if Delta and Northwest are wrong about the efficiencies, then there is no justification for distorting the current equilibrium of six systems. We see no reason to believe that the benefits of merger are due to efficiencies rather than market power and are therefore quite skeptical.

Giving additional market power to the airlines that survive the mergers will not reduce the price of fuel. That is out of the airlines' control and will have to be passed on to consumers, as will be occurring in all of our industries. This will predictably result in fewer people flying. The question is whether the inevitable downsizing needs to be handled through cartelization of the industry or by individual decisions by the incumbent airlines. It is our commitment to competition in the airline industry, as opposed to regulation, that is fundamentally at stake here. Downturns are not forever and the country will be better off in the next growth period if there are more rather than less systems in competition with one another.

We are at a critical moment in the structural history of the US air transportation industry. While there are a few instances in which an antitrust agency has looked at two proposed mergers in the same industry simultaneously, the usual approach is to say that the agency can only consider that which is immediately before it. Taking this narrow view would be a disservice to the public, which is already concerned about the increasing unreliability and discomfort associated with air travel.

We urge that the antitrust analysis take the broad view of the industry and that the strategic plans and counter-plans of all large carriers must be examined and analyzed before any antitrust decision is rendered.

**9. International Considerations**

Domestic air transportation is closely related to international air transportation and this relationship will grow stronger as the US/EU Open Skies agreement takes effect. There are currently only three global alliances that dominate international air travel: Star Alliance (United/Lufthansa), SkyTeam (Delta/Air France/Northwest/KLM), and oneworld (American/British Airways). The first two have U.S. antitrust immunity to jointly set prices and allocate capacity on those international routes covered by the immunity grants.

The international alliances are coming to look more and more like single global companies that operate as closed systems using various brand names. (While Delta and Northwest may be acting as if they are already one company with respect to trans-Atlantic flights, they are still two competitive companies domestically.) Are we satisfied that these systems, with or without US antitrust immunity, will provide sufficient competition? The individual airlines within the alliances will have fewer incentives to compete against each other so there will be minimal intra-system competition. Arguably, a merger between alliance members such as Northwest and Delta would exacerbate this problem. With only three alliances, the chances are that inter-system competition will often be indirect rather than direct, unless antitrust and aviation policies mandate non-discrimination in interline services, a condition about which we have no reason to be sanguine.

With the large US carriers participating in immunized global alliances, the competition injected by a seemingly larger number of different airlines becomes less and less meaningful.

**CONCLUSION**

The ultimate question is whether the public will be satisfied with four domestic and three global air transportation systems? There is little if any empirical knowledge that says how many systems are needed to provide a workable degree of intersystem competition. There is substantial data, both empirical and theoretical, that suggests that competitive problems increase as a market becomes highly concentrated. There is substantial experience with domestic air mergers that suggests how difficult they are to execute successfully; how few efficiencies have resulted from big carrier mergers; and how slow entry has been at the network level. To the extent there is doubt about the Delta/Northwest merger, it should be resolved as essentially a public policy question as to whether we are willing to interfere with business decisions in order to preserve the few competing systems, at the possible expense of whatever efficiencies might realistically be lost. We suggest that the magnitude and certainty of these proclaimed efficiencies should be analyzed with great skepticism and must be weighed against inefficiencies due to other diseconomies of scale and scope, the cost of consummating the merger, and the reduction in competition arising from the merger.

# TESTIMONY OF

PATRICIA FRIEND
INTERNATIONAL PRESIDENT
ASSOCIATION OF FLIGHT ATTENDANTS –
CWA, AFL-CIO

BEFORE

THE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE'S SUBCOMMITTEE ON AVIATION

# "IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIRLINES AND NORTHWEST ARILINES"

U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC

MAY 14TH, 2008

Association of Flight Attendants – CWA, AFL-CIO
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Thank you for holding this vital and timely hearing on the proposed merger of Northwest and Delta Airlines. My name is Patricia Friend and I am the International President of the Association of Flight Attendants – CWA, AFL-CIO. AFA-CWA represents over 55,000 flight attendants at 20 U.S airlines and is the largest union in the world representing flight attendants. We especially want to 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. Flight attendants and other employees have kept these airlines flying during the good times . . . and through some very *difficult* times. We appreciate having a seat at this table to testify on behalf of the tens of thousands of airline employees across this county who have collectively sacrificed billions of dollars in pay and benefit cuts over the last several years, and to share our views and our concerns about what this merger could mean to them.

Since deregulation, this country has lacked a sound and rational aviation policy. Prior to deregulation, the airline industry was nurtured and developed by federal policy crafted to ensure that the industry was stable and was able to promote economic development in communities it served. In the post-deregulation environment, the industry was thrown into a massive market driven restructuring. So what have the results been? Hundreds of bankruptcies and defunct airlines, thousands of displaced and unemployed airline workers and their families, the worst consumer rankings and on-time performance in history and a out-dated air traffic control system that cannot handle the demand. We have seen hundreds of communities across every single region of this country lose vital and crucial air service as airlines cut routes and scheduled service and move those assets to serve large communities along with every other airline. Despite the promises of deregulation, the industry still struggles to make a profit even when the price of a barrel of oil was half its current value. We've heard the excuses repeatedly from airline executives. They've blamed everything from the national economy, to low cost, start up airlines and to their favorite excuse – labor costs. It's interesting to me, that the one thing that has remained constant in the industry is the outrageous sums collected in pay and benefits by airline management regardless of the economic performance of their carrier. Corporate greed is the one thing that's remained constant during my career. If anything in that category has changed, it's that the amounts they reward themselves every year grows more and more excessive while employees earn less.

Since deregulation, our aviation policy has been dictated and driven entirely by the marketplace. Is this a wise policy for an aviation system that is as important and vital to our country? The marketplace has indeed increased competition and reduced fares for consumers in some markets. But the unfettered marketplace has also led to the loss of air service to struggling communities, the increasing difficulty for airline employees to make a decent living, calls for a passenger bill of rights and, most troubling, life saving safety initiatives that are the first casualty of the cost cutting knife.

Some may interpret my comments as a call for re-regulation. I'm not convinced that is the full answer. What I am saying is that we need a serious national dialogue to start now, so that we can determine a sound and rational aviation policy that works for everyone in this country – employees, consumers and communities. And we cannot afford to wait. Everything should be on the table in this discussion, including the possibility of re-regulation – or at least re-regulating part of the market.

The solution advanced by the industry today, and which seems to daily become almost accepted fact by many, is for greater consolidation. They tell us that in order to survive a world of dramatically high fuel prices and increased foreign competition, mergers and consolidation are necessary. I'm not so sure that we should rush headlong into supporting this call for greater consolidation without taking a very serious pause. With us standing at the edge of great change in this industry, it is important that we begin the debate, discussion and dialogue on what kind of national aviation policy we want.

This merger between Northwest and Delta has drawn significant attention from the media, communities served by both carriers and here on Capitol Hill. The attention being paid to what will create the largest airline in the world is appropriate . . . and *necessary*. Already this announced merger has led to credible speculation about what airlines will be next to merge. Airline CEOs continue to call for greater consolidation in light of the exploding cost of fuel, although the merger drumbeat started much earlier as airline executives sought greater profits following the recent epidemic of bankruptcies.

Consumers are frightened that this airline merger in particular, and further consolidation of the industry in general, will lead to much higher fares and reduced service. Hundreds of communities are rightfully concerned that this merger and others could lead to the loss of valuable air service as the evolving mega-carriers shed routes in hopes of consolidating their profits.

The increase in consolidation activity requires appropriate oversight to protect the interests of employees and passengers. Federal regulators will look carefully at the impact this merger and others will have on the consumers and communities. We hope that this Committee and other Congressional Committees will exercise – beginning with this hearing – vigorous oversight responsibilities as well.

While some protections are in place 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 has not always been the plight of airline workers. 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 no real protections from our federal government exist today to cushion airline workers involved in mergers. After Deregulation employers successfully lobbied for an end to the LPPs because, as they argued at the time, these matters are 'better left to the collective bargaining process.' Union contracts provide a level of protection for those employees covered by the agreement, but there is little to no protection for non-union airline employees.

Those same employers who wanted to leave these protections to the bargaining process now spend millions of dollars on union busting, trying to prevent their employees from attaining the right to bargain, or to strip that right from those who have had it for decades. And today, many of those same employers who hold press conferences to trumpet the fact that their mergers will not cause any layoffs often refuse to agree in writing to such guarantees when they come to the bargaining table.

Of all the well-developed rules referred to prior to Deregulation as the Allegheny-Mohawk Labor Protective Provisions, only one exits today – the provision establishing basic seniority protections in the event of a merger. And, that provision was only recently resurrected and included in last December's Omnibus Appropriations bill after the advocacy of AFA-CWA and the strong support of Representative Russ Carnahan, Senator Claire McCaskill and this Congress.

Earlier attempts by Congress to provide protections for airline employees during mergers provides us with an instructive history in the current context. We continue to feel the effects of the Airline Deregulation Act; the proposed Delta - Northwest merger is just the latest manifestation of the impact of Deregulation. But an attempt by Congress to cushion the clearly anticipated effects of the start of Deregulation proved to be a complete failure.

Congress included the Airline Employee Protection Program (EPP) in the Deregulation Act to assist adversely affected employees. At least 40,000 employees lost their jobs in the wake of Deregulation. The EPP was supposed to provide for both monthly compensation and first-hire rights at other airlines. However, displaced employees never received the benefits Congress promised and 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. So while Congress has recognized the need to assist airline employees facing the traumatic effects of industry consolidation in the past, a fully-funded federal effort is desperately needed now in what is shaping up to be another significant era of airline consolidation.

As we look for solutions to cushion the enormous negative impact this latest merger will have on workers at Northwest and Delta, perhaps it's time to revisit the concept of employee protection from the Deregulation Act. No, we are not proposing to re-regulate the industry today; that's a worthy discussion for a different hearing that we welcome and we would encourage Congress to hold. But we do think that – at a minimum – something needs to be done to shield workers from the harshest effects of this merger and any future mergers.

Executives at the airlines have, to date, promised that there will be no layoffs, but they refuse to put that commitment in writing. We all know that the minute the ink is dry on the merger agreement, executives will be looking for cost saving 'synergies' that will make the new airline ever more profitable. Many of the synergies that the executives will likely turn to first are precisely the steps that will harm the interests of the workers, such as furloughs, base closures, fleet reductions and, perhaps worst of all, outsourcing.

Workers cannot, and should not, be left to fend for themselves in this situation; we did not bring these problems on ourselves. The federal government set this chain of events in motion with the passage of the Deregulation Act and its subsequent neglect in forming a rational aviation policy for our country. The airlines themselves have compounded the problems for workers with an almost endless string of cutbacks, bankruptcies, mergers and layoffs. Government and the airlines, then, bear the responsibility. And, either the federal government or the airlines must pay to offset what is otherwise the unfair burden placed on the workers resulting from Deregulation and its current aftermath.

The Deregulation Act provided monthly compensation and first-hire rights to protect displaced airline workers. Those same protections are needed and appropriate today on the eve of the Delta - Northwest merger and potential mergers to come. Congress could adopt and fund those protections, or it could require the employer, as a condition of approval of this merger, to fund those protections. We must stop shifting these costs on employees who are least able to shoulder that burden.

This merger also seriously jeopardizes the collective bargaining rights of all the Northwest employees who have fought for and won the legal right to have union representation. Virtually all employees at Northwest have chosen to join a union. Delta, on the other hand, has only one major workgroup that is unionized – its pilots. I am proud to say today that the approximately 13,500 Delta flight attendants are now the closest to securing their future by forming a union through AFA-CWA as they are currently engaged in a representation election.

Delta flight attendants have been working diligently to secure a better future through joining AFA-CWA and eventually securing a legally binding contract. Their hard work paid off when they filed cards from over 50% of all the Delta flight attendants requesting an election to join AFA-CWA. In fact, yesterday, the National Mediation Board (NMB) mailed voting instructions to Delta flight attendants and the voting will end on May 28th. We remain confident that this brave, strong and proud group of Delta flight attendants will come together – despite the efforts of the company's anti-union consultants – and choose union representation and a strong voice to protect themselves and the future of their profession.

In the context of this merger, the company's anti-union tactics take on added urgency; the merger should not be permitted to become a vehicle for union busting. Airline executives have realized the opportunity that this merger presents: not just a chance to prevent thousands of non-union employees from gaining a union, but also a chance to eliminate the unions that already provide protection for their members at Northwest.

While Delta flight attendants vote on whether to join the union, the Northwest flight attendants face a very real threat to their collective bargaining rights. Northwest flight attendants joined AFA-CWA 20 months ago, but have been union members for 60 years. Their proud tradition of union representation is threatened by management's use of this merger process to attempt to eliminate the Northwest flight attendants collective bargaining agreement which, in turn, poses a real threat to the job security for thousands of flight attendants.

In fact, we view the current representation election among the Delta flight attendants as not just an opportunity for them to gain a voice on the job and a seat at the table, but as the "first line of defense" to protect the over 60 years of collective bargaining rights for the Northwest flight attendants. This is due to the unique way that representation elections are governed by the National Mediation Board. Although the Railway Labor Act (RLA) makes no mention of such an extraordinary requirement, the NMB rules state that in order for a representation election to be considered valid, 50%+1 of all eligible voters must turn out to vote in the election. If 95% of flight attendants who cast a vote want to join AFA-CWA but only 49.9% of all the eligible flight attendants cast a vote, then the election is invalid.

In effect, a person who chooses not to cast a vote in an NMB election is counted as a "no" vote, encouraging management to focus their efforts on voter suppression in every election. I ask the members of the Committee to consider if they, or most of their colleagues, would be sitting here today if our Congressional elections were governed under the same onerous rules, where turnout is more important than the votes cast.

Based on the number of Delta flight attendants who have signed AFA authorization cards, and the number of Northwest flight attendants who are already union members, AFA has the support of a solid majority of the combined workforce. Since at least 1926, national labor policy as defined by this Congress has been to encourage unionization of workers. Congress could further that goal, and prevent airline mergers from becoming an occasion for union busting, simply by defining victory under the RLA organizing rules as a *majority of the votes cast.*

It is our hope, and the hope of thousands of Delta flight attendants, that they will overcome these difficult election procedures and decide next month to join AFA-CWA. They will then have the right to bargain for improved work rules through a legally binding contract and the historic collective bargaining rights of the Northwest flight attendants will have been protected in the newly merged Delta Airlines. Delta and Northwest flight attendants, working under the umbrella of AFA-CWA's constitution and bylaws, can move forward on integrating their two groups and negotiating for an improved contract for what will be the largest flight attendant workgroup in the United States. This does not require new legislation; all we ask is that the Committee urge these employers to remain neutral so, as originally envisioned by Congress when it adopted the Railway Labor Act, the employees can decide the issue of union representation for themselves, without coercion, interference or influence by the employer.

Bargaining rights are paramount if the flight attendants are to have an opportunity to negotiate over the impact this merger will have on their work lives. Our primary concern is that Delta executives will use the merger to eliminate the rights of employees to have a seat at the table when the airline is fully merged with Northwest. One need look no further than Delta's past actions in organizing campaigns. In the last flight attendant election, Delta engaged in numerous activities to suppress the number of flight attendants casting ballots and to spread mis-information. When AFA-CWA appealed to the NMB to hold a "re-run" election due to the overwhelming interference of Delta management in the election process, the NMB swept aside overwhelming evidence of interference and Board precedents. The current chairman of the NMB stated in his dissent that "[t]he majority's decision now creates a gray area of legally allowable conduct: that which is "troubling," but does not constitute interference. I am at a loss to understand this reasoning that rationalizes an attempt by management to silence the voices of their employees"

Delta executives have not been shy about their efforts to prevent the employees from forming unions. In fact, in a meeting with AFA-CWA Northwest leadership, Northwest management stated flatly that there would not be a seat at the table for the flight attendants in the merger discussions. He went on to state that the current Delta was a non-union company and that the "New Delta" had every intention of remaining a non-union company; Delta planned to defeat the union and prevent the flight attendants from having, or keeping, the bargaining rights that are essential in the face of this merger.

Delta has already demonstrated that they will again continue to spread disinformation and make every effort to prevent Delta flight attendants from casting ballots in the upcoming election. Is this what we've come to in this country? They've even gone so far as to state that they supported and were instrumental in having the seniority integration protections passed by Congress in the Omnibus Appropriations late last year, even though they spent months opposing inclusion of the language. I would ask this Committee: what is wrong with our system when the majority of these flight attendants want union representation and yet face such great barriers to achieve that goal?

Using this merger as an opportunity to destroy unions provides these airlines, and all who would follow, with an opportunity to drive down wages, work rules and benefits for all airline employees. It can create a domino effect that will force even unionized carriers to match those drastic cuts in order to compete. They will set industry standards back to levels we have not seen in decades. If Delta is a non-union carrier, as well as the largest carrier, they will be poised to set in motion an unprecedented remaking of the entire airline industry that will destroy airline jobs as a stable and secure middle class career once and for all.

Flight attendants face one other devastating threat in this merger, one that no other work group is likely to encounter. This merger may resurrect efforts by Northwest executives to outsource our best jobs to flight attendants based outside the U.S. Such outsourcing of flight attendant jobs on international routes to foreign nationals will resurface and become a standard industry practice. When Northwest first proposed doing just this during bankruptcy, a bipartisan group of House and Senate members rose up to decry such a move as jeopardizing aviation safety and especially security. With a union fighting to protect the Northwest flight attendants jobs, and support from members of Congress, Northwest management backed off such a proposal and thousands of good paying jobs remained for Northwest flight attendants. Only if the union retains its bargaining rights following the merger will the flight attendants have the legal standing to continue the fight against such outrageous ideas as outsourcing flight attendant jobs; such an idea is just the tip of the iceberg. Many of the current Delta executives were involved in earlier outsourcing attempts when they were at Northwest Airlines.

I urge the members of this Committee to send a strong and clear signal to Northwest, and especially to Delta executives, that they must not use this merger as a means to destroy the collective bargaining rights of the employees. I would urge this Committee to use its good offices to monitor Delta management as this representation election progresses over the next five weeks so that they do not engage in election activities similar to those of five years ago – actions that violated the spirit of the Railway Labor Act, even if the NMB ruled they did not violate the letter of the law. And finally, I hope that you will use your influence to persuade Delta management to remain neutral in this representation election. If they are successful in their goal to keep the "new Delta" non-union, we could see this merger as the beginning of the end for the airline industry as a source of decent and respectable jobs.

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. Most importantly, don't let them destroy the one thing we have protecting us – our unions.

# TESTIM0NY

**of**

**Aaron J. Gellman**

**before the**

**U.S. House of Representatives**

**Committee on Transportation and Infrastructure**

**Subcommittee on Aviation**

**May 14, 2008**

Thank you for the invitation to appear before you today.

I am Aaron J. Gellman, Professor at the Transportation Center at Northwestern University.

There are five reasons most often given these days for seeking to become a single airline through merger or acquisition:

1. Economies of scale: reduction of costs
2. Economies of scope: there will be more single-line service to more places, especially internationally
3. A varied fleet can be deployed to meet more precisely the needs of each city-pair market
4. High and mounting fuel costs
5. Reduction in the rate-of-growth of the economy.

I will consider each of these "reasons" in turn. But before doing so, I need to state that the views I express today are my own and do not necessarily reflect those of the university, its faculty and staff nor of the Transportation Center at Northwestern University with which I am principally associated. I should also make it clear that I am not categorically against mergers between airlines. There are amalgamations that make economic and public policy sense but, as I shall demonstrate, this is not one of them.

Economics of Scale: Reduction of Costs

I should not be surprised if certain non-flying jobs would be eliminated were NWA and DAL to marry. Some functions are surely duplicated in the two carriers and not all the associated people would be needed in the future. The challenge for a new management team is to assure that the best, most productive, persons are retained while the others, sadly but necessarily, pay the price of displacement.

But the history of mergers in this as well as other industries give little comfort that this will be the case, thus decreasing the prospective cost-savings.

As for other cost-related issues, there would be some benefit from geographically broader, more efficient advertising and marketing programs but airport space rental and maintenance costs are unlikely to be much reduced given the representations of the prospective merger partners not to close hubs or cut services significantly.

The prospects regarding the pilots of the two carriers suggest either a minimal beneficial effect on costs or a substantial increase. In the former case, it will require the two carriers to continue operating essentially as two airlines (much as U.S. Air has had to do). Many economies of scale would be sacrificed in the process but costs attributable to pilots may well not change much.

On the other hand, in order to achieve real and full integration of the two airlines, it will be necessary to bring the pilot corps together through a merger of the two seniority lists on a basis acceptable to both pilot groups, something US Air has still not been able to accomplish. This is likely to be an even greater issue with DAL and NWA.

Assuming the new Delta can do it, this will mean a substantial additional cost burden for some time as seniority number, rather than pilot age or experience, will determine what equipment the pilot can bid for. And given the great, and perhaps unprecedented, disparity of the two airlines' fleets, this will take a considerable period to implement with attendant training and logistics costs all along the way.

Economies of Scope

There are economies of scope to be exploited in a combined carrier. Perhaps this is why there is the pledge in this instance to retain all the hubs now in each system. But how the economies work out from greater scope, and the value of such economies work out from greater scope—and the value of such economies—is not clear, except for the advertising and cost savings previously cited. It should also be noted that one of the principle reasons given for international alliances, in which both carriers already participate, is that they enable airlines to gain many economic and marketing benefits without the need to merge.

Varied Fleet Benefits

A disparate fleet of aircraft is not usually considered productive of economic benefits. To be sure, a variety of aircraft is required to carry out the wide range of missions of Delta and Northwest either individually or combined. But the number of aircraft types must be constrained if all the benefits of economies of scale are to be realized. This means, in the present case, that either one of the carriers has to substantially re-fleet (which would be exceptionally costly and take considerable time) or that, again, the two carriers be operated separately with all that entails. (At present, the only aircraft type flown by both carriers is the 757-200 with Pratt and Whitney engines. Otherwise, Northwest is oriented to Airbus and Delta is exclusively Boeing.)

In any event, presently, each airline alone appears to have a fleet varied enough to assign aircraft types to the markets best suited to them. Also, each carrier has regional jet and turbo-prop operations--either through subsidiaries (e.g. Comair) or through contracts—providing each with even greater flexibility. Therefore to make a virtue of an exceptionally diversified combined fleet seems more of an excuse than a reason to merge.

High and Mounting Fuel Costs and a Slowing Economy

First, again we have excuses being offered as reasons. Regarding fuel, with very limited exceptions, all U.S. Airlines are faced with the same conditions. Moreover, how can the combination of these two airlines influence either "condition"? Only by reducing service can fuel costs be lowered in the short-run and there is the representation this will not be pursued to any significant degree if these carriers combine. (The service cuts that clearly can be made are those where there are directly competitive services; there are few such opportunities in what is predominantly an end-to-end merger as is here proposed.)

But a larger issue must be faced: when fuel prices decline and economic growth is restored, both of which will surely happen, what of these "reasons" then? You will not be able to un-scramble the egg. And if these were not valid bases for consolidating, how much will the public suffer in future because of higher fares and reduced services as a result of the merger having taken place?

I would like to conclude with three, more general, observations. First, the recent withdrawal of Continental Airlines from negotiations with United is of considerable importance in the present context. Note that Mr. Kellner, Continental's CEO, prominently cited "cultural" differences as a reason for not going forward. One has to admire Mr. Kellner for his candor which is of benefit to you and, indeed to all of us, because cultural differences do matter in mergers between firms, especially where they serve the public with a "soft", personal product.

Second, what, if any, has been the role of hedge funds in the present urge-to-merge of several airlines? After all, how can this question be ignored when a fund named Pardus, out of whole cloth, announced to the world some months ago that Delta and United were negotiating, after which both carriers quickly and firmly denied. Was this an attempt to manipulate the share prices of one or both companies? Shouldn't the SEC be alert to the possibility, even probability, that this is an emerging pattern?

Finally, there is the issue of how do you hold the merged firm to the representations made in order to gain approval to join? Will the system be maintained as promised? If not, what, can be done? I don't have an answer. I hope you do.

Thank you for your attention and for the opportunity to appear before you today.

## STATEMENT OF HUBERT HORAN
## THE ANTI-COMPETITIVE RISKS OF A DELTA-NORTHWEST MERGER AND EXTREME CONSOLIDATION OF INTERCONTINENTAL AIRLINES

HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
AVIATION SUBCOMMITTEE HEARINGS 14 MAY 2008

Mr. Chairman, the Delta/Northwest merger is part of an organized movement towards extreme consolidation of large Intercontinental airlines. My belief that these mergers will be bad for consumers and bad for the future economic efficiency of the industry is based on 25 years of experience as to how these airlines actually compete and how these types of mergers actually work. In my testimony today, I'd like to focus on the primary sources of the threat to consumers and competition, and why I believe that these mergers can only be financially justified by artificial profits from anti-competitive behavior.

Overview—The Anti-Competitive Risks of Megamergers and Intercontinental Consolidation

- Delta/Northwest and other Megamergers can not be justified by synergies and improved efficiencies; profits from Megamergers will come from highly anti-competitive behavior. The anti-competitive gains will occur in two stages--anti competitive pricing on the North Atlantic made possible by the permanent elimination of competition, followed by serious distortions to domestic US competition
- In the first stage, healthy competition between the US and Europe is completely eliminated, replaced by a duopoly of two collusive alliances, led by Air France and Lufthansa, controlling 90% of all traffic to Continental Europe and a third collusive alliance, led by British Airways, controlling over 60% of all traffic to the UK.
  - "Collusive alliances" are those where airlines have antitrust immunity to collude on prices, capacity, service and marketing (functioning as a single competitor), and where the collusive alliance has the same antitrust implications as a full merger. Other airline alliances that do not have antitrust immunity do not have the same antitrust implications.
  - The Delta/Northwest and United/USAirways mergers focus on the US-Continental Europe market, a highly profitable, strongly growing market of over 30 million passengers that had very healthy competition with low concentration levels as recently as five years ago.

Hubert Horan has been in aviation for 25 years, and offers both the perspective of an analyst who has published extensively on airline competition issues and the first-hand experience working with over a dozen major airline mergers, alliances and restructurings. In addition to consulting work with over 25 carriers, he held strategic planning and network management positions at Northwest, America West, Swissair and Sabena, and was responsible for the original development of the Northwest-KLM alliance network. His articles have analyzed the financial crisis and restructuring of Legacy airlines in both America and Europe, the negotiations leading to the recent US-EU Open Skies treaty, and the competition and economic issues behind recent calls for industry consolidation. He is a graduate of Wesleyan University and the Yale University School of Management and is based in Phoenix, Arizona.

Recent Publications on Airline Competition and Consolidation include:
"Top Ten False Claims About the Need for US Airline Mergers" (Business Travel Coalition, Jan 2008)
"Airline Consolidation: Myth and Reality" (Aviation Strategy, November 2006)
"Update on Industry Consolidation and EU-US Treaty Negotiations" (Aviation Strategy, March 2007)
"Why the US Industry is at a stalemate" (Airline Strategy, January 2005).
"The EU-US Open Access Area" (Aviation Strategy, July 2003)
"United and American: are the turnaround plans viable?" (Airline Strategy, March 2003)
"What is the future of the European Flag-Carrier--An analysis of emerging European business models" (Aviation Strategy, September 2002).
"Is the Big Hub Business Model still viable?-The US network carrier crisis"(Aviation Strategy, July 2002)

- Following approval of the Delta and United mergers, a new collusive alliance is expected to be proposed between British Airways and American (and possibly Continental) that would immediately control 50-70% of the US-UK market. It would not face competition from anyone with more than a 10-12% share, and neither of the two European Duopoly groups would have any incentive to compete aggressively.
- At that point, three collusive groups---the Air France and Lufthansa led groups focused on Continental Europe and the British Airways led group focused on the UK market—will control over 95% of the entire Transatlantic market. Every US Legacy carrier will be a member of one of the three groups. There is no possibility of significant future competitive entry. Healthy, dynamic competition on the North Atlantic will have been completely replaced by airlines groups with full antitrust immunity to collude on pricing, capacity and service levels.
- With overwhelming market dominance and huge entry barriers, the three collusive alliances will be able to raise prices at will for many years to come, with no possibility of marketplace or regulatory discipline.
- This anti-competitive behavior will create a ongoing stream of artificial super-normal profits, large enough to totally justify the costs and risks of these mergers, and to bolster the financial returns of these companies. The improvement in airline profits will have come from price gouging made possible by the elimination of competition and not from synergies, efficiencies, improved service or increased productivity.

- In the second stage, the Megacarriers will use profits from gouging Transatlantic consumers to weaken and distort competition in the domestic market
  - Megacarriers will quickly distort every domestic market where the megacarriers compete with airlines that don't serve intercontinental markets. In Atlanta, Delta competes directly with Airtran which has much lower costs on many domestic routes. But Delta can use the artificial profits from Intercontinental markets to subsidize its domestic flying, blocking Airtran's ability to profitably grow in Atlanta, completely undermining the way competitive markets are supposed to work. Similar threats exist in any markets where the megacarriers compete with JetBlue, Southwest, Hawaiian, Alaska or any other domestic carrier
  - The megamergers would create a situation where 3 or 4 companies control 80% of the total US airline revenue and 100% of many important sectors where low cost carriers do not compete, including most mid-sized and smaller cities, and the large "fortress hub" cities such as Newark, Minneapolis and Cincinnati. While this would not directly create the artificial pricing power one would immediately see on the North Atlantic, it would seriously undermine the competitive market dynamics that have existed since deregulation. These carriers would now be "too big too fail"—lenders and local communities could not afford the costs of any financial or operational breakdowns. Competitors or capital markets would have little ability to discipline bad management or bad service. Costs will rise and quality will deteriorate over time, but no market or regulatory mechanisms will be able do anything about it.
- Over time, extreme consolidation would undermine competition in other intercontinental markets such as Asia, the Middle East and South America. The three collusive megacarrier groups would control all network airline service within the United States and the European Union. Thus any other intercontinental airline would find it increasingly difficult to compete for traffic in the world's two largest and most important markets. Carriers such as Japan Air Lines, Singapore Airlines, Emirates and many others would be forced to limit service to large gateway cities, or to join collusive arrangements with the three megacarrier groups on unfavorable terms.

The balance of this testimony will be limited to the immediate (first stage) risks to consumers from anti-competitive pricing on the North Atlantic, and the antitrust issues raised by the Delta and United merger applications, and will not discuss the serious second stage domestic competitive risks. The following sections will outline the evidence demonstrating the strong existing movement towards extreme concentration, and the evidence of specific actions taken to undermine competition.

1. Delta/Northwest and Other Megamergers Can Not Be Justified By Synergies and Improved Efficiencies

Mergers that significantly reduce competition can sometimes be justified if they produce clear, verifiable efficiency gains that could be passed onto consumers in the form of lower prices, expanded service, innovation or improved quality. The claims that Delta/Northwest and United/USAirways will produce billions in synergies lacks credibility and will not survive any serious, independent scrutiny.

- Megamergers will not achieve cost savings. Delta, Northwest, United and USAirways just went through years of draconian cost cutting while under bankruptcy protection. The overhead and fat was eliminated years ago.
- Megamergers cannot achieve savings from increased scale economies. It is ludicrous to argue that Delta and United are not large enough to be competitive.
- Because of the hugely complex implementation process, Megamergers will actually increase costs and worsen cash flow for several years. The cost of integrating reservations, operations control and maintenance system will easily wipe out most savings from firing redundant staff.
- Some network synergies may be achievable, but the magnitude of revenue synergies needed to economically justify this merger would require both major hub restructuring and major new growth, and these mergers will not achieve either. Delta management has clearly indicated that the size of the combined network won't change, and the size and roles of the individual hubs won't materially change. Tweaking a few routes here and there will not drive billions in revenue away from the competition. Repainting Northwest's red airplanes into Delta Blue will not give consumers any new services or choices that they don't have today.
- The Delta and Northwest networks have enormous overlaps. Claims that this is an "end-to-end" merger are false. The two networks overlap across all of North America, the entire North Atlantic, and from the US to Japan, Korea and China. True "end-to-end" benefits are limited to extremely tiny markets such as South Carolina to Southeast Asia, and North Dakota to South America. Isolated schedule improvements are possible, but most will quickly be neutralized by the United/USAirways merger and other competitive responses.

As shown in Appendix A, almost every US airline merger since deregulation (including every merger remotely comparable to these megamergers) has been a dismal financial failure. Like all of the failed mergers, the proposed Delta/Northwest and United/USAirways mergers have wildly underestimated implementation costs and risks and wildly overestimated cost savings and network synergies. If mergers cannot generate sufficient synergies to provide a return on the capital "invested" in the merger, it cannot possibly provide additional gains to consumers to justify the reduction in competition.

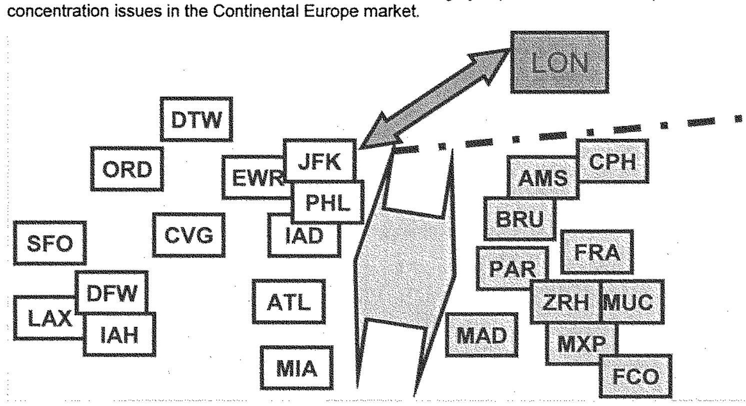
The synergy/efficiency issue involves factual questions that must be one of the first priorities of the Department of Justice investigation. Approval of these megamergers should not be granted unless Delta and United fully document their synergy claims and find a way to convince independent, objective experts that these billions in efficiency gains are readily achievable, and how they uncovered synergy opportunities that no previous airline merger had ever been able to find. Past DOT decisions have taken airline claims of synergy at face value, without any attempt to independently evaluate whether claims had been inflated by gains that would have occurred without the merger, whether all implementation and transaction costs had been properly included, or to understand the legitimacy of merger synergy claims in light of the horrible historic track record of past mergers.

Delta and United have no hope of achieving the synergies they have forecast, but they were never the real source of merger profits.

2. <u>The US-Continental Europe Market is Large, Growing, Highly Profitable and Never Needed Mergers.</u>

- The USA-Continental Europe Market that is the central focus of the Delta/Northwest merger is a large, healthy, highly profitable market that was never in any need of mergers or a major competitive shakeout. It is one of the largest international markets in the world, with over 30 million passengers each year. The market grew at an annual average rate of 4% over the last 15 years, and grew at an average rate of 6% in the last 4 years
- Intercontinental markets have been the most important recent source of airline profitability and growth; they have significant entry barriers and there has been very little growth in the number of competitors over the years. Domestic US, intra-EU and similar shorthaul markets have few entry barriers, and have experienced strong actual entry and price competition, leading to overcapacity and poor profitability. Mergers such as Delta/Northwest and United/USAirways could not address these domestic problems without major capacity cuts and hub restructuring, which would not be possible outside of bankruptcy protection. Advocates of "industry consolidation" focus on domestic competition hoping to create the impression that Megamergers pose no threat to consumers (because of abundant existing competition) and to divert attention from the much more restrictive and profitable longhaul markets where consolidation poses much greater threats to consumers.

- The USA-Continental Europe Market is a highly integrated market that can only be served by large hubs and cannot be served by "point-to-point" airlines
    - only a very tiny fraction of market demand is in city pairs (such as New York-Paris) large enough to support nonstop widebody service without heavy reliance on connecting feed traffic.
    - because of the highly fragmented O&D markets, because of entry barriers at the largest transatlantic airports (Newark, Kennedy, Paris, Frankfurt, etc.) and because of the need for a large fleet of modern widebody aircraft, there is no possibility that low cost carriers such as Southwest, Jetblue, Ryanair or Easyjet could ever enter the market and establish a meaningful overall US-Europe competitive presence.
- The hub-based US-Continental Europe market must be considered separately from the US-UK/Ireland market, which is exclusively served by nonstop flights, predominately to London. Nobody flies from the US to London, Glasgow or Dublin via Paris or Amsterdam. British Airways no longer seriously competes for US-Europe traffic. For the last decade it downsized transatlantic aircraft that used to carry low-yield European connecting traffic and has reallocated its Heathrow slots to more profitable uses. Competitive and concentration issues in the UK/Ireland markets are largely separate from the competition and concentration issues in the Continental Europe market.



3. EU-Continental Europe Concentration Levels Have Dramatically Increased Since 2004 and the Drive Towards Permanent Market Duopoly Is Nearly Complete

The chart below uses various common measures of concentration to illustrate the radical shift away from healthy, profitable competition that began in 2004, and the permanent duopoly concentration that consumers will face after these Megamergers are implemented.

**Healthy, Profitable Competition**
**even as Alliances grew**

Rapidly Increasing Concentration after 2004

**Permanent Duopoly** with huge entry barriers

US-Continental Europe concentration levels

| | 1993 | 1995 | 1997 | 1999 | 2001 | 2003 | 2005 | 2007 | 2009(?) |
|---|---|---|---|---|---|---|---|---|---|
| top 2 share | 32% | 38% | 44% | 45% | 50% | 55% | 77% | 76% | 92% |
| top 3 share | 41% | 47% | 55% | 56% | 61% | 67% | 85% | 86% | 97% |
| top 4 share | 51% | 56% | 64% | 63% | 68% | 74% | 92% | 93% | 99% |
| # competitors with minimum departure share of | | | | | | | | | |
| 5% | 7 | 7 | 6 | 6 | 7 | 6 | 4 | 4 | 2 |
| 2% | 12 | 12 | 10 | 10 | 10 | 8 | 5 | 5 | 3 |

Departure share of the US-Continental Europe market, DOT Form 41 T100 data

forecast 2009 levels assume the elimination of Continental as an independent competitor

The US-Continental Europe market enjoyed vibrant competition with low levels of concentration until 2004. Increases in concentration through 2003 reflected the normal workings of a dynamic market and posed no threat to consumers.

- The three original alliances with antitrust immunity to collude on price and service (KLM-Northwest in 1993, Delta-Swissair-Sabena in 1995 and United-Lufthansa in 1997) developed without damaging the overall market dynamic. Although the alliances initially reduced the number of competitors, they developed in an environment with low concentration, and consumer losses from collusion were offset by improved schedules and expanded price discounting in alliance markets, and by the major expansion of two smaller competitors, (Continental at Newark, USAirways at Philadelphia).
- Several carriers exited the market in the decade prior to 2004, but these were either the weakest/worst run competitors (Pan Am, TWA, Sabena) or extremely small carriers linking up with one of the larger groups.

The shift to extreme consolidation was triggered by the Air France-KLM merger in 2004. Prior to Air France-KLM, there were six strong, viable competitors in the market. The Air France and Lufthansa groups each had 20-25% of the market, the KLM-Northwest alliance had 10-15%, three large US carriers—American, Continental and USAirways, each had 5-10% of the market, and various smaller niche carriers competed independently. Because each carrier (or alliance) had a slightly different geographic focus, actual levels of competition were even higher than these aggregate numbers suggest. The KLM alliance was fully competitive with the Air France and Lufthansa alliances for traffic from the large pool of "interior" European and US cities. Continental, American and USAirways were strong competitors in the larger O&Ds from the US to the main European gateways.

The 2004 Air France-KLM merger was designed to destroy this healthy competition by making it impossible for most mid-sized airlines to remain competitive, and forcing the market towards an inevitable Air France/Lufthansa Duopoly. The entire move towards extreme concentration is explained by mergers and external pressures. None of the movement to permanent Duopoly since 2004 can be attributed to the normal workings of a healthy competitive market.

- The merger eliminated competition from KLM, the profitable #3 Intercontinental competitor in Europe, which provided the major source of price competition against Lufthansa and Air France (the #1 and #2 competitors)
- The merger eliminated the KLM-Northwest alliance as a competitor on the North Atlantic, so that only two US airlines could possibly have access to the huge European traffic base beyond the large gateway hubs
- Northwest was no longer viable as an independent competitor, although sham competition was "preserved" with an interim agreement to maintain the appearance of an "independent" KLM-Northwest entity in the market. Northwest faces a "merge-or-die" dilemma at the end of this interim agreement, since it would have to abandon most (if not all) of its profitable European flying without an collusive alliance arrangement, and the loss of this large, profitable network could easily drive Northwest back into bankruptcy.
- Other mid-sized competitors including USAirways, Austrian, LOT and Aeroflot felt they had no choice but to sign up as junior members of the Air France or Lufthansa groups, and the European Union actively supported these efforts towards higher concentration. Swiss and Alitalia were forced into these groups as part of efforts to stave off financial difficulties.
- American Airlines found it increasingly difficult to compete for Continental Europe traffic against the growing dominance of the Air France/Lufthansa led groups and its market share declined from 11% in 1995 to 7%. The Air France and Lufthansa groups also discontinued many interline agreement with smaller competitors, blocking these carriers access to connecting traffic.
- Continental and Iberia, the only other carriers with a market share greater than 2%, were under constant pressure to merge with one of the Duopoly partners.

4. The Delta and United Mergers Are Part of a Concerted, Well Organized Five Year Effort To Eliminate Competition on the North Atlantic

The rapid movement from healthy competition to extreme concentration between the US and Continental Europe since 2004 did not result from "market forces" such as the exit of uncompetitive carriers or the rapid growth of highly productive airlines. It resulted from proactive, carefully planned efforts by the European Union and the largest carriers to artificially reduce competition and increase concentration. Major steps in this proactive campaign included:

- Early this decade European Union aviation policy shifted from a hands-off "led the market decide" view of airline competition, to an active advocacy for mergers between Intercontinental airlines, and support for Air France and Lufthansa (and to a lesser extent British Airways) as "national champions" in their competition with Intercontinental airlines based outside Europe.
  - While the EU's advocacy is stated in terms of favoring "industry consolidation", it has only taken active steps in the longhaul Intercontinental sector (which is highly profitable, and where there had never been any significant growth in the number of competitors) while largely ignoring the shorthaul intra-European market, which experienced explosive competitive entry in recent years, and is arguably much more fragmented, much less profitable, and is hypothetically much more in need of "consolidation")
- With the active support of the EU, Air France acquired KLM in 2004, immediately driving a major reduction in Intercontinental competition
  - As noted earlier, the merger eliminated the major competitor to the Air France/Lufthansa Duopoly, made it impossible for more than two US airlines to have access to the majority of the European market (cities that were not major intercontinental gateways), eliminated the possibility of serious competition from Northwest and most other mid-sized competitors
- The European Union actively campaigned for other EU Intercontinental airlines (such as Iberia, Alitalia, Swiss, LOT and TAP) to join either the Air France or Lufthansa led collusive groupings, and aggressively opposed Ryanair's efforts to enter the North Atlantic via a merger with Aer Lingus

- The EU was willing to subvert traditional antitrust standards out of explicit favoritism to Air France and Lufthansa. Even though the Air France-KLM merger eliminated competition in tens of thousands of Intercontinental markets their antitrust review looked at nothing except a tiny handful of nonstop O&Ds. When the Aer Lingus-Ryanair merger threatened to establish a new low fare Intercontinental competitor, they used radically different antitrust standards, banning the merger by claiming that the simple reduction in the number of market competitors was an irremediable violation of competition law.

- A major press/public relations campaign in the United States advocating "industry consolidation" was spearheaded by United Chairman Glenn Tilton
  - As with the EU's campaign, the claimed need for "industry consolidation" was strictly limited to profitable, high entry barrier Intercontinental markets, not to the more intense competition in most domestic US markets.
  - All of the public advocacy of "industry consolidation" in the last five years has come from either the EU, the dominant airlines in the emerging Air France/Lufthansa led groups, or Wall Street analysts beholden to those airlines. There has been no support for Intercontinental "industry consolidation" from small or mid-sized airlines in America or Europe, from Intercontinental airlines based in Asia, the Middle East or South America, or from any independent economists or industry analysts.
- Air France began an active drive for its US partner (Delta) to acquire Northwest, Lufthansa began an active drive for its partner (United) to acquire Continental, the last remaining independent competitor on the North Atlantic
  - Air France and Lufthansa were the only two parties to ever express a willingness to invest in either of these two mergers
  - Delta's claim that the Northwest merger is a response to today's high fuel prices is false; it had been conceived and planned when fuel prices were less than half of today's prices
- The European Union delayed agreeing to a new Open Skies treaty with the United States for over five years while it demanded (unsuccessfully) the right for Lufthansa and Air France to take much larger ownership positions and to directly control the management of their US partners
  - This five year delay kept the EU in violation of a 2002 European Court of Justice ruling which had invalidated traditional bilaterals that did not grant equal rights to all EU-based airlines. The final 2007 treaty was virtually identical to terms that the United States would have accepted in 2002 but for the EU's pursuit of full Transatlantic mergers
- Following the Delta (Air France) and United (Lufthansa) applications, industry observers have long expected that British Airways and American would apply for the same full antitrust immunity on North Atlantic services that the Air France and Lufthansa led groups enjoy.
- Recent events follow the pattern of a careful PR strategy designed to minimize public awareness and discussions about extreme concentration. By announcing Delta-Northwest first, fewer alarm bells about "competitive issues" (compared to other Megamergers) because of superficial appearances about domestic route overlap and slots at constrained airports. If press reports emphasized claims that Delta/Northwest didn't require serious antitrust review, there would be less pressure for a rigorous, independent analysis of the Delta's claims and the actual consumer and competitive impacts. Rapid approval of Delta/Northwest makes the approval of all subsequent Megamergers virtually certain. If Delta's claim of huge synergies and efficiencies driven by increased scale and network scope is accepted, there would be no plausible basis for denying the same benefits to United. Once the immunized Air France and Lufthansa led groups have secured permanent dominance of the Continental Europe market, there is no logical basis for denying immunity for similar collusive practices to American and British Airways.

In five years, these actions will have transformed the Transatlantic market from one with vibrant, profitable competition, to one where three collusive groups will have permanent control of over 95% of all traffic, and will have the ability to raise prices at will without the possibility of any competitive or regulatory discipline.

The "endgame" of this five year process is the question of whether Continental Airlines joins the Lufthansa led group (via either collusive alliance or merging with United) or whether it joins the British Airways-led collusive group focused on the UK market. United/Lufthansa aggressively pursued the merger option for four years, knowing this would eliminate the last independent competitor on the North Atlantic and give the Lufthansa group a market share edge over the Air France group. While Continental decided not to take on the enormous risks of a full United merger at this time, it remains extremely unlikely that it would remain independent--its current 10% market share would be not be sustainable over time against an 85% Duopoly position. Whether Continental decides to join one of the collusive groups on an alliance basis, or decides to wait until more favorable terms for a United merger, the result would lock-in permanent control of the North Atlantic for the three collusive groups.

Potential Impact of Megamergers on Transatlantic Concentration Levels

| Continental Europe | 2003 actual | | 2009 post-merger | UK/Ireland market | 2003 actual | | 2009 post-merger |
|---|---|---|---|---|---|---|---|
| AF group | 30% | LH group | 48% | BA | 33% | BA group | 63% |
| LH group | 26% | AF group | 44% | AA | 18% | LH group | 11% |
| KL group | 11% | BA group | 6% | VS | 12% | VS | 11% |
| AA | 7% | other | 2% | UA | 11% | AF group | 9% |
| CO | 7% | *assumes CO joins LH* | | CO | 8% | EI | 4% |
| US | 5% | | | DL | 5% | other | 2% |
| other | 15% | Duopoly | 92% | EI | 5% | *assumes CO joins BA* | |
| | | | | US | 5% | | |
| | | | | other | 3% | | |

2003 data from DOT Form 41 T100

5. <u>Megamergers Fail Every Important Antitrust Test</u>

Megamergers and the extreme consolidation of Intercontinental airlines violates all of the following basic tests used to evaluate whether mergers that eliminate competition might be in the public interest

- Is concentration increasing in markets with low entry barriers?
  - NO—these transatlantic markets have huge barriers to new entry—there is absolutely no possibility that future entrants could ever achieve the market presence needed to discipline anti-competitive abuses by either the Air France/Lufthansa led Duopoly in Continental Europe or the prospective British Airways led group in the US-UK market
- Is concentration increasing because of marketplace success?
  - NO—all of the movement towards extreme concentration since 2004 results from mergers and government interference favoring the interests of the very large carriers over the broader interest of consumers or industry efficiency. None of the movement towards Duopoly since 2004 results from carriers with lower costs, more efficient operations, lower prices or superior service displacing less productive, less competitive airlines.
- Can regulators rely on "market forces" to discipline any future anti-competitive behavior?
  - NO—these markets are not "contestible"—the Air France/Lufthansa Duopoly would be permanent, as would be the dominance of the prospective British Airways/American/Continental collusive alliance
- Would marginal losses in competition be offset by efficiency gains, that could yield tangible consumer benefits in terms of lower prices or improved service?
  - NO—at the carrier level, true synergies and efficiencies are very limited, and could not possibly justify the cost and risks of these Megamergers to the carriers shareholders, and thus could not possibly provide tangible consumer gains offsetting the loss of competition. The carrier claims about synergy/efficiency gains cannot be taken at face value since no comparable airline merger in North American history has ever justified shareholder costs (much less risks to consumers) based on synergies and efficiency gains.
- Would mergers lead to a shakeout of structurally uncompetitive, unprofitable industry capacity leading to a much more efficient allocation of capital across the industry?

- NO—at the industry level, Megamergers and extreme industry consolidation are designed to make the shakeout of unprofitable industry capacity more difficult and to increase the misallocation of capital. Delta management is committed to retaining all of its unprofitable domestic capacity. The market capitalization of Delta and Northwest fell by $1 billion after the merger announcements because Wall Street felt that the merger would make needed capacity changes more difficult. By using artificial North Atlantic profits from anti-competitive pricing to distort domestic competition (as discussed earlier), Megamergers would make competitive and capital misallocation problems across the industry even worse.

- Would mergers create clear, tangible service and pricing improvements for consumers?
  - NO— these mergers are explicitly designed to screw consumers. The entire economic rationale depends on artificial pricing power. If you take away the anti-competitive impacts in International markets Delta and United would have no interest in a merger. If these Megamergers are implemented prices will increase and service will continue to decline, especially to Europe. Consumers will have fewer choices. Consolidation will not drive meaningful improvements in schedule frequency or hub operations. Over time the loss of market competition will lead to a steady deterioration in service, cost efficiency and innovation.

6. Extreme Consolidation on the North Atlantic Could Not Have Happened Without Direct Government Interference With Open-Market Competition

"Market Forces" did not drive the rapid movement from healthy competition and low concentration to permanent domination of the European market by a Duopoly of collusive groups and permanent domination of the UK market by a third collusive group—it was driven by the carriers, themselves, in pursuit of profits from market power and anti-competitive pricing. But it could never have happened without the full support of the European Union and the US Department of Transportation. As noted earlier, the EU's made an explicit, public policy decision to abandon its previous focus on the general public interest in open-market Intercontinental competition and to actively intervene in airline competition and industry structure in favor of the interests of the shareholders of Air France, Lufthansa and British Airways. EU decisions and actions over the last five years have been clearly aligned with its stated pro-"industry consolidation" and pro-"national champions" policies. However, the DOT's ongoing support for artificial consolidation has not been based on any stated policies, and has not been the subject of public comment and review much less Congressional oversight.

DOT has approved, with minimal analysis or review, every Legacy carrier application to increase North Atlantic market concentration in recent years, including every requested expansion of Lufthansa/United antitrust immunity to a wider group of airlines, and the recent merger of the previously independent Air France/Delta and Northwest/KLM alliance. It is unclear whether these decisions represent gross negligence on the DOT's part (a total disinterest in protecting the public interest in healthy market competition, or a refusal to assign the required resources and expertise needed to address these issues) or a willful attempt to undermine existing competition policies in favor of the interests of companies like Delta. At no point in any decision or analysis has the DOT acknowledged either the clear historical evidence of rapidly growing consolidation since 2004 (as shown in the table in section 3), or publicly acknowledged the possibility that extreme consolidation might threaten consumers, or attempted to define any objective analytical framework for evaluating the tradeoffs between increasing airline concentration, industry competition and efficiency, and consumer welfare.

The DOT issues are illustrated by its recent decision on Air France's application to merge the Air France and KLM alliances (Docket OST-2007-28644). It rapidly rubber-stamped the alliance merger without any scrutiny of merger claims and without any attempt to independently analyze any of the competitive/consumer issues, and would be extremely dangerous to assume to use it as precedent in future cases . The two alliances that were "merged" by this decision have greater route overlap and would achieve higher concentration in their core markets than a merger between United and American at Chicago would achieve, but the DOT failed to conduct anything similar to the serious merger/antitrust analysis such cases would require.

- DOT totally ignored all historical evidence of rapidly increasing US-Europe concentration, and the artificial causes of this concentration, and the specific risks that concentration levels this high could lead to anti-competitive pricing behavior

- DOT accepted undocumented carrier claims of consumer benefits and cost efficiencies without any independent objective analysis or any attempt to explain why the alleged gains offset consumer risks from reduced competition, and
    - yet DOT rejected evidence of higher prices and other anti-competitive behavior because it didn't provide definitive proof of "a substantial reduction in competition"
- DOT deliberately ignored the consumer risks created by high barriers to entry, asserting that "Open Skies" treaty conditions automatically ensured fully contestible market conditions
- DOT deliberately understated actual concentration impacts by including the separate 10 million passenger US-London market (which KLM and Air France have never served)
- DOT ignored the fundamental economics of the DL/AF/NW/KL hub-based networks by ignoring the extreme concentration of the connecting markets that drive US-EU competition. Aside from its deliberately understated comparisons of aggregate Transatlantic shares, its only competitive analysis (simple tables that counted nonstops) was limited to country-by-country nonstop service. Over half of all traffic on Air France/KLM transatlantic flights connect to other cities beyond the gateway. The Air France/Lufthansa Duopoly will control almost 100% of this huge traffic base, and it is a critical factor in Transatlantic competition, but the DOT did not even acknowledge its existence.
- DOT did not consider any evidence except what was presented by the large Legacy airlines

Appendix A

Almost All Mergers Between Large Airlines Since Deregulation Have Been Dismal Financial Failures

In almost every case, airline mergers have failed to generate positive returns for shareholders, which is to say profit improvements (above and beyond what the carriers would have earned absent the merger) that fully justified the financial costs and risks. Mergers that cannot earn positive returns for shareholders cannot possibly justify the risks (from reduced competition) imposed on consumers. The rare successes, involved either
---Major restructuring of hubs whose development had been artificially blocked before deregulation
---Very Small acquisitions that were easily integrated into the parent airline
---Mergers implemented under chapter 11 or bankruptcy-like conditions
The proposed Delta/Northwest and United/USAirways mergers have none of the characteristics of any successful merger and have many of the characteristics of the failed mergers.

| Large Airline Mergers | Category | **Were merger acquisition and implementation costs fully justified by improved profitability?** |
|---|---|---|
| 80: Pan Am/National | 1-Post Dereg | **FAILURE**—NA network largely liquidated |
| 82: Texas Intl/Continental | 1-Post Dereg | **FAILURE**—carrier quickly went bankrupt |
| 85: Southwest/Muse | 2-Quasi-BK | Profitable—cheap acquisition in lieu of MC bankruptcy |
| 85: People Exp/Frontier | 4-Synergy/Scope | **FAILURE**— carrier quickly went bankrupt |
| 86: TWA/Ozark | 1-Post Dereg | Profitable—Restructured STL into a competitive hub |
| 86: Northwest/Republic | 1-Post Dereg | Profitable—Restructured DTW/MSP into competitive hubs |
| 86: American/Aircal | 4-Synergy/Scope | **FAILURE**—OC network totally liquidated |
| 87: Continental/PE/NY/FL | 4-Synergy/Scope | **FAILURE**—carrier soon bankrupt, FL/NY networks liquidated |
| 87: Delta/Western | 4-Synergy/Scope | **FAILURE**—WA network largely liquidated |
| 87: Continental/Eastern | 4-Synergy/Scope | **FAILURE**—CO soon bankrupt, EA network liquidated |
| 88: USAir/PSA | 4-Synergy/Scope | **FAILURE**—PS network largely liquidated |
| 88: USAir/Piedmont | 4-Synergy/Scope | **FAILURE**—US soon bankrupt, PI partially liquidated |
| 94: Southwest/Morris | 3-Small Acquis | Profitable—easy fit with SWA network/operations |
| 99: American/Reno | 4-Synergy/Scope | **FAILURE**—QQ network largely liquidated |
| 00: American/TWA | 4-Synergy/Scope | **FAILURE**—TW network largely liquidated |
| 00: United/USAir (plan) | 4-Synergy/Scope | **FAILURE**—both carriers went quickly bankrupt |
| 05: America West/USAir | 2-Quasi-BK | Jury Still Out—favorable bankruptcy terms, but struggling |

Note: 2000 United/USAir merger reached regulatory review process but was never implemented
All Canadian airline mergers during this time frame were also failures

Merger Categories, based on the economic rationale for pursuing the merger
1—Post Deregulation Network Restructuring: integrating routes and hubs that had been artificially constrained under CAB regulations
2—Quasi-Bankruptcy Asset Restructuring: sale/integration of assets under chapter 11 protection (or a transaction in lieu of chapter 11) where only assets were acquired at highly favorable rates and assets not required post-merger were not acquired
3—Very Small Acquisitions: mergers involving very small fleets, where operations could be easily and quickly integrated into the parent company
4---Cost Synergies/Network Scope—mergers (outside of bankruptcy) justified by cost synergies, scale economies and network scope synergies.
5—Highly Anti-Competitive (no USA examples in the 1980-2005 timeframe) mergers designed to create and exploit market dominance and pricing power in environments with high entry barriers

BTC

# Testimony of Kevin P. Mitchell
# Chairman, Business Travel Coalition
# Before the House Committee on Transportation and Infrastructure, Subcommittee on Aviation

## Regarding Airline Industry Consolidation

**May 14, 2008**

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Mr. Chairman and Members of the Committee thank you for requesting that the Business Travel Coalition (BTC) appear before you today to represent consumer and business traveler interests on the subjects of a potential Delta Air Lines and Northwest Airlines merger and radical U.S. airline industry consolidation. My testimony today is also on behalf of the 400,000 members of the International Airline Passengers Association (IAPA).

Congress must insist that the Departments of Transportation and Justice not focus on the proposed Delta / Northwest merger as a standalone transaction, but rather, the analysis must include implications for the competitive structure of the industry resulting from a radical consolidation of the other major network carriers. Moreover, Congress needs to understand the total consumer costs resulting from massive service disruptions and the degradation of the reliability of the system. The direct, indirect and opportunity costs for mid-size communities that lose efficient connectivity to important business centers around the country and globe need to be quantified.

Importantly, given the existence of federal preemption, and the major airlines' general unresponsiveness to consumers' customer service concerns, fewer competitors will make a bad and costly situation for consumers far worse. The consequences of mergers for the national economy, airlines and consumers must be carefully and deliberately examined. BTC, therefore, applauds this Committee for taking this early and important oversight step.

## I. INTRODUCTION

What is powering the urgency of this merger proposal, and the ones that are sure to follow, is the dangerous idea that they must be rushed through, without careful analysis, in the waning days of the current administration. Urging a rubber-stamping of such a profound change to the competitive structure of the U.S. aviation marketplace, with all that is at stake, is both irresponsible and insulting – to this administration, to the next one and to Congress.

BTC believes there are powerful reasons why these megamergers would be harmful to consumers, and would solve none of the industry's most serious problems. A "rush to judgment" regarding this merger proposal is a sure recipe for failed policy. BTC urges the Committee to examine the consumer and competitive issues very carefully. Over time, and with appropriate econometric and stakeholder impact analyses, concerns that DOT and DOJ might rubber-stamp this transaction would be abated. In the fullness of time, it will be important for Congress to hear from many more industry participants so that it can understand and act on the passionate concerns that so many experts have recently been expressing about airlines' misguided plans to merge.

Airline consumers have an equally vital interest in a functioning competition needed to ensure the most service at the best prices. However, as every Committee Member knows well, and your constituents who fly frequently know, the managements of the legacy airlines have done a terrible job over the last decade in almost every area, including service quality, people management, operational efficiency and returns to shareholders. The managements of Delta and Northwest drove their companies into painful bankruptcies.

When airline CEOs say, "trust us, this megamerger will be great for consumers and solve many industry problems," this Committee needs to respond, "we would fall down in our duty to approve this merger on trust alone." The burden of proof that this merger is good for consumers needs to be on the airlines, and DOT and DOJ should not approve this megamerger unless a very thorough, rigorous scrutiny by independent experts, who are focused on consumers and the public interest, is undertaken.

Without question, the U.S. airline industry has real problems. Some are self-caused, others relate to excessive government tax burdens and mandates, and still others, such as fuel costs and a slowing economy, are of such a nature that the ability of airlines to influence them is increasingly limited. However, these problems should not be used as a justification for rash or pretextural solutions that will not work and will harm consumers. For example, this Delta / Northwest merger will provide near-zero relief vis-à-vis the high cost of jet fuel.

Below is an examination of the key arguments consumers would make in opposition to a Delta / Northwest merger and radical industry consolidation that most experts anticipate would follow.

## II. THE PROMISE OF INCREASED EFFICIENCIES

The claim that a megamerger would produce many billions of dollars in network and costs efficiencies enough to not only provide a reasonable return on a very risky investment, but enough new additional profits on top of that to counteract high fuel prices is absolutely unrealistic. How can there be billions of dollars in untapped cost savings at two airlines that just underwent years of cost cutting in bankruptcy. Likewise, how can one claim huge scale benefits from megamergers unless one believes that airlines the size of Delta and United are too small to be competitive. With respect to Delta / Northwest, how can one accept that there are billions of dollars in revenue synergy when there are no plans to restructure either network?

## III. THE REALITY OF AIRLINE INDUSTRY MERGER HISTORY

Virtually, every large U.S. airline merger in the last 20 years has been a dismal financial failure. The Delta / Northwest proposal emphasizes all of the features of past mergers that have consistently failed and doesn't exploit any of the synergies of the rare mergers that did produce positive returns, e.g., TWA / Ozark and Northwest / Republic. Delta needs to carry the burden of demonstrating how they are going to avoid the disasters of the past, and how they uncovered new sources of merger efficiencies that no other competitor has yet discovered.

## IV. THE PROBABILITY OF CUSTOMER SERVICE DISASTERS

Megamergers create a risk of an operational meltdown that could cripple the nation's aviation system. Fuel prices and the lack of merger-related synergies would create huge pressures to cut corners on implementation spending, creating pressures that would exacerbate conflicts with (and among) employee groups. Difficulties with the integration of complex computer systems and maintenance programs could create problems that made the recent American Airlines' debacle seem unobtrusive. There is simply no way that these airlines can assure Congress, and the communities that rely on dependable airline service, that these problems won't happen and become a permanent and unacceptable part of U.S. aviation. Claims to the contrary represent the triumph of hope over experience. Hope is not a strategy.

## V. THE HIT TO DOMESTIC U.S. COMPETITION

**A. Corporate Buyers' Concerns.** In anticipation of airline merger proposals, and potential resultant industry consolidation, the U.S. General Accountability Office requested of BTC that it survey corporate travel buyers from around the country during the fourth quarter of 2007. Some 60% of buyers were of the judgment that industry consolidation would lead to higher fares. Likewise, 60% felt that customer service levels would decline in such a scenario. Further BTC analysis of the proposed Delta / Northwest merger validated these buyers' concerns in important markets.

In six heavily traveled and important nonstop city pair markets where Delta and Northwest fly head-to-head, these carriers account collectively for more than 85% of all passengers who fly nonstop.

ATL-DTW - 90%
ATL-MEM - 85%
ATL-MSP - 88%
CVG-DTW - 100%
CVG-MSP - 100%
MSP-SLC - 99%

The Herfindahl-Hirschman Indexes (HHIs) in these city pairs, and the increase in them post merger, are off the charts. These services are into and out of airports that are already Fortress Hubs for Delta or Northwest, and the prospect of any entry sufficient to replace the lost head-to-head competition is very remote. As such, a large number of business and leisure travelers face the certain prospect of paying even larger hub premiums than is already the case for citizens of these communities.

**B. Unilateral Effects.** Merged mega airlines will leverage their route structures to dictate terms and conditions (pay more for less) to corporate buyers, even for those airline pairings without significant route overlap. For example, in a combined Delta / Northwest, the new airline would be in a position to insist, that if a corporation wanted any discount on the highly regulated fares and capacity-controlled routes to Asia, it would need to provide significant domestic and international market shares at Atlanta, Salt Lake City, Cincinnati, etc. (The problem is lack of route rights for most carriers and limited capacity, which creates a real lever over corporate customers.) In this example, discounts on the previous domestic Delta routings would be reduced and high-yield business traffic that before would have been available for low-cost carriers, and other competitors on domestic and international routes, would be locked up by the newly created largest carrier in the world.

**C. Coordinated Effects.** Going from 6 to 5 airlines would make fare increases easier to stick, especially if Northwest were absorbed into another large carrier because this carrier has often played the role of the "spoiler." And of course, the problem with fare increases is even more enormous if the industry goes from 6 to 3 super major carriers. United Airlines recently brought back the infamous *Saturday Night Stay* requirement that will virtually fence-off lower-priced fares for business travelers increasing ticket prices by hundreds of dollars. Other major carriers are currently evaluating United's move, and any one of them, unwilling to go along, could scotch the price increase. However, if the industry were to collapse to 3 super carriers, such price moves would be easier to coordinate by an order of magnitude. The pernicious effects of conscious parallelism would become a permanent feature in this new industry competitive structure.

**D. Strategies of Predation.** The resulting mega carriers would fortify their hubs with near-exclusive contracts with corporations and travel management companies, and other well-tested practices such as gate hoarding, schedule bracketing, triple frequent flyer points and travel agency override programs, making the barriers-to-entry for low-cost carriers of the 1990s seem very low. Congress should be concerned with the market power of super-mega airlines and their incentive and means to frustrate new airline entry at hub airports.

**E. Adjacent Market Power.** Congress should be concerned with an industry that could collapse to 3 mega airlines from 6 major airlines with respect to the ability of these mega carriers' ability to drive supplier prices to below competitive rates for travel agencies, travel management companies, airports, global distribution systems, parts suppliers, caterers and all manner of supply chain participants. Likewise, these carriers would have the power to accelerate the transfer of costs onto the backs of consumers. Congress should also view with great concern the increased joint purchasing power of the global alliances (buying groups) with respect to their ability to exercise monopsony power and drive supplier prices below competitive levels.

**VI. COMPETIVE END-GAME**

The primarily objective and dirty little secret of these megamergers is the permanent end to meaningful competition between the U.S. and Continental Europe—two airline competitor groupings would control 80% to 90% of a profitable, growing market of over 30 million annual passengers, where there would be virtually no possibility of new competition. Airlines could raise prices at will without any risk that "market forces" could constrain competitive abuses.

The only rational justification of these expensive, risky mergers is the profits from anti-competitive behavior internationally. All of the public arguments for radical industry consolidation have come from the airlines that would benefit from the permanent strangulation of international competition. All of the potential external funding for Northwest / Delta and United / US Airways would come from the European airlines that would be the leaders of this two-airline duopoly, Air France and Lufthansa. Given today's economy and exchange rates, anything that damages healthy competition and healthy growth of international air travel would be horrible for the U.S. economy.

## VII. THE OPTIONS

A. **Status Quo.** In this scenario, airlines accelerate their own unilateral reductions of uneconomic capacity and continue to address cost issues and efficiency issues with respect to optimizing fleet, network structure, information technology, employee relations, operational efficiency, customer service, brand marketing, supplier relationships and capital structure. Indeed, with respect to fleet rationalization, the proposed Delta / Northwest merger would result in complex and costly assemblage of aircraft types, the exact opposite direction the industry needs to go in.

B. **Robust Recovery.** If oil prices should fall back to below $80.00, as many energy experts predict, because of the cost-cutting initiatives of the past few years, the major network carriers could come out on the other side of the current U.S. economic slowdown and experience a robust airline sector recovery.

C. **Mergers.** Mergers of the type and scale being proposed would burn up cash and drive high-yield business travelers away at the worst possible time for airlines.

D. **Break Ups.** One of the major network carriers could be broken up at the direction of shareholders with the assets going to the most efficient competitors.

E. **Liquidations.** If the proponents of "let the market work its will" truly believe what they say, then let a major carrier fail instead of propping them up with government-sanctioned anticompetitive combinations. Antitrust law is not meant to be sympathetic to industries that cannot solve its own problems.

## VIII. THE REMEDIES

The Committee was interested in potential conditions and remedies for DOJ to consider in its decision-making process, in the event that it decides to approve this and other megamergers over a broad range of stakeholders' objections. Here are some of our initial ideas of ways to somewhat lesson what would otherwise be the anticompetitive effects of radical airline industry consolidation:

**A.** As a remedy for passengers who were involuntarily bumped or whose flights were canceled or connections missed due to labor work stoppage or slowdown, airlines would be required to amend their Contracts of Carriage for a 5-year period to increase the level of compensation for denied boarding and afford that same increased level of denied boarding compensation to travelers who missed their flights or had them cancelled in those circumstances.

**B.** As a remedy for passenger disruption and increased risk to passenger safety during an anticipated prolonged period of labor strife, operations integration issues, management team changes and general distraction for senior executives at the mega carriers, for a period of 5 years there would be a moratorium on the further outsourcing of aircraft maintenance.

**C.** As a remedy for the anticompetitive effects of code sharing and alliance antitrust immunity, and in consideration of the global scope and scale of these powerful new mega carriers, code sharing and antitrust immunities would be done away with and replaced with a functioning interlining system.

**D.** As a remedy for the anticipated loss of hub services, or degradation of service to mid-size communities, for a period of 5 years the new mega carrier would not be allowed to reduce the number of seats at its major hub airports.

**E.** As a remedy for the adjacent market power of these new mega carriers, specifically the dramatically increased incentive and means to transfer costs to travel agencies and reduce their compensation--a move that would directly raise the cost of travel for business travelers--the National Labor Relations Act would be amended to expressly permit travel agents to engage in collective bargaining with airlines and with antitrust immunity.

## VIII. CONCLUSION

If these airlines cannot convince Congress that these megamergers will generate many billions more in synergies than any past merger, and if Congress does not believe that they will be flawlessly implemented with the enthusiastic support of all employees, then the only rational explanation for these mergers is the expectation of long-term profits from anti-competitive behavior internationally. This proposed merger, and the highly anticipated United / US Airways combination would have been rejected out-of-hand in the 1980s or 1990s. However, the airlines are hoping that the current administration will quickly rule that a permanent 80% to 90% U.S.-to-Continental Europe duopoly poses no threat to consumers or the public interest.

...

**STATEMENT OF**
**CAPTAIN LEE MOAK**
**CHAIRMAN, DELTA AIR LINES MASTER EXECUTIVE COUNCIL**
**AIR LINE PILOTS ASSOCIATION, INTERNATIONAL**

**BEFORE THE**
**SUBCOMMITTEE ON AVIATION**
**COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE,**
**UNITED STATES HOUSE OF REPRESENTATIVES**

**WASHINGTON DC**

**May 14, 2008**

# THE IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES

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DELTA

STRONG · FOCUSED · SAFE
ALPA 75 Years
OF PILOTS IN COMMAND

**STATEMENT OF**
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**BEFORE THE**
**SUBCOMMITTEE ON AVIATION**
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**UNITED STATES HOUSE OF REPRESENTATIVES**
**ON**
**THE IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY,**
**WITH A FOCUS ON THE PROPOSED MERGER BETWEEN**
**DELTA AIR LINES AND NORTHWEST AIRLINES**

**MAY 14, 2008**

Mr. Chairman, Ranking Member Petri, and members of the Committee, thank you for providing me the opportunity to testify in today's hearing on the "Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger between Delta Air Lines and Northwest Airlines."

My name is Lee Moak, and I am a Captain with Delta Air Lines. I am also the chairman of the Delta Master Executive Council of the Air Line Pilots Association (ALPA), the governing body of the union that represents the over 7,300 pilots of Delta Air Lines. I have flown for Delta for over 20 years. Prior to my career at Delta, I served this nation as a United States Marine Corps fighter pilot, and as I joined Delta, I transitioned to the Naval Air Reserve Force to finish my military career as a US Navy fighter pilot. At Delta, I was one of the many airline pilots who volunteered to transport our troops to the Middle East on Delta aircraft as part of our country's Civil Reserve Air Fleet (CRAF), a crucial program that allows for the rapid mobilization of our nation's civil airlift resources to meet Department of Defense force projection requirements as demonstrated in Operation Desert Storm/Shield and Operation Iraqi Freedom.

I mention my military credentials because, as I continue, I want to emphasize that I am proud of my service in defense of our American way of life and its free market economy.

Our nation's aviation industry is unique, and careful government scrutiny and oversight must ensure that any potential industry consolidation is in the best interests of the traveling public. It is for this reason that, as a union leader, I welcome this opportunity to testify in *support* of the proposed merger between Delta Air Lines and Northwest Airlines.

===========================

Since 2001, our country's airline industry has been through the worst seven years of its existence, and many challenges loom on the horizon. The protectionist union mindset must change if our industry is to survive, and more importantly, thrive. While that statement may seem paradoxical coming from a labor leader, it is not. My goal, and that of our union, is that our pilots be provided with pay, benefits and retirements commensurate with the responsibility and experience we bring to our profession. An airline with the increased potential to be financially healthy with a stable long-term future provides the best opportunity to ensure that happens.

We must find a way to break from our traditional roles while still ensuring we represent the best interests of our members as we help to forge a new future. After all, management teams come and go; it is the employees who stay for a career.

That is why the Delta pilots' union leadership elected to provide our pilots with an alternative to the traditional merger process. We were recently able to reach a consensual agreement with Delta management designed to facilitate the merger while providing financial returns for the value we bring to the transaction.

An important part of that agreement is the *unanimous* commitment on the part of Delta's pilot union leaders that "the Delta [union leadership] welcomes the Northwest pilots as partners in the building of the new merged airline and looks forward to working with the Northwest [union leadership] to bring about the rapid completion of a new joint agreement to take effect on the closing of the corporate transaction providing immediate parity in rates of pay and further providing for a rapid completion of a fair and equitable integrated seniority list to take effect on the effective date of the new joint agreement."

Northwest Airlines MEC Chairman Captain Dave Stevens and I have discussed the importance of commencing negotiations with Delta management in the very near future.

The Delta pilots have a long and proud history of treating each other fairly and acting with the best interests of our fellow pilots in mind, as demonstrated by our successful integrations of the pilots of Northeast Air Lines in the 70's, Western Airlines in the 80's, and Pan Am in the 90's. Make no mistake, once the corporate transaction closes, the Delta and Northwest pilots will *all* be Delta pilots. Our ethics, our integrity and our record of fairness and professionalism *will not* be compromised as we transition to a group over 12,000 strong.

To understand why we are where we are today, it is useful to take a brief look at the recent history of Delta and Northwest and the industry as a whole.

On September 11, 2001, terrorists used commercial airliners as weapons of mass destruction to attack the United States of America. Those horrific events changed our lives forever and also marked the beginning of drastic change for America's aviation industry. In the years that followed, the airline industry was rocked by record financial losses, skyrocketing oil prices (which were a bargain compared to today's prices), increased security costs, and numerous airline bankruptcies and liquidations.

Delta and Northwest were two of the carriers that successfully restructured under Chapter 11 of the U.S. Bankruptcy Code during this timeframe. When Delta and Northwest exited bankruptcy in the spring of 2007, crude oil traded in the mid-sixty dollar per barrel range, and the industry appeared to be on the rebound. But that rebound was short-lived.

Just last week, the price of crude broke through the $126 per barrel mark, an increase of over **90 percent** in the past year, and many analysts predict the cost of crude will continue to rise. Additionally, the nation's economy is suffering, and many economists assert that we are entering a recession; others argue we may already be in recession. The credit markets have become increasingly difficult if not impossible to access. Last month, due largely to the unavailability of debtor-in-possession financing, Aloha, ATA, Skybus and EOS ceased operations; Champion Air announced that it will shut its doors on May 31. Frontier Airlines recently filed for Chapter 11 protection. Legitimate concerns exist about the long-term financial viability of several other carriers, both large and small. The market continues to punish airline stock prices to the point that the sum market capitalization of all six U.S. network carriers is now less than that of Lufthansa.

In short, our nation's aviation industry is now in jeopardy for the second time since the terrorist attacks of September 11, 2001, and if it is to survive, there must be change. The economics of the industry overwhelmingly suggest that the time for *rational and sensible* industry consolidation has arrived.

From its earliest days, airline industry consolidation has been a controversial and often emotionally charged topic. Some will argue that consolidation—any consolidation—must be avoided at all costs, but the fact of the matter is that many of our nation's current airlines—including Delta and Northwest—are themselves products of several consolidating events.

It is my view that each merger must be weighed on its own merits and within the context of the many variables that affect both the involved carriers and the industry itself. Mergers must be evaluated based on the facts, not on the fear and other emotions that so often dominate the discussion.

Just over fifteen months ago, I submitted written testimony to the U.S. Senate Committee on Commerce, Science and Transportation. The committee was holding a hearing entitled "State of the Airline Industry: The Potential Impact of Airline Mergers and Industry Consolidation." At that time, Delta Air Lines was the target of a hostile takeover attempt by US Airways, an attempt which ultimately failed due in large part to the extreme opposition demonstrated by Delta's employees. I submitted my testimony on behalf of the pilots of Delta Air Lines who, along with tens of thousands of other Delta employees, stood solidly opposed to the hostile takeover attempt of our company.

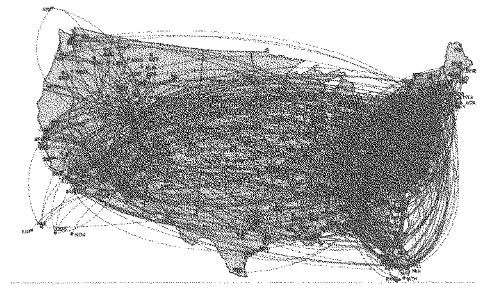
Today, I am submitting testimony on a distinctly different matter, the proposed merger between Delta Air Lines and Northwest Airlines, and I am testifying in *support* of the proposed merger.

While you may ask whether I have changed my position on industry consolidation since I testified last year, nothing could be further from the truth. In fact, the position of the Delta pilots' union has been clear and consistent over time. Last year, in opposition to US Airways' hostile takeover attempt, I wrote:

> Many leading industry experts suggest, and we recognize, that eventually, industry consolidation is not only likely, but probable and perhaps even inevitable. With that in mind, I want to make the following point:
>
> We support a free market solution that includes *rational* industry consolidation; consolidation that does not lead to reduced service, increased fares and other problems for the industry's constituents.
>
> In the future, *sensible* airline consolidation opportunities may occur. If faced with such an opportunity, the pilots of Delta Air Lines are interested in participating in the "right" consolidation effort, a consensual merger with a rational mix of routes, employees and resources, and with the absence of major antitrust and other detrimental issues. The "right" merger opportunity could draw our support and result in a successful merger that benefits everyone involved—the traveling public, the corporations, the employees, and the communities we serve.

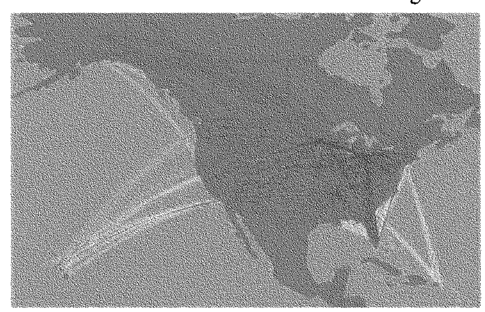
The Delta pilots have consistently asserted that for a merger to draw our support, the combination must produce an even *stronger* and *growing* airline that will vigorously and successfully compete in the domestic and international marketplaces for years to come. After all, a financially viable airline provides the best long-term security and career prospects for all employees including the pilots I represent and is also in the best interests of our passengers.

The proposed merger between Delta and Northwest is far different from the one that would have resulted had US Airways been successful in its attempt to take over Delta. Delta and US Airways are strong competitors in many markets, with large overlapping route structures and several hub city pairs located in close geographic proximity. Had that takeover attempt succeeded, it would have cost thousands of jobs, significantly reduced competition in key business markets, resulted in hub closures and eliminated customer choice, all in the name of a short-term financial gain for a few.



**US Airways/Delta Combined Domestic Route Map**

In contrast, the proposed merger between Delta and Northwest is an "end-to-end" merger with far different dynamics. Delta and Northwest have very little route overlap both domestically and internationally, and in fact have complementary route structures that will *expand* opportunities to the traveling public. Over the months leading up to the merger announcement, the Air Line Pilots Association conducted its own independent analysis which showed that the value in the proposed merger will manifest itself not at the expense of employees, passengers and communities served, but by the synergies of the combined strengths of both carriers. As a result, the merger will serve the interests of the corporation, the approximately 78,000 employees of the merged company, the communities we serve and most important, the lifeblood of our industry, our passengers.



**Delta/Northwest Combined Domestic Route Map**

As a union leader, I would like to discuss the merger from a labor integration standpoint. The stated purpose of this hearing is to investigate the impact of consolidation on the aviation industry, with a focus on the proposed merger between Delta Air Lines and Northwest Airlines. Other congressional committees have conducted similar hearings in recent weeks. The discussion has sometimes turned to issues of union representation. I respect and support the right of my fellow employees to exercise their right to self-determination regarding union representation now and in the future, but this is not a hearing on union representation.

That said, there has been much rhetoric directed toward labor integration issues surrounding the proposed merger between Delta and Northwest, and I would like to provide my perspective. Much of the discussion is based, not on facts, but on emotion and fear mongering by those who purport to speak on behalf of airline workers throughout North America when they do not. The fact is, while some segments of the labor movement have expressed reservations or even opposition to the proposed merger between Delta and Northwest, that sentiment is far from universal.

Some have even suggested that government re-regulation will somehow solve the industry's problems including labor integration issues. I strongly disagree. This global industry is rapidly moving toward less regulation, not more, through open skies agreements and expanded international alliances that have increased competitive pressures worldwide. Globalization *is* our future.

An important operating premise of the re-regulation argument and other similarly misguided arguments is that all consolidation is inherently bad and would never be necessary if airline management teams would simply "manage their airlines." To be clear, I am not and will never be an apologist for airline management. Airline history is rife with examples of gross mismanagement, and that mismanagement has certainly contributed to the woes of this industry. But the other half of the story is that the labor movement has often found it convenient or perhaps even necessary to identify a villain—a villain who can be blamed for all that goes wrong with our industry and our careers, and airline management has often been a convenient target. The price of oil and the condition of the economy are but two of the factors that are beyond the control of either labor or management, yet both can have and are having devastating effects on the industry.

Collectively, we have a choice to make. We can sit back and do nothing and hope that everything will turn out ok—that the price of oil will retreat; that the economy will recover quickly; that consumer confidence will return; that the credit markets will be revived. Or we can be proactive and embrace a rational consolidation strategy designed to provide for a financially stable and investable airline with the prospect for a much brighter future than might otherwise be possible.

In my opening remarks, I acknowledged that careful government scrutiny and oversight must ensure that any potential industry consolidation is in the best interests of the traveling public. I submit that the proposed merger between Delta Air Lines and Northwest Airlines is not only in the best interests of the traveling public, but also the employees of both companies, the communities we serve, our nation's aviation industry and economy.

We look forward to working with all 78,000 employees of the merged Delta as we help build our nation's first truly global airline.

On behalf of the over 7,300 professional pilots of Delta Air Lines, thank you for the opportunity to testify before the committee.

CALYON SECURITIES in association with CLSA ASIA-PACIFIC MARKETS

CREDIT AGRICOLE GROUP

# Airlines

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May 14, 2008 Industry Update

**USA**
**Airlines**

## Airline Mergers: Potential Benefits and Risks

- Ray Neidl presented today on M&A activity in the airline sector to the House Committee on Transportation and Infrastructure Subcommittee.
- Reasons for mergers: the industry remains too fragmented in an era of historically high fuel prices, which is threatening the industry because it lacks ticket price discipline.
- Certain mergers make sense and do not significantly reduce competition if they are end-on-end such as the proposed Delta-Northwest merger.
- The benefits of a merger would include the opportunity to reduce costs, increase the scope of the airlines route system to better serve customers, and enhance revenue through a larger system.
- The main risk is the complications of trying to merge two large and diverse systems, especially in the labor, fleet and computer components. If the two carriers are already in the same alliance, such as Delta-Northwest, this task would be simpler.

There will be industry consolidation one way or another, in our opinion. Either the carriers will be allowed to merge in a logical manner to make the industry less fragmented or eventually certain airlines will fail and possibly liquidate disrupting the careers of employees, disrupting service, and destroying investment capital in the process. Any liquidation of a major carrier would create the same efficiencies as created by a merger, in that surplus seats will be taken off of the market, but it would be in a more disruptive manner.

Airlines would expect to benefit in three main ways through mergers including cost savings through the elimination of duplicate operations, revenue enhancement through synergies from a larger system and stronger pricing power, and increased scope and the ability to attract additional passengers through a broader product line offering (more destinations). The question is how achievable these goals are and in what timeframe could they be achieved.

We do not believe that a merger can be justified only on potential additional revenue synergy of the combined carriers since a large part of any advantage gained would be short-term and neutralized as other carriers merged and evened the playing field. Unit revenue would have to be increased as a result of any merger through tighter yield management and/or price increases resulting from a more stringent control of seat inventory in the industry. Both can be done, we believe, and should strengthen the revenue side of the ledger in the long run.

## Main benefits of Airline Mergers

**Cost Reductions**

- To justify the expense and risk of a merger, cost cuts would be needed. Merging two carriers with route overlap would contribute towards this but would have greater difficulty passing regulatory scrutiny.
- A merger with little route overlap would not produce the major cost savings that investors would be looking for immediately, since the merged systems have to be evaluated as to where costs can be saved and guarantees made at the time of the merger would have to honored for a reasonable period of time.
- Costs may actually be higher in the first year as the two systems are integrated and costs resulting from possible service disruptions during the integration period could add to this.
- A major risk is that in order to get labor support for any combination, wages and benefits might have to be increased, raising overall unit costs and putting a greater cost burden on any merged carrier.
- Ultimately, facilities would have to be consolidated including under-performing or duplicate hubs in order to achieve major cost savings. For political and business reasons this would take time, probably years to accomplish.

**Increased Scope of Service**

- A single carrier cannot serve all areas of the world on its own and, as a result, a system of worldwide partnerships has evolved to meet customers' needs.
- Network airline carriers have been able to serve their customers worldwide through joining one of the three worldwide partnerships, OneWorld, SkyTeam or the Star Alliance. However, it does not offer the complete service as flying on the same carrier does, and the host carrier loses control of the passenger, plus some of the revenue generated by the ticket sale, as it is shared with the partner.
- Being able to keep your passengers on your own product under one name gives the customers a feeling of continuity and would be beneficial in guaranteeing the same level of service and keeping all of the revenue generated by the ticket.

**Revenue**

- In the short-term, the merged carrier would have the ability to enhance revenue through a broader product offering.
- The initial revenue spurt may be short-lived, however, and could eventually be neutralized if other carriers merged and then were able to offer as broad a product line. This conclusion is not totally definitive since all combinations are not equal and a weaker rival merger might not produce as strong as a competitive system.

- The carriers' main benefit from mergers regarding revenue generation in our opinion is that they would, as an industry, have greater pricing power, since a less fragmented industry would have greater control of the seats being offered.

- Long-term, even the advantage of having greater marketing power could be eroded as low-cost carriers move in to fill any voids left by consolidating carriers pulling out of marginal markets or hubs.

- However, strong worldwide airlines with large strategic hubs would be able to service a broad sector of the traveling public through these strengths. Worldwide partnerships, even if they had anti-trust exemption, cannot offer as broad a product line as a single carrier can. By being able to serve the customer in a more cost effective manner, investors would benefit.

### Main Risks of Airline Mergers

**In the past, most airline mergers resulted in a deterioration of service during the initial stages of integration**

Airline mergers tend to be time consuming and expensive. If not properly planned and executed, it can turn into a nightmare of logistics as employee groups, fleets, computer systems, and cultures are merged. In the past, most airline mergers resulted in a deterioration of service during the initial stages of integration, drawing the wrath of the travelling public and ultimately attracting the attention of the politicians.

A major risk would be to have multiple airline mergers trying to be implemented at the same time whereby a large part, if not a majority, of the domestic system is negatively affected as integration takes place.

This is a service industry and employee cooperation is needed to make a merger work. Management may be tempted to buy off labor for their support but in the process raise their costs, which could entirely negate the benefits of any merger. This has to be avoided.

We believe some merger-related problems can be reduced if the two airlines have worked in a partnership before the attempted merger, such as we have in the case of Delta and Northwest. Further, in the case of Delta and Northwest, if they can get a pilot agreement pre-merger, it should make the integration easier but this, as in any merger, still poses some risk.

**One of the main problems in trying to integrate two airlines is meshing the work forces**

One of the main problems in trying to integrate two airlines is meshing the work forces. Ironically, the only U.S. airline merger post-deregulation in 1978 that went fairly smoothly from the beginning was the Delta acquisition of Western Airlines. Good planning and execution were a key part but we believe that fact that Delta was largely non-union made the integration much simpler.

### Is Re-regulation or Nationalization of the Industry the Answer?

Some suggest that the industry should be nationalized or run like a public utility. Our prediction is that we will not have a nationalized airline industry under any circumstances. There will be an airline industry but it will be private and restructured through merger and/or bankruptcy actions. We envision possibly a more 'virtual" structure eventually evolving in which airlines provide the basic service and other functions go to specialized companies such as aircraft leasing, maintenance, possibly marketing and other functions that the airlines currently do themselves.

**What we need is a more rati nal structure of the industry, keeping it c mpetitive but not fragmented**

Politicians of all stripes do not want to get the government involved in this industry since they realize that ticket prices would rise substantially on fewer services and that even taxpayer money may have to be involved. Foreign countries would condemn such a move since they have been going the other way in privatizing their carriers. They are basically tired of having their taxpayers subsidize airline service, and correctly so. A nationalized industry would be a tremendous burden on the taxpayer, non-responsive to consumer needs, inflexible in adjusting to market changes, and become a service for only the wealthy, something that is totally unacceptable in today's political environment. What we need is a more rational structure of the industry, keeping it competitive but not fragmented. Also remember, barrier entries are relatively easy and when the smoke clears we will have a new stream of start-up airlines with their own new unique model, such as Virgin America. Private start-up capital always seems to be available without any government involvement.

**Everyone is in the same boat and they must help the airline by paddling in the same direction as everyone else**

The airlines are not the only ones who will have to learn to adapt. The powerful labor unions, particularly the pilots, will have to realize that cooperation and not confrontation is in their best interests. Everyone is in the same boat and they must help the airline by paddling in the same direction as everyone else instead of trying to poke holes in the boat to sink it. They would drown just as quickly as everyone else. On the other hand, the workers have to have confidence that management is working in their best interests and looking out for them as much as they are looking out for themselves. All parties have to be rowing in the same direction for the mutual benefit of the workers, the company, consumers and the investor.

## IMPORTANT DISCLOSURES

### Analyst Certification

I, Ray Neidl, hereby certify that the views expressed in this research report accurately reflect my own personal views about the securities and/or the issuers and that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report. In addition, the analysts included herein attest that they were not in possession of any material, non-public information regarding the subject company at the time of publication of the report.

RATING RECOMMENDATIONS (based on anticipated returns over a 12-month period): BUY, above 20%; ADD, 10%-20%; NEUTRAL, +/-10%; REDUCE, negative return, but by less than 20%; SELL, negative return of more than 20%. OVERALL RATING DISTRIBUTION for Calyon Securities (USA) Inc., Equity Universe: BUY/ADD - 68%, HOLD - 29%, REDUCE/SELL - 3%, Restricted - 0%. Data as of March 31, 2008. INVESTMENT BANKING CLIENTS as a % of rating category: BUY/ADD - 20%, HOLD - 3%, REDUCE/SELL - 0%, Restricted - 0%. Data for 12-month period ending March 31, 2008. FOR A HISTORY of the recommendations and price targets for companies mentioned in this report, please write to: Calyon Securities (USA) Inc., Compliance Department, 1301 Avenue of the Americas, 15th Floor, New York, New York 10019-6022.
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# Department of Justice

STATEMENT

OF

JAMES J. O'CONNELL
DEPUTY ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON AVIATION
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
U.S. HOUSE OF REPRESENTATIVES

ENTITLED

"IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES"

PRESENTED ON

MAY 14, 2008

**STATEMENT OF
JAMES J. O'CONNELL
DEPUTY ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION
U. S. DEPARTMENT OF JUSTICE
BEFORE THE
SUBCOMMITTEE ON AVIATION
TRANSPORTATION AND INFRASTRUCTURE COMMITTEE
U. S. HOUSE OF REPRESENTATIVES
MAY 14, 2008**

Mr. Chairman and members of the Committee, I am pleased to appear before you to explain how the Antitrust Division evaluates the likely competitive effects of airline mergers. As you know, the Antitrust Division cannot comment on the specifics of any transaction it is currently investigating, such as the proposed merger of Northwest Airlines and Delta Air Lines. In my testimony today, I accordingly will not address the Division's analysis of that transaction specifically. But I am happy to talk about the standards the Division generally applies in evaluating mergers and acquisitions in the airline industry as well as merger and non-merger enforcement actions the Division has taken in the past.

## A Brief History of Antitrust Enforcement in the Airline Industry

Since Congress enacted the Airline Deregulation Act of 1978, the Antitrust Division has pursued an active program of enforcement in the airline industry to ensure that consumers receive the benefits of airline competition sought by Congress. During the first years following deregulation, antitrust jurisdiction was divided between the Division and the Civil Aeronautics Board (CAB). Though airlines were generally subject to the antitrust laws, the CAB retained jurisdiction to review mergers and acquisitions. When Congress sunset the CAB in 1985, the Department of Transportation (DOT) assumed that merger review authority. In the following years, the Antitrust Division played a significant role by investigating the likely competitive effects of proposed mergers and submitting comments to DOT in some proceedings. Effective December 31, 1988, jurisdiction over airline mergers transferred from DOT to the Department of Justice. In the Department's merger review, it works closely with the DOT to benefit from DOT's substantial data and expertise in the airline industry. Since receiving jurisdiction for antitrust review of airline mergers, the Division has actively worked to ensure that mergers that would threaten to harm competition are not permitted to proceed.

In October 1998, for example, the Division sued to block Northwest Airlines from buying a controlling stake in Continental Airlines. Northwest and Continental were the fourth and fifth largest airlines in the United States at the time. They competed on hundreds of routes across the country, and the proposed transaction would have substantially diminished the airlines' incentives to compete against each other. The Division rejected Northwest's plan to put its Continental stock in a "voting trust" for six years as insufficient to prevent the competitive harm likely to result from the acquisition. In November 2000, after trial had begun, Northwest announced it was selling Continental the shares that would have given it control, retaining only a five-percent share. Because the sale of control remedied the competitive harm, the Division dropped its suit.

In 2001, the Division announced its intent to challenge the merger of United Airlines and US Airways, then the second and sixth largest airlines in the United States, after concluding that the merger likely would reduce competition and result in higher fares on routes throughout the United States and internationally. The Division concluded that United's proposal to divest assets at Reagan National Airport and American Airlines' promise to fly five routes on a non-stop basis were inadequate to replace the competition that would have been lost due to the merger. In response, the parties abandoned their merger plans.

The Division has also successfully challenged other transactions that would have eliminated competition between airlines. In 1993, for example, the Division challenged an investment agreement between British Airways and US Airways after concluding that the transaction threatened competition in gateway city pairs and certain connecting city pairs—in particular, service between parts of the east coast of the U.S. and London, England. As a result, US Airways was required to divest its authority to provide service to London from three of its hubs. The Division has also challenged proposed acquisitions of gates or slots that would have eliminated existing or potential hub competition, including Eastern Air Line's proposal to sell a block of gates to US Airways at the gate-constrained Philadelphia International Airport, and Eastern's proposed sale of slots and gates at Washington National Airport to United, which operated a significant hub out of nearby Dulles Airport.

In addition to challenging transactions that would adversely affect market structure, the Division has investigated and challenged collusion in violation of section 1 of the Sherman Act. In 1992, the Division sued Airline Tariff Publishing Co. (ATPCO) and eight major airlines, alleging that the airlines used the ATPCO electronic fare submission and dissemination system to fix prices, which the Division concluded had cost consumers up to $2 billion in travel expenses. And, in an ongoing criminal probe of major international airlines for fixing rates for cargo shipments (including medicines, food, and consumer electronics) and rates for passenger transportation, more than $770 million in criminal fines have been imposed and guilty pleas have been entered by British Airways, Korean Air Lines, Qantas Airways, and Japan Airlines.

In addition to pursuing these enforcement matters, the Antitrust Division also engages in competition advocacy in various matters before the Department of Transportation. For example, the Division has filed comments in DOT proceedings considering whether to approve and grant immunity to all or part of international airline alliances, matters over which DOT retains authority under 49 U.S.C. §§ 41309 and 41308, respectively. It participates with the Departments of Transportation, State, and others in efforts to open international airline markets, and has advocated for addressing airport congestion issues through efficient market-based mechanisms.

All of the Division's efforts in regard to the airline industry have as their goal the assurance that U.S. consumers recieve the benefits of a competitive marketplace.

**General Standards for Evaluating Mergers and Acquisitions**

Many mergers raise no competitive concerns and can benefit consumers. However, certain proposed mergers do raise serious competitive issues. Antitrust analysis is highly fact-specific. In each case, we carefully review the facts and the evidence to determine whether a proposed transaction would violate the antitrust laws. The Antitrust Division reviews airline mergers under section 7 of the Clayton Act. Section 7 prohibits the acquisition of stock or assets "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." The primary focus is to determine the likely competitive effects of a proposed merger in the future.

The Antitrust Division and Federal Trade Commission (the "Agencies") apply jointly developed Merger Guidelines that describe the inquiry the Agencies follow in analyzing mergers. The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power for this purpose is the ability profitably to raise prices above competitive levels (or reduce competition on dimensions other than price, such as product quality, service, or innovation), for a significant period of time. In some circumstances, for example, the sole seller in a market (a monopolist) can charge a price higher than what would prevail in a competitive market. Or, where only two or a few firms account for most sales in a market, they may be able to exercise market power by explicitly or implicitly coordinating their competitive actions. And, in some cases, where the merging firms are the closest competitors to each other for a substantial number of consumers, combined they may be able to exercise market power unilaterally, without coordinating with rivals. The likelihood of such competitive effects depends on the specific market facts.

As suggested by the language of section 7, the Agencies generally assesses likely competitive effects in relevant product or service ("line of commerce") and geographic ("section of the country") markets in which the parties to a merger agreement compete, determining whether a merger would likely lessen competition in those markets. The purpose of this inquiry is to ascertain whether there are alternative products and services to those of the merging parties to which customers could reasonably turn in response to a price increase by the merged firm.

After identifying the relevant markets, the Agencies consider a variety of market factors to determine whether the transaction would likely be anticompetitive. For example, the Agencies consider both the post-merger market concentration and increased concentration resulting from the merger. Although market shares and market concentration are instructive, the

Merger Guidelines make clear that they provide only the starting point for analyzing the competitive impact of a merger. The Agencies do not make enforcement decisions based solely on market shares and concentration, although both measures are an important part of the analysis. In some cases, for example, new entry (including expansion by fringe firms or re-positioning) is likely to occur on a timely and sufficient basis to frustrate any attempt to exercise market power. Other factors relate to the ability of the merged firm, alone or in combination with others, to exercise market power.

The Merger Guidelines identify two broad analytical frameworks for assessing whether a merger of competitors is likely to substantially lessen competition: "coordinated interaction" and "unilateral effects." A merger may substantially lessen competition through coordinated interaction if, after the merger, competitors could more completely or successfully coordinate their pricing or other competitive actions than before the merger. A merger may substantially reduce competition through unilateral effects if the transaction would enable the merged firm to raise price or otherwise exercise market power without coordinating with its non-merging rivals.

The Agencies also consider merger-specific efficiencies of the kind likely to enhance the merged firm's ability and incentive to compete, potentially resulting in lower prices, improved quality, enhanced service, or new products. For example, a merger may enable two ineffective, high-cost competitors to become a more effective, lower cost competitor. Or, marginal cost reductions may reduce a firm's incentive to raise price after the merger. The Agencies must be convinced that the nature and magnitude of the efficiencies are such that the merger is unlikely to be anticompetitive. Where the potential adverse competitive effects of a merger are likely to be large, the size and certainty of efficiencies resulting from the merger will have to be very substantial.

In evaluating the likely competitive effects of a transaction, the Agencies examine all available evidence, both qualitative and quantitative. We obtain evidence from the merging parties, their competitors, their customers, and other sources, such as consumer groups, government agencies with experience in the relevant industry, and third party experts. The Division relies heavily on evidence from documents and first-hand observations of the industry by customers and other market participants, and in some cases this understanding is enhanced significantly by quantitative analyses of various sorts. By carefully evaluating this evidence, the Agencies obtain an understanding of the market in which the proposed merger would occur and how best to analyze competition.

**Evaluating Mergers and Acquisitions Among Air Carriers**

The Division applies the Merger Guidelines to mergers in the airline industry. In airline mergers, the definitions of product and geographic market converge: relevant airline markets are likely to consist of scheduled passenger airline service between a point of origin and a point of destination, generally referred to as city pairs. Thus, for example, a relevant market might be Atlanta to Minneapolis-St. Paul. This market makes intuitive, as well as economic, sense. If you want to fly from Atlanta to Minneapolis-St. Paul for a business meeting or vacation, you are not likely to regard a flight from Atlanta to Detroit or Milwaukee, for example, as a reasonable alternative if the fare from Atlanta to Minneapolis-St. Paul goes up. The Division would thus be concerned about a transaction that significantly reduces competition in city pair markets.

The relevant market may, however, also be narrower than all scheduled airline service in a city pair. Certain cities may have multiple airports and, depending on the facts, it may not always be the case that all of those airports are in the same relevant antitrust market for certain consumers. Also, it may be the case that non-stop and connecting (one-stop) service may not be in the same relevant antitrust market. Many city pairs are served by some carriers on a non-stop basis and by other carriers on a connecting basis. This circumstance poses the following question: Do passengers regard connecting service as a reasonable alternative to non-stop service, such that the availability of connecting service would constrain the price of non-stop service?

In the Division's experience, passengers traveling for leisure—on vacation, for example—are more likely to consider connecting service as a good alternative to non-stop service because they are less time sensitive (in other words, their demand is more elastic). But business travelers may be significantly less likely to regard connecting service as a reasonable alternative because they place a higher value on getting to their destination quickly (their demand may be relatively inelastic). A carrier offering the only non-stop service on a route could raise fares to those time-sensitive travelers without losing them to another carrier's connecting service. There thus may be circumstances in which a transaction will be competitively problematic because of its impact on non-stop service in city pair markets, even if other carriers provide service in those markets on a connecting basis.

In considering the possible competitive effects of an airline merger, the Division accordingly looks at the effect in all city pair markets served by both of the merging carriers in terms of both nonstop service and connecting service. Once overlapping city pairs have been identified, the Division looks at the number of other carriers serving each of the markets and at the nature of that service (whether it is connecting or non-stop). Using detailed data that carriers are required to report periodically to the DOT, the Division calculates market shares. It then focuses further analysis on those city pairs in which market shares and concentration levels indicate a post-merger structure conducive to the creation or enhancement of market power.

As I have discussed, the Division's analysis does not stop with the market shares. The prospect of potential competition through entry or expansion by other airlines can constrain the ability of incumbent airlines to raise price or reduce output below a competitive level. Under the Merger Guidelines, the Division considers whether entry into the affected markets is easy, in the sense that it would be timely, likely, and sufficient in its magnitude, character and scope, that it will likely deter or counteract the competitive effects of concern.

The Division also will consider and take into account airline-specific business practices and characteristics that affect merger analysis. For example, in the Division's review and ultimate determination to challenge the merger of United Airlines and US Airways, we were concerned that the merger would reduce competition with respect to high volume corporate and government business contracts. The Division will consider these and other factors in assessing the likelihood that a transaction will create or enhance the merging carriers' market power or facilitate its exercise, on a unilateral or coordinated basis.

The Division also takes into account any efficiencies that may result from the merger. If a merger brings efficiencies that will enhance the combined firms' ability to compete, and the benefits from that enhanced competition will negate any otherwise potential anticompetitive effect, then the merger is procompetitive. A merger may enable the combined airline to offer U.S. consumers better service, for example, by offering more frequent flights between some city pairs, fewer connections, shorter layovers, or service to more destinations throughout the country or the world.

**Conclusion**

Mr. Chairman, competition in the airline industry is critical for the millions of people who depend on air travel in their business life and personal life. If the Division concludes that a proposed merger will violate the antitrust laws or that air carriers are engaging in illegal collusive or monopolistic conduct, the Antitrust Division takes appropriate enforcement action. Mr. Chairman, this concludes my prepared remarks. I will be happy to answer questions that you or other members of the Committee may have.

**STATEMENT OF MICHAEL W. REYNOLDS**
**ACTING ASSISTANT SECRETARY FOR AVIATION & INTERNATIONAL AFFAIRS**
**U.S. DEPARTMENT OF TRANSPORTATION**

**before the**

**AVIATION SUBCOMMITTEE**

**of the**

**TRANSPORTATION AND INFRASTRUCTURE COMMITTEE**
**U.S. HOUSE OF REPRESENTATIVES**

**May 14, 2008**

Chairman Costello, Ranking Member Petri, and Members of the Committee:

**Introduction**

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

Although it would not be appropriate for me to discuss the specifics of any proposed transaction that is currently before the federal government, I hope I can shed some light on the process of reviewing an airline merger.

**State of the Airline Industry**

Let me begin with the state of the airline industry. The U.S. airline industry has been emerging from a major restructuring, one that was precipitated by a fundamental change in passenger demand. This change in demand had begun prior to September 11 and continued even as the industry adjusted to the subsequent security measures and made operating and workforce changes.

Despite fuel price increases, the industry as a whole was profitable for 2007, with net income of $3.8 billion in 2007 versus $1.7 billion in 2006. Legacy carriers had successfully restructured and adapted their business models to compete in a more price-sensitive environment with low-cost carriers that have continued to expand throughout the decade. In 2008, however, persistent record-high fuel prices have eclipsed the benefit of legacy carrier cost reductions and other efficiencies obtained through restructuring, both in and out of bankruptcy, and are changing the fundamental economics of the industry. In the first quarter of this year, the industry posted a net loss, excluding special items, of about $1.7 billion, compared to a profit of $58.9 million in the first quarter of 2007.

Going forward the outlook for airlines has certainly become cloudy. The industry faces three major challenges in 2008: significantly higher than expected fuel prices, a potentially weaker economy, and labor cost pressures. Wall Street currently estimates that, with oil at $110 per barrel, the U.S. airline industry will lose approximately $4.5 billion this year. Let me briefly address each of these major concerns.

Clearly, the major challenge for the industry remains record high fuel prices, hovering around $120 per barrel. Fuel is now the largest single cost center for the airlines. A one cent per gallon increase in the price of jet fuel costs the U.S. airline industry an additional $16 million per month for fuel on a system basis. This figure may not seem like much, but when you consider the drastic change in the price of crude oil and its distillate, jet kerosene, over the last three years, the rising cost to the airlines becomes much more understandable. Between 2004 and May 2008, the New York spot market jet fuel price increased approximately 247 percent from $0.98 to $3.40 per gallon. While the industry posted an operating loss of approximately $1.7 billion in the first quarter 2008, it would have posted an operating profit of $3.61 billion in that quarter had fuel prices remained at 2004 levels. More recently, Gulf Coast jet fuel prices, driven by jet fuel "crack" spreads in excess of $33/bbl, have surged as high as $3.57 per gallon. Although current crack spreads are not nearly as high as they were during the period following Hurricanes Katrina and Rita in the fall of 2005, the all-in price of jet fuel is still at a record high. The increase in the price of jet fuel is demonstrated by the proportion that it represents of a carrier's total operating expenses. Fuel has increased from 19 percent of total operating expense in 2004 to 28 percent in 2007 and may be nearly 40 percent for 2008 based on current trends. It is unclear, however, the degree to which carriers will be able to pass at least part of the high fuel cost to consumers.

Soaring fuel prices have masked the tremendous progress legacy carriers have made in reducing their costs to levels more competitive with those of low-cost/low-fare carriers and eclipsed gains that could have been used to fund essential long-term capital expenditures. Ongoing fuel price pressures have motivated industry-wide cost and capacity discipline. All carriers are trying to adjust their business models to cope with yet another significant challenge.

With respect to the second challenge, passenger carriers report that demand currently remains fairly strong going into the busy summer travel season. There is, however, some regional weakening in domestic markets and greater concern for the fall and winter. Airlines continue to cut unprofitable capacity, rather than focusing on maintaining or increasing their market shares. Most legacy carriers are planning to substantially reduce domestic capacity after the summer travel season. Should economic conditions fail to improve, carriers will likely make additional capacity cuts when finalizing their fall schedules. Even low-cost carriers, which seek to expand their networks to appeal to a larger customer base and establish more broad-based networks to compete with larger legacy carriers, have significantly trimmed their growth rates.

Labor costs pressures constitute a third challenge facing the airline industry. As airlines returned to profitability over the past two years, labor groups have sought to restore much of the estimated $6 billion in annual wage reductions shed in recent years. High fuel prices and low-cost carrier competition are making it extremely difficult for airline managements to address labor's concerns.

In addition to the major challenges already described, airlines are also confronted with institutional investors who have become frustrated with lagging stock prices and have suggested ways to unlock stockholder value. These suggestions include the sale of frequent flyer programs, regional airline operations, and carrier-owned heavy maintenance divisions – as well as mergers, which I will address in a moment.

During this period of adjustment to high fuel prices, cash and liquid assets are essential to an airline's survival. It is important to note, however, that unlike the situation during the last recession, which led to large operating losses, legacy carriers are now generally better prepared to weather an economic downturn. Not only have carriers significantly reduced their cost structures and become more efficient, but their cash balances are substantially higher than they were in 2001. On the cost side, according to one study, there are over 450 aircraft in the legacy carrier mainline fleets that are either nearing lease expiration or are otherwise unencumbered. These aircraft could be grounded, without significant cost, to further cut capacity.

With record high fuel prices, the U.S. economy slowing down, and credit and financing more difficult to secure, some observers suggest that consolidation is the only route the industry can take to address the challenging short-term environment and to achieve long-term stability. Industry consolidation – regardless of the business sector – fundamentally occurs in two different ways: through the exit of failed companies or through the combination of companies. Historically, both forms of consolidation have been part of aviation since the industry was deregulated.

The first form of consolidation is already well underway as Aloha Airlines, ATA Airlines, Skybus, MAXjet, and EOS Airlines have all filed for bankruptcy and ceased passenger operations. While each of these airlines also experienced difficulties unique to its particular business, all of them noted that record high fuel prices played a primary role in their demise. Concerns about the implications of slowing demand on the industry's fortunes led the credit card processor for Frontier Airlines to increase holdbacks on tickets purchased using credit cards. In turn, the larger holdback led the carrier to file for Chapter 11 protection in order to protect its cash position as it continues to operate while restructuring.

Delta and Northwest have proposed the second type of consolidation -- a merger combination. Other, similar announcements may follow in response. One stated goal of this merger is the reduction of costs through operating efficiencies and synergies.

In the current environment of record high fuel prices and a slowing economy, however, mergers are unlikely to ease the short-term financial pressures on carriers for a number of reasons. While mergers might help reduce capacity and cut costs in the medium- to long-term, they are unlikely to be a short-term solution to the industry's current challenges unless the merging carriers plan to immediately and drastically reduce capacity and increase fares. Even if the merging carriers take such action, short-term results would be limited because capacity comes out of an airline's system much faster than costs; while grounded aircraft do not accrue some variable and fixed costs, many such costs remain in the system. Few short-term benefits therefore result from any capacity cuts facilitated by a merger. In short, past experience with airline mergers suggests that they may bring large, up-front costs while any benefits are not realized until several years later.

Historically, even over the long-term, past mergers have been expensive and time-consuming, as diverse components including fleets, computer systems, and cultures are combined. Labor integration has been among the most challenging hurdles to overcome. Merging unions in the past has proven to be difficult and costly, with the most expensive features of each contract becoming the standard in the combined labor agreement. Though often overlooked, systems integration – the heart of vital airline planning and operating functions – is also enormously costly and complex. Even the most ardent proponents of consolidation (most notably the hedge fund managers who are less concerned about the long-run financial health of the industry) recognize the significant risks of execution and poor track record of past airline industry mergers.

The value to the carriers in any merger would primarily result from the synergy and cost cutting that could be obtained. Ultimately however, consolidation through mergers as a successful endgame for the legacy carrier segment of the industry must result in lower costs, the ability to profitably charge relatively low fares, better service, a rationalization of high-cost capacity, and hence a more efficient and viable industry. If a merger agreement does not result in lower costs for the merged entity – in the short, medium, and long term – the merged carrier will still be unable to compete with low-cost carriers, which continue to steadily gain market share as well as enter additional markets.

As low-cost carriers continue to expand, legacy carriers must find ways to become more efficient producers, particularly given the commodity nature of the airline seat. In short, the fundamental restructuring of the airline industry that occurred in the first half of this decade revealed an outdated industry structure built around an unsustainable cost structure. Today's airline industry economics can be boiled down to one irreducible fact: carriers with high costs and a weaker product offering lose market share; carriers with low costs are able to gain market share – almost without exception.

**Role of Government**

Having outlined the challenges facing the airline industry, I would like to discuss the appropriate role of government in the airline industry. By deregulating the airline industry in 1978, Congress set the DOT permanently on the path away from intervention in the marketplace. Many, including the DOT, have a long-held view that deregulation has been a success. It has enabled carriers to produce an abundance of service with low fares – while achieving a spectacular safety record.

Indeed, the fundamental restructuring that we have observed over the last six years is largely the result of market forces that were set in motion prior to the September 11 terrorist attacks. The architects of airline deregulation predicted that new, innovative airlines would enter the market, establish a significant and sustained market share, and exert competitive discipline on incumbent firms and ensure that savings from efficiencies were passed along to consumers. That is precisely what happened, although it happened differently and somewhat more belatedly than expected.

While deregulation has been a success – adjusted for inflation, the average fare in 2005 was half of what it was in 1979, the industry continues to undergo restructuring as a result of dynamic market forces.

A healthy industry that is responsive to the needs of passengers and shippers is important. September 11 showed us how the effects of a disruption in air commerce reverberate throughout the economy. Over the longer term, an industry that perennially either loses money or makes suboptimal returns cannot consistently offer the quality and breadth of service that consumers demand.

We therefore need to fully understand and address the challenges facing airlines. If we want a healthy airline industry – and not just a few quarters of positive earnings, we need to ensure that government is not advertently or inadvertently preventing the industry from undertaking the restructuring demanded by market forces. Providing a regulatory environment in which U.S. carriers can compete and leverage their strengths in perhaps the most obviously global of industries must remain one of our policy objectives. Put differently, the rules and policies we follow domestically should not inadvertently tilt the playing field against American companies in the global marketplace.

The history of deregulation has shown quite clearly that American travelers and shippers are best served by a mix of carriers with different business models. The challenge we face is to ensure that our regulatory regime does not stand in the way of marketplace forces that would otherwise result in new entry, business combinations, or other commercial responses.

In a dynamic market, new entry acts as a force that disciplines incumbents and thus ideally fosters innovation and efficiency. But just like new entrant carriers need to be afforded the access they require to satisfy marketplace demands, so too do incumbent firms need to be able to adapt and adjust to the market, and perhaps even exit the market when market forces decide that assets should be reallocated to more efficient firms. As I noted earlier, carriers with high costs and a weaker product offering lose market share; carriers with low costs are able to gain market share – almost without exception. When incumbent carriers are able to achieve the changes necessary to compete – through whatever legal means - they can, and do, succeed. This cycle of market entry and exit is a natural consequence of a deregulated industry and the mechanism by which market forces ensure that the needs of American travelers and shippers are met in the most efficient way possible.

The issue of "consolidation" should thus be understood in the broader context of allowing deregulation to address the airline industry's perennial challenges. In an industry that is truly subject to marketplace forces, we will inevitably see restructuring resulting in consolidation. This can occur in a variety of forms – not necessarily just mergers and acquisitions. The airline industry is very dynamic and government policy should take into account cyclical economic conditions, the competitive environment, infrastructure access and capacity, and industry innovation. Each proposed transaction must be considered on a case-by-base basis. The airline industry should be held to the same antitrust standards as every other industry and there will inevitably be transactions that fail to satisfy a rigorous antitrust test.

**DOT's Role in Merger Transactions**

Since the sunset of DOT's authority to approve airline mergers on January 1, 1989, the Department of Justice (DOJ) is responsible for reviewing proposed airline mergers, due to its primary jurisdiction over the antitrust laws. The DOT typically provides the DOJ with advice and analysis on airline competition issues. 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. The DOT is committed to ensuring an environment that both allows airlines to adapt to rapidly changing economic conditions and embraces competition and provides consumers with the price and service benefits that competition brings. In order to make it more transparent, let me explain how the review process might transpire.

The proposed merger would be reviewed by the Antitrust Division of the Department of Justice under the antitrust laws. The Antitrust Division would consider whether to challenge the transaction in the courts. The DOT could examine the proposed merger and submit its views to the Antitrust Division privately.

If the Antitrust Division does not challenge a transaction between major airlines, DOT would then consider a wide range of issues that fall within its jurisdiction, including international route transfers, economic fitness, code-sharing, and possible unfair or deceptive practices.

With respect to international routes transfers, by statute (49 U.S.C. 41105), we may approve a transfer only if we find that it is consistent with the public interest. We must also analyze 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. As a practical matter, route transfers are important only when the acquired airline holds route authority in limited-entry markets.

We would only decide whether to approve the international route transfer after we had established a formal public record and given all interested persons the opportunity to comment. If the DOT determines that the transfer would not be consistent with the public interest or would be inconsistent with international aviation policy, the DOT could disapprove the transfer in whole or in part. Alternatively, the DOT may condition its approval on requirements that would protect the public interest.

Because a proposed merger of major carriers would involve either a new entity created to acquire one of the carriers or a significant change in the structure of one of the existing carriers, the DOT would institute a fitness review of both carriers. In addition to a review of airline management, financials and compliance disposition, the merging carriers would have to file a joint application requesting that the DOT transfer the economic authorities under 49 U.S.C. 41105. The transferred authority will not become effective until such time as evidence supporting the actual integration of the merger carriers' operations into a single entity is received by the DOT or until such time as the integrated air carrier's authority is surrendered to the DOT and/or the Federal Aviation Administration, whichever occurs earlier.

The DOT may also review any code-share arrangements involving the merging carriers under 49 U.S.C. 41720. In the DOT's experience, code-share arrangements would likely be necessary during the early phases of integration post-merger.

The DOT has the obligation under 49 U.S.C. 41712 to protect consumers from unfair and deceptive practices by airlines. In carrying out that responsibility, we could, if appropriate, review a proposed merger's arrangements to protect the rights of consumers. For example, it might be necessary to assess whether the merging airlines plan to give consumers reasonable notice and an opportunity to adjust to any changes in their frequent flyer programs.

With respect to Federal Aviation Administration (FAA) oversight of an airline merger, the agency will set up a Joint Transition Team to ensure that changes at the two merged carriers will not have negative safety impacts and to coordinate activities between FAA organizations. The surviving airline is expected to submit a "transition plan" to the FAA, the purpose of which is to outline changes to be made and establish a timetable for those changes. The FAA acceptance of the merger transition plan represents a commitment by the principal inspectors to make reasonable efforts to accommodate the controlling airline's planned changes in a timely and responsive manner. When the FAA finds that an airline merger transition plan is acceptable, it will issue Operations Specification (OpSpec) A-502 to both carriers involved in the merger. This OpSpec provides legal authority for the merging airlines to operate during the transition period and specifies which airline will have operational control authority over the combined operation.

During the transition from two separate airlines to one, the FAA will monitor and verify the current operations of the separate entities and validate the new operations and procedures that will be adopted for the "new" airline. The FAA will ensure that management personnel at the controlling airline are aware that it must continue to operate with current approvals. Once changes required by the transition plan are completed, and FAA approvals obtained, the airline can then implement those procedures. FAA surveillance is increased during and following airline mergers in order to ensure that operations are conducted in accordance with the transition plan.

**Conclusion**

Airlines are the circulatory system of national and global communities – linking friends and family, suppliers and producers, retailers and manufacturers, 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 service. In addition, the U.S. airline industry employs over half a million people. It is therefore easy to understand why so many people who otherwise have little interest in corporate mergers and acquisitions in other industries, have opinions on airline mergers.

Our consideration of aviation economic policy must necessarily focus on what is best for both a healthy and a competitive industry. Our goal must be to strike what is admittedly a very difficult balance in the face of a complex and dynamically changing industry. It must also embrace not just a short-term view of the impact on a particular group of stakeholders, but must consider the longer term, collective impact on all stakeholders.

Testimony of
General Vice President
Robert Roach, Jr.

International Association of Machinists
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Before the
House Committee on Transportation and Infrastructure's Subcommittee on Aviation

"Impact of Consolidation on the Aviation Industry,
with a Focus on the Proposed Merger between
Delta Air Lines and Northwest Airlines"

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**"Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger between Delta Air Lines and Northwest Airlines."**

**May 14, 2008**

Thank you, Chairman Costello, and members of this Subcommittee for the opportunity to speak to you on behalf of airline workers throughout North America. 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. I am appearing on behalf of International President R. Thomas Buffenbarger. The IAM represents more than 160,000 active and retired airline workers in almost every job classification, including flight attendants, ramp service workers, mechanics, customer service, reservation agents and office employees.

It is my firm belief, and the belief of many others, that airline executives are using a crisis of their own making to justify the establishment of what can only be called a monopoly.

**Regulation**

Airline CEOs regularly complain about overcapacity. The need to address overcapacity has been a favorite battle cry for airline management for decades and won't be resolved by mergers. Braniff, Eastern, Pan Am, TWA, Peoples Express, Aloha Airlines and others have all disappeared from the scene. Reducing capacity will not overcome management's failure to run a profitable business.

The Machinists Union is not advocating that we maintain the status quo in the airline industry. When there are problems, we must seek solutions. Immediately after 9/11, airlines demanded more than $6.3 billion in government aid. Carriers then sought and won pension relief legislation, but still abandoned their pension obligations.

Airlines also used the bankruptcy law to force employees and shareholders to make sacrifices to save the carriers. IAM members alone at Northwest Airlines, US Airways, United Airlines, Comair, Hawaiian Airlines and Aloha Airlines gave up nearly $9 billion in bankruptcy to help their airlines.

Some airlines are constantly asking the government for relief, begging the courts to abrogate contracts and forcing the government to absorb its pension obligations. History has shown that poorly managed airlines cannot operate without government assistance. Those airlines repeatedly appeal to the government for bailouts.

However, it should be noted that since 9/11 airlines such as Southwest, Continental and American have been able to, in most cases, be profitable and, at the very least, have been successful in navigating through these turbulent times. It is those airlines who are resisting the quick-fix urge to merge philosophy.

In 1993 the Clinton administration recognized the problems facing the air transportation industry. President Clinton empanelled a National Commission to Ensure a Strong Competitive Airline Industry, and 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 airline 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.

The Machinists Union's assertion that deregulation had failed to deliver on its promises were ignored in 1993 in favor of supporting airline industry executives who advocated staying the course. Congress now has a second chance to make effective changes to this industry. If that opportunity is squandered again, bankruptcies will increase, more proud airlines will disappear, employees will continue suffering and passenger will be even further alienated. We can close our eyes and ignore millions of consumers, employees and investors, or we can have an efficient air transportation industry. More than 150 carriers have gone bankrupt since deregulation.[1]

As a direct result of increased fuel prices, airlines clearly need immediate relief and we strongly urge that the Congress join with the industry and request that President Bush release oil from the strategic oil reserves. We are recommending that there be a complete moratorium on airline mergers until long-term solutions are found. Instead of resolving problems, merging airlines in this environment would only create more chaos.

Since 9/11, the Machinists Union has been in the forefront in trying to establish a format in which industry leaders, labor leaders and government would come together to resolve the industry's problems. We urge the Congress to raise its voice in establishing an airline transportation summit so that we can, once and for all, come together and discuss ways to improve this industry.

Airlines today compete by cutting standards, eliminating services and reducing ticket prices to the bone, which makes a profitable industry impossible. The GAO estimates that median ticket prices have dropped nearly 40% since 1980, although the costs of aircraft, airport leases and fuel have increased dramatically.[2] No business can survive if they sell their product for less than what it costs to deliver their goods.

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[1] The New York Times, *Did Ending Regulation Help Fliers?* By Micheline Maynard, April 17, 2008

[2] Government Accountability Office, "Airline Deregulation" GAO-06-630

The long-term cost of under pricing tickets is too extreme. Pan Am, TWA, Eastern, and Aloha Airlines all survived for more than half a century, but could not endure the insanity of deregulation. This industry is crying out for sane regulation that includes limiting capacity, setting fares or both.

**Effective Management**

Even with limited re-regulation, more competent management is needed to save the industry, not consolidation.

If airline executives spent as much time running their airline as they do looking for bailouts or mergers, this industry and our country's transportation system would be much better off.

Mergers prevent airlines from running effective operations. United Airlines emerged from bankruptcy with a plan to pay its executives undeserved multi-million dollar bonuses, but with no intention of operating the airline. Instead of finding ways to conserve cash and operate United Airlines in times of record-high fuel prices, the airline paid out an unnecessary $250 million dividend to shareholders in December 2007, against the objections from employees who warned against such reckless actions. This demonstrates that United's only plan is to plunder the airline and market it for acquisition, to the detriment of passengers and employees.

This industry is in disarray and the executives in charge are only making things worse. Airlines can't police their own maintenance programs, small communities are under-served, passengers are treated like cattle and employees are continually being steamrolled.

There is too much at stake to let executives and their legacy of failure try and solve the industry's problems. It is time for airline passengers, employees and the government to finally say "NO" to airline executives.

Some form of limited re-regulation is necessary if this country has any chance for a safe, reliable, profitable and competitive air transportation industry. And I'm not the only one calling for re-regulation.

Although I do not agree with everything former American Airlines CEO Robert Crandall says about the airline industry, I share his opinion that, "market –base approaches alone have not and will not produce the aviation system our country needs" and that "some form of government intervention is required."[3]

**Northwest-Delta**

Re-regulation is the only long-term solution. Today, however, we must deal with immediate issues. One factor the airlines will not admit publicly is that they expect this

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[3] The New York Times OP-ED, April 21, 2008

merger to eliminate the union representation rights of Northwest Airlines workers. They want to use this merger as weapon to eliminate the jobs and rights of thousands of workers.

The Machinists Union will not allow this to happen.

An issue that neither Northwest nor Delta have addressed is how they will deal with current pensions. IAM members at Northwest Airlines still have a secure defined benefit pension plan, the IAM National Pension Plan. Our members are the only employees at either carrier still earning a traditional pension benefit, but that will be lost if our members lose IAM representation in a merger. Delta has not guaranteed that our members will not lose the security of a defined benefit pension plan in the merger.

Additionally, both Delta and Northwest have frozen or terminated their pension plans. If a merger takes place, and the combined carrier ultimately fails, the pensions will be forced onto the Pension Benefit Guaranty Corporation (PBGC).

This will burden the PBGC with more than $7 billion in combined liabilities. The PBGC has already expressed concerns about such a scenario.

Delta and Northwest have made commitments to employees, but these commitments are unenforceable and subject to change. If the combined airline wants to make a true commitment, then they should stop interfering with Delta employees' right to organize, and make their commitments part of collective bargaining agreements that protect employees at the combined carrier.

Northwest and Delta say that no frontline workers will be lose their jobs. Don't believe them. If Northwest Headquarters is downsized, 930 IAM-represented clerical workers are at risk. The frontline employees, not the high level management employees, which Northwest has said are the only jobs at risk in a merger.

Northwest has a history of broken promises. The State of Minnesota bailed out Northwest to the tune of $761 million in 1992. In return, Northwest Airlines promised to continue employing at least 1,000 workers in Duluth, Minnesota, and committed to building an engine maintenance facility in Duluth with a minimum of 500 new jobs. Instead, they never opened the engine shop and closed their operation in Duluth entirely in 2005. Additionally, Northwest committed to keeping employment levels in the state to a minimum of 18,000 employees. They are already down to about 12,000. Northwest Airlines has left a trail of broken promises throughout Minnesota that will multiply and expand throughout the country if this merger is approved.

Delta also is not averse to making promises it doesn't keep. Over the last 10 years the airline offered employees early retirement packages based principally on very attractive free or minimal cost health care programs.

According to the Delta Air Lines Retirement Committee, retirees' health care deductibles and co-pays were increased dramatically after accepting the packages and retiring.

If the airlines truly cared about their employees they would have engaged all their unions when they first contemplated a merger. Instead, they rebuffed our efforts to cooperate and have ensured labor turmoil for years to come, even if a merger is not completed.

Faced with inadequate or indifferent responses from airline management, the IAM has contacted Governors, Senators and Representatives as part of our efforts to protect the thousands of employees and dozens of communities that will be negatively impacted by these proposed mergers.

**Seniority**

Delta has said that it will integrate seniority fairly, and that they are required to do so under the law. But what does "fairly" mean? There are no less than five recognized methods for "fair and equitable" integration of airline seniority lists.

1. The surviving group principle, where the acquiring company's employees receive seniority preference over the acquired employees;
2. The follow-the-work-principle, were seniority is allocated by a ratio of what assets each individual airline contributed to the combined company;
3. The absolute rank principle, where employees retain their respective rank on the newly mergers seniority list;

4. The ratio-rank principle, where a ratio of the employees of each group to be merged are assigned places on the combined seniority list according to a ratio of total employees.
5. The length of service principle, where all employees are combined by their current seniority date, regardless of which airline they came from.[4]

Fairness is in the eye of the beholder, and what Richard Anderson deems fair is not important. We need to focus on what employees consider to be fair.

Northwest and Delta employees sacrificed wages, pensions and, in too many cases, their jobs to help their airlines survive bankruptcy.

Mergers are another avenue for airlines to cut even more jobs.

I realize this hearing was prompted by the Northwest Airlines - Delta Air Lines merger announcement. However, we must recognize this announcement will lead to additional merger attempts.

Continental Airlines, United Airlines, American Airlines and US Airways have all discussed various pairings and alliances in response to the Delta-Northwest action. This

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[4] *How Arbitration Works, Sixth Edition* Elkouri, Elkouri, Reuban; BNA Books, p.868-870

will lead to other mergers, likely cutting the number of major national carriers in half, from six to three.

**Financial Health**

Both Northwest and Delta have seen their stock prices sink since exiting bankruptcy, and more so since the merger was announced. Passengers, employees and investors, three groups with different concerns, all think this merger is a bad idea.

If the two airline CEOs testifying today can't independently provide their customers and shareholders with value for their dollar, what will happen under a merged company that is saddled with debt and even harder to manage?

If allowed to proceed, Northwest and Delta will form the world's largest airline, creating the world's biggest corporate headache. The combined carrier would have $15 billion in long-term debt, plus $11.3 billion in current liabilities and $14.23 billion in non-current liabilities, including pension liabilities. This non-current liabilities figure includes $7.51 billion in pension and retiree benefit liabilities. The total liabilities of the combined company would be $40.55 billion. It is not in this country's best interest to approve the creation of an enormously debt-ridden company.

**Consumer Impact**

The wholesale reshaping of the industry will destroy competition and harm consumers on routes throughout the United States.

It would be difficult to find anyone outside of a small group of airline executives who expects to benefit from additional airline consolidation.

Passengers, employees and shareholders have suffered enough by senseless management decisions. In the last month, four airlines have declared bankruptcy.

We have seen how airlines fail to comply with FAA-mandated safety compliance directives. Do we really need more instability in this chaotic industry?

Both Northwest and Delta operate a hub and spoke system. Combining the two will create redundancies, which, if the airlines keep their promise not to close hubs, will create regional dominance.

The new Delta will control the South East and Upper Midwest with two hubs in each region.

Atlanta and Memphis, less than 400 miles apart, will both be Delta hubs.

Delta will also have two major hubs in Detroit and Cincinnati, less than 300 miles apart. If these two airlines merge, the frequency of flights between cities they both serve will be diminished.

It is both insulting and a testament to these airlines' arrogance that they think anyone believes they can combine these two companies without eliminating service and purging employees.

Passengers originating or traveling to Memphis, Detroit, Cincinnati, Minneapolis and the smaller communities served by airports in these cities will lose service frequencies and pay higher fares.

Experience has shown us that commitments made by airlines in bankruptcy are absolutely worthless.

When American Airlines purchased TWA out of bankruptcy in 2001, promises were made to TWA employees. American's then-CEO Donald Carty testified before the Senate Commerce Committee saying, "We look forward to adding TWA's 20,000 employees to the American Airlines family," and that American was willing to make "commitments to the 20,000 TWA employees and their families that no one else would make."[5]

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[5] Testimony of Don Carty, http://judiciary.senate.gov/oldsite/te020701dc.htm

In spite of these assurances, the overwhelming majority of former TWA employees are no longer employed by American Airlines.

Thousands of mechanics, ramp workers, customer service agents, flight attendants and pilots who were promised careers with American are no longer working in the industry.

We also cannot count on Delta's promise not to further reduce capacity beyond already announced service cuts. American Airlines promised the City of St. Louis that it would maintain TWA's hub operation at Lambert Field after the TWA merger.

That once bustling hub had over 474,000 flights in 2000, TWA's last full year of operation. In 2007 that number was reduced to a little more than 254,000. Passengers flown have been reduced nearly in half, from 30.5 million to 15.4 million in the same period.[6]

With the loss of passengers came the loss of tax revenue to the city of St. Louis and income for the businesses that support the airport and service the airlines.

Just over a year, ago Delta Air Lines was making the rounds in Washington trying to block a merger proposal with US Airways.

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[6] http://www.lambert-stlouis.com/

Delta said then that "the competitive impact of the US Airways proposal deal is that if the merger were to go forward, it would trigger broad industry consolidation."[7] Delta was right then, and wrong now.

Both Northwest and Delta entered bankruptcy on the same day in 2005 to make their companies leaner and more competitive.

Since they are here today saying that they must merge to become profitable, their bankruptcy restructurings must have failed.

So why should we believe them when they say this merger will be a positive step for employees, consumers and shareholders? Too much is at stake to take these airlines at their word.

**Who Benefits?**

One final point, Mr. Chairman.

Since employees, passengers and shareholders will lose in this merger, who benefits?

Doug Steenland stands to gain as much as $19 million due to the ending of his employment at Northwest.

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[7] Delta Air Lines press release, http://news.delta.com/print_doc.cfm?article_id=10533

Richard Anderson has said he would wave the $15 million in merger-related compensation he could receive due to change in control, but he could still realize tremendous benefits through a new employment contract as the CEO of a much larger company.

If employees lose their right to collectively bargain, if IAM members lose the new pensions they negotiated in bankruptcy, if employees are going to be sacrificed to grow executives' personal bank accounts, then this merger will fail.

A Delta-Northwest merger will eliminate jobs, reduce choices for passengers, further deteriorate customer service, trigger additional senseless mergers, make millionaires even richer, and most importantly, do nothing to address the problems of a failing industry.

While the status quo is unacceptable, we believe that consolidation will not produce a stable, profitable industry. Instead, consolidation and the ensuing reduction in service, coupled with insanely low barriers to entry, will simply produce a variant of competition that is less reliable, less safe and more unstable.

This merger and the ones that will follow should not be allowed to proceed. I wish to reiterate that the International Association of Machinists is prepared to work with CEOs, industry experts, passenger consumer advocates and government to find ways to improve the transportation industry in America.

Thank you for the opportunity to appear before this committee.

I welcome any questions.

# Committee on Transportation & Infrastructure
# Subcommittee on Aviation

## Hearing on:
## Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger between Delta Air Lines and Northwest Airlines

May 14, 2008

Testimony on behalf of:

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**STATEMENT OF DOUGLAS M. STEENLAND,**
**CEO OF NORTHWEST AIR LINES, INC.**
**BEFORE THE HOUSE AVIATION SUBCOMMITTEE**
**DELTA / NORTHWEST AIRLINES MERGER**
**MAY 14, 2008**

**INTRODUCTION**

I am Doug Steenland, the Chief Executive Officer of Northwest Airlines. I appreciate the opportunity to appear here today to explain the benefits of the recently announced merger between Northwest Airlines and Delta Air Lines.

The U.S. airline industry is at a crossroads, creating two choices for Northwest. One choice is to continue on the road now traveled: being whipsawed by the high price of oil; facing nationwide competition from discount carriers while unable unilaterally to achieve the cost and revenue synergies that the merger will produce; and struggling to remain competitive in the face of heightened competition from large, well-funded foreign airlines that are increasing service to the United States following implementation of Open Skies agreements that have liberalized aviation markets around the world.

The other choice is to merge with Delta to create a single global network by combining the complementary end-to-end networks of two great airlines. By achieving substantial cost savings and building a more comprehensive and balanced network, the combined company will be more financially resilient, better positioned to satisfy customers' demands, and better able to meet the challenges of the future at home and abroad.

From the outset, we have promised that we would consider a transaction only if it benefits all of our key stakeholders. We are confident that we have met this objective. Our customers and the communities we serve will benefit because this is a merger of addition, not subtraction. Combining the end-to-end networks of two great airlines means that Delta/Northwest will serve more U.S. communities and connect to more worldwide destinations than any global airline. Our passengers will benefit from direct service from the United States to all of the world's major business centers in Asia, Latin America, Europe, Africa, and North America. Because the networks of the carriers are complementary, no hubs will be closed. Delta and Northwest are committed to maintaining service to all points on the combined network In fact, in an environment of rising oil prices, the new carrier will be able to capitalize on combined traffic flows to preserve some routes that otherwise might have been cut as economically unsustainable.

All stakeholders, and our employees in particular, will benefit from the improved financial resiliency and better competitive positioning of the combined carrier. The merger will create over $1 billion in annual synergies that will help the new carrier withstand volatile fuel prices and cyclical downturns. The proposed combination also will allow us better to use Northwest's valuable Pacific franchise, better develop both carriers' domestic hubs, and better match the right planes with the right routes. Northwest has already integrated many aspects of its technology with Delta through the SkyTeam alliance, paving the way for a smooth integration process.

All of these benefits will be achieved without a substantial lessening of competition. The existing domestic and international route networks of Northwest and Delta are complementary, so the two carriers compete only to a minimal extent today. Of the more than 800 domestic non-stop routes that NW and DL collectively fly, there are only 12 non-stop city-pair overlaps. The vast majority of these non-stop overlaps enjoy substantial competition from other carriers, and all consumers will benefit from the significant cost savings that the transaction will create.

We did not come easily to the decision to merge with Delta. Northwest is proud of its long and distinguished history as a stand-alone carrier, and the company and our employees have made Herculean efforts in recent years to preserve our ability to continue operating independently. As you know, Northwest filed for Chapter 11 protection in September of 2005. As part of the Chapter 11 reorganization process, employees at every level of the organization made substantial sacrifices to insure that Northwest could emerge successfully from bankruptcy. We saw the success of this reorganization effort in 2007 when Northwest earned $760 million in profit, $125 million of which went to our employees as profit sharing and incentive payments. Yet, with fuel prices at record highs and amidst an economic slowdown, we remain financially challenged. In the first quarter of 2008, Northwest lost $191 million. Our fuel cost year over year went up $455 million even though our network stayed the same. The combined company will be more stable and better positioned to meet the challenges of the future, both at home and abroad. The bottom line is that we have achieved our goal of crafting a transaction that creates significant value for all stakeholders.

Small communities are among those that stand to gain the most from the merger. These communities need better access to the global marketplace. In a number of small cities, only one carrier currently provides service. But each carrier individually lacks the ability to provide customers the full range of international destinations. Consequently, a passenger in Hibbing, MN wanting to visit Panama – or a Gainesville, FL passenger with business in Nagoya -- would have to travel on two different carriers to reach the desired destination. After the merger, passengers flying these itineraries will benefit from seamless service on a single carrier. Together, we can provide better service to all customers across a broad, worldwide network, and these benefits will be delivered with no hub or station closings.

The testimony proceeds as follows. Section I of the testimony discusses why the merger of Delta and Northwest is procompetitive and consistent with regulatory requirements. The domestic airline market today is highly fragmented and will remain so post-merger. Furthermore, because this merger will combine complementary end-to-end networks, it will result in only 12 domestic non-stop overlaps, none of which will cause competitive problems. In addition, the merger presents no international competitive issues. Section I also examines how competition in the airline industry has been transformed since 2000. Low-cost carriers have changed the industry, and technology has created a transparency revolution that enables customers to compare airline fares quickly and easily. These factors will assure that a combination between Delta and Northwest will not reduce competition or harm consumers.

Section II of the testimony discusses market conditions in the airline industry, particularly the effect on network carriers of the dramatic increase in oil prices, the slowdown in the economy, the Open Skies treaty, and the consolidation of foreign flag carriers. These conditions require that Delta and Northwest respond proactively, and the merger accomplishes that goal.

Section III of the testimony explains how the Delta/Northwest merger benefits U.S. customers. The combined carrier will offer access to more worldwide destinations, accelerate investments to enhance the flying experience, and create the world's largest frequent flyer program. Section II also discusses how Delta and Northwest are uniquely positioned for a smooth integration process given their past coordination as part of the SkyTeam alliance.

Finally, Section IV explains how the combined carrier will continue to deliver exceptional service to U.S. communities by bringing increased single-carrier connectivity to smaller communities across the nation. In addition, this section discusses our commitment to maintaining all current hubs.

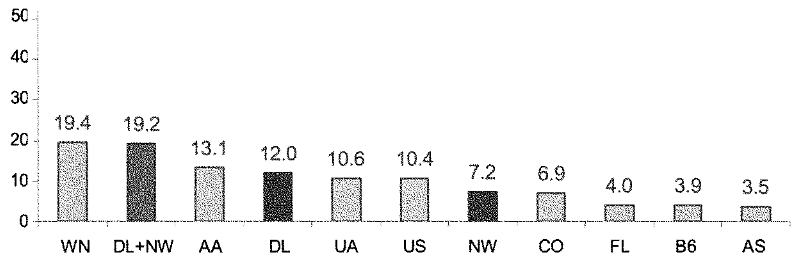
## I. THIS MERGER IS PROCOMPETITIVE AND CONSISTENT WITH REGULATORY REQUIREMENTS

The domestic airline market is highly fragmented and there is little overlap between the networks of Delta and Northwest, proving that a merger of the two carriers will not substantially lessen competition. The fundamental characteristics of the airline business will continue to constrain any hypothetical anticompetitive effects of the merger. Most notably, low-cost carriers have achieved rapid growth in this decade, changing the competitive dynamics of the industry. In addition, new Internet search tools have created a transparency revolution in airline fares to enable customers to access low fares easily. Finally, customers will benefit from enhanced competition in the industry as the combined company becomes a stronger airline, better able to compete with discount carriers and growing international airlines that are now serving more markets in the United States.

**The Domestic Airline Market Is Highly Fragmented.**

The domestic airline market is not concentrated; no airline currently has greater than a 20 percent domestic passenger share. Even post-merger, a combined Delta/Northwest would capture less than 20 percent of the domestic passenger share, and Southwest would continue to have the highest domestic passenger share. (See Figure 1).

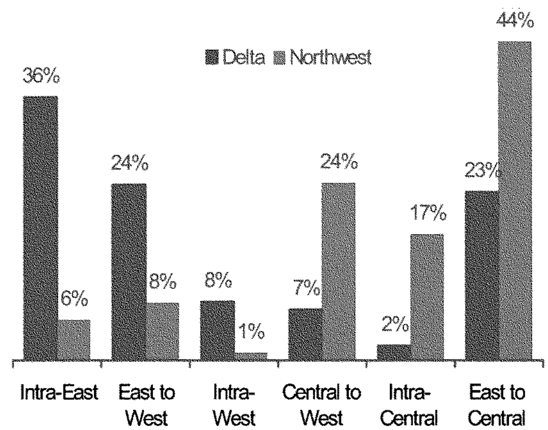
**FIGURE 1: DOMESTIC PASSENGER SHARE (3RD QUARTER 2007)**




**There Is Very Little Domestic Overlap Between Delta's and Northwest's Networks.**

There is very little overlap between the route systems of Delta and Northwest. Delta has a strong presence in the East and Mountain West, whereas Northwest's domestic route network is focused in the Midwest. As Figure 2 demonstrates, Delta and Northwest operate very different domestic route structures.

**FIGURE 2: DELTA AND NORTHWEST CARRY DISTINCT PASSENGER BASES**




The domestic overlap between the two airlines that exists is minimal and raises no competitive concerns. Because Delta and Northwest have complementary networks, the two carriers provide overlapping non-stop service on only 12 of the more than 800 domestic non-stop city-pairs that they collectively fly.

**TABLE 1: DELTA/NORTHWEST NON-STOP OVERLAPS**

| Route | Other Competitors (non-stop competitors in bold) |
|---|---|
| Atlanta-Detroit | **AirTran** offers 8 daily non-stop round trips and has a 32% share |
| Atlanta-Memphis | **AirTran** offers 5 daily non-stop round trips and has a 36% share, with one-year growth of 9% |
| Atlanta-Minneapolis | **AirTran** offers 4 daily non-stop round trips and has a 22% share, with one-year growth of 10% |
| Cincinnati- Minneapolis/St. Paul | American and United offer connecting service; Midwest and AirTran both serve Dayton (only 57 miles from downtown Cincinnati) and Minneapolis |
| Cincinnati-Detroit | Competitors offer connecting service through Chicago and Cleveland; AirTran already serves both Detroit and Dayton (only 57 miles from downtown Cincinnati), and Southwest already serves Detroit; driving is an option, as the trip takes little more than four hours by car; non-stop entry can easily occur on this route with gate availability at both airports |
| Detroit-New York | **American, Continental, Spirit** |
| Detroit-Salt Lake City[1] | American, Frontier, Southwest, United, and US Airways offer connecting service with a collective share of 40% |
| Honolulu-Los Angeles | **United, American, Continental,** and **Hawaiian** |
| Indianapolis-New York | **Continental** and **US Airways** |
| Los Angeles-Las Vegas | **United, American, Southwest, US Airways,** and **JetBlue** |
| Minneapolis/St. Paul-New York[2] | **Continental** and **SunCountry** |
| Minneapolis/St. Paul-Salt Lake City | American, Frontier, United, and US Airways offer connecting service; Southwest and JetBlue serve SLC and AirTran serves MSP |

Notes: 1) Northwest will launch service on Detroit-Salt Lake City in June 2008; 2) Delta will launch non-stop service on New York-Minneapolis in June 2008

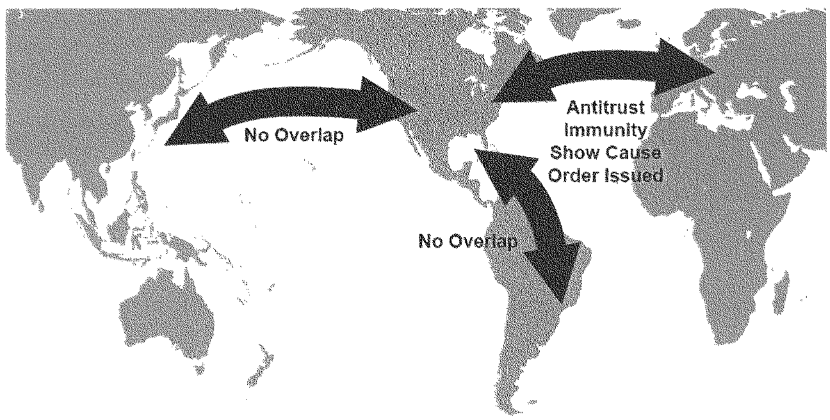
As Table 1 demonstrates, Northwest and Delta currently face significant competition from other non-stop and connecting competitors on most of these routes. In addition, other factors lessen potential antitrust concerns. Both discount carriers and legacy carriers can easily enter routes and provide competing service, and nearby airports provide competitive alternatives. Moreover, relatively few passengers travel on these non-stop routes; overall, passengers will derive benefits from the merger far greater than any potential competitive concerns raised by these few overlaps.

**Delta/Northwest Presents No International Competitive Issues.**

Finally, in the international markets, there are no significant competitive concerns. In fact, the U.S. Department of Transportation, in tentatively approving the joint application from Air France, Alitalia, Czech, Delta KLM, and Northwest for authority to operate an immunized alliance in transatlantic markets, found no basis to deny the request on competition grounds. In issuing its Show Cause Order on April 9, 2008, the Department stated "that the proposed alliance will not substantially reduce or eliminate competition, provided that transatlantic markets remain governed by a regional open skies agreement that promotes new entry regardless of national borders." The Department further noted, "We see no basis upon which the Joint Applicants could, as a result of this transaction, impose and sustain supra competitive prices or reduce service levels below competitive levels." (U.S. Department of Transportation, Show Cause Order, Docket OST-2007-28644, Apr. 9, 2008, at 13.)

Indeed, on an operating carrier basis, New York-Amsterdam is the only international non-stop overlap, and recently granted antitrust immunity permits Northwest and Delta to coordinate their service on this route even in the absence of a merger. Post-merger, the global aviation marketplace will remain intensely competitive; no global carrier – including Delta/Northwest – will have more than a 7 percent share of available seat miles.

FIGURE 3: NO SIGNIFICANT CONCERNS IN INTERNATIONAL MARKETS




The combination of Delta and Northwest increases competition in all international regions. The combined carrier will have a broader network closer in scope and depth to that which foreign flag carriers already possess, as well as a significant presence in all key international business markets, making it a stronger competitor against the foreign flag airlines.

**This Merger Should be Evaluated on its Own Merits.**

Each merger needs to be evaluated on its own merits. Delta/Northwest is a procompetitive combination and that fact remains true regardless of what else may happen down the road with respect to industry consolidation. Our merger illustrates the fact that consolidation can result in more cost-efficient carriers with lower unit costs and greater financial stability. To the extent that any further consolidation involves an end-to-end combination like ours and is not predicated on hub closures or "rationalization," it could enhance competition in the industry. In contrast, a merger of carriers with overlapping networks would raise competitive concerns that do not arise in the Delta/Northwest transaction. The competitive impacts of each individual major carrier combination are vastly different – and it does not follow that if the Department of Justice approved one combination that it should, or would, necessarily approve others. The Department of Justice will evaluate the competitive effects of each merger on its own merits and has the authority either to block any merger that would harm consumers or to fashion remedies to address specific competitive concerns.

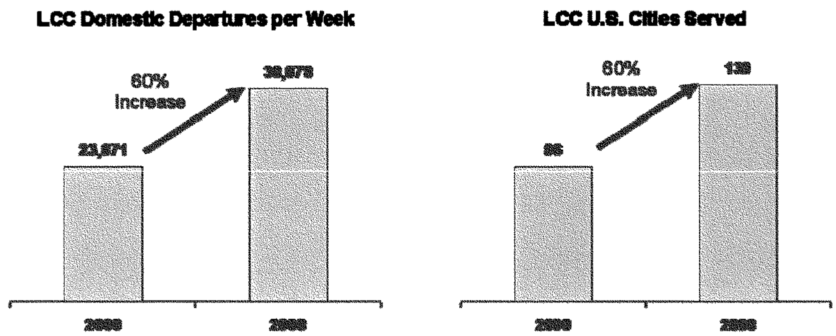
**Competition in the Airline Industry Has Been Transformed Since 2000.**

Since 2000, low-cost carriers (LCCs) have grown at a rate of more than 10 percent annually. Southwest Airlines, an LCC, now carries the largest number of domestic passengers. At the same time, Internet pricing engines and online travel agencies have created unprecedented price transparency, enabling passengers easily to find the lowest fares for a given itinerary. Compounding this phenomenon, LCC advertising has conditioned passengers to expect ultra-low fares.

*Low-Cost Carriers Have Changed the Industry.*

In July 2005, the General Accounting Office reported that "[t]he low cost carriers are really the price setters and have transformed the competitive environment in the airline industry." LCCs are strong competitors and have experienced explosive growth. Since 2000, LCC weekly departures and the number of cities served by LCCs have increased by 60 percent. (See Figure 4.)

FIGURE 4: THE RAPID GROWTH OF LCCS




LCCs have grown at an average annual rate of 11 percent since 2000 and in 2007 carried one-third of domestic passengers. The rapid growth of low-cost carriers domestically has created new competition that offsets historical regulatory concerns. Furthermore, LCCs are increasingly targeting business passengers: "Faced with slowing growth and higher costs, discount carriers like Southwest and JetBlue Airways Corp. are making a new push for business travelers, adding flights in heavily traveled business routes and even quietly offering companies special deals." ("Discount Airlines Woo Business Set," *Wall Street Journal*, February 19, 2008.). Led by Southwest, LCCs will continue exerting pricing pressure on legacy carriers.

Over the past several years, the major LCCs have been more financially stable than their legacy peers. Indeed, Southwest is the only domestic airline whose corporate debt is rated as "investment grade" by Standard and Poors, a fact that speaks both to the financial challenges facing the domestic airline industry generally and to the viability of the large LCCs. During the last decade, substantial discount carrier growth has resulted in a more competitive and fragmented industry. Today, LCCs serve all major cities, including all legacy carrier hubs, and are expanding into smaller cities.

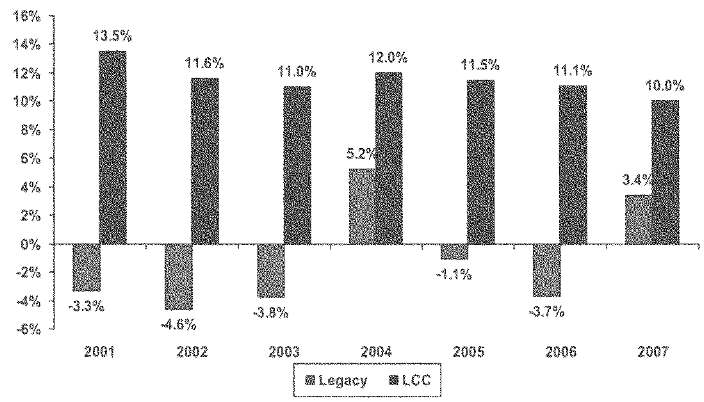
Southwest Airlines has continued to experience dramatic growth over the past several years. Since 2000, Southwest has grown at an average annual rate of 9 percent. Today, Southwest carries more domestic passengers than any other airline. Southwest also has been the most successful domestic airline at hedging against rising fuel prices and will continue to benefit from its 70 percent fuel hedge for 2008, and its 55 percent fuel hedge for 2009.

Southwest and other LCCs also command significant market share as a result of recent competitive successes:

- **Southwest:** continues to have the strongest balance sheet in the industry, with a business model built on growth and expansion; added new non-stop service on 23 routes in 2007; initiated service at San Francisco International and now offers 25 daily non-stop flights to four cities and connecting flights to 49 other destinations.
- **JetBlue:** added new non-stop service on 24 routes in 2007; experienced a 15 percent increase in passengers; and received a $300 million cash infusion from Lufthansa.
- **AirTran:** set record traffic levels in 2007, and enjoyed increased load factors and enplanements; added new non-stop service on 35 routes; ordered 15 new Boeing 737s; has added four new domestic destinations since May 2007.

As Figure 5 shows, LCCs have accomplished this dramatic growth during the same period in which legacy carriers have shrunk.

**FIGURE 5: YEAR-OVER-YEAR CHANGE IN DOMESTIC SCHEDULED ASMs**



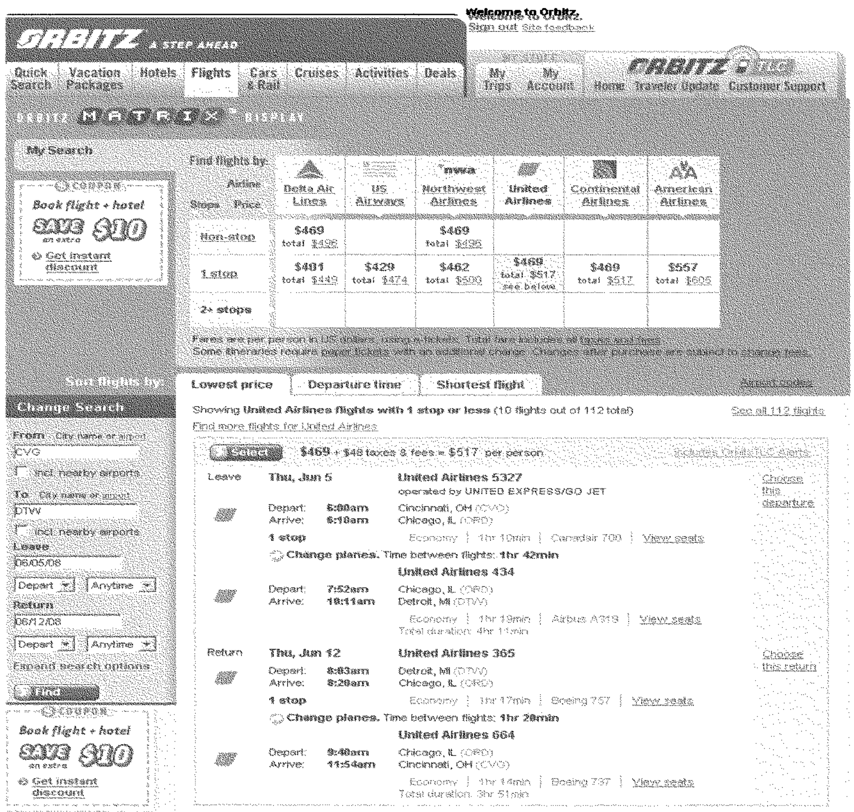

LCCs will continue to provide pricing discipline across the board. Entry in this business is wide open. There are plenty of airport gates available, and airplane manufacturers have always been ready to finance airplane deliveries.

In recent weeks, some smaller LCCs have gone out of business and Frontier Airlines recently filed for Chapter 11 protection. Nonetheless, competition from the large LCCs remains strong. In an April 11, 2008 report, Credit Suisse rated AirTran, JetBlue, and Southwest as "outperform."

*Technology Has Created a Transparency Revolution.*

Over the past several years, online sites such as Orbitz, Expedia, and Travelocity have been created to enable customers to compare airline offerings directly. (See Figure 6, depicting flight options from Cincinnati to Detroit as listed on Orbitz.com). These tools have provided enormous benefits to consumers and have increased the price-competitiveness of the airline industry. In fact, there are few businesses in which there is as much pricing transparency.

**FIGURE 6: ORBITZ.COM SEARCH SCREEN**




A consumer can log on to the Internet and, at the push of a button, review choices available across a wide variety of carriers. That same customer easily can sort those choices to find the lowest available fare and view extraordinarily competitive prices for both non-stop and connecting flights. For example, the Orbitz.com screen in Figure 6 displays competing one-stop connections on US Airways, Continental, United Airlines, and American for the Cincinnati-Detroit route.

Over the last several years, online travel sites have developed advanced search functions such as flexible-date airfare searching and route-specific e-mail fare alerts. Furthermore, sites such as Expedia, Orbitz, Travelocity, and numerous others provide their advanced pricing information and functionality to customers free of charge. Even business travelers now seek discount fares and travel sites such as Expedia Corporate Travel and Travelocity Business have evolved to target business customers.

In sum, customers have become far more sophisticated at comparing the offerings of competing carriers, and airline consumers have more tools at their disposal than do consumers in the vast majority of industries in the United States. As the *Economist* stated in June 2007, "[t]he web has made it possible for passengers to be their own travel agents by comparing fares and schedules and booking flights – and at prices much lower than a decade ago." ("Fear of Flying," *Economist*, June 14, 2007.) As online technology continues to evolve, airfare transparency will continue to be enhanced.

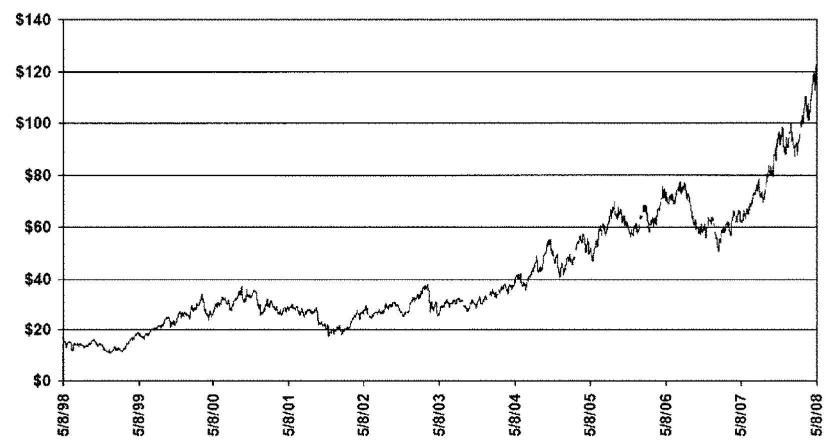
## II. Market Conditions Require Change in The Airline Industry

Significant economic pressures from record fuel prices and intense competition, particularly from discount carriers and foreign airlines based in Europe, the Middle East, and Asia, have fundamentally changed the airline industry. This new environment has resulted in diminished profits, restructurings, more than 150,000 lost jobs, and financial losses of over $29 billion among U.S. network carriers since 2001.

**Oil Prices Have Increased Dramatically And Continue to Rise.**

Record fuel prices have fundamentally changed our economics, forcing airlines to cut routes and reduce capacity and jobs. Over the last five years, the price of oil has increased at an annualized rate of 36 percent, now exceeding $120/barrel. (See Figure 7.) And the price of crude oil has nearly doubled over the past 12 months alone. In addition, the average crack spread for jet fuel was $31.61 in April 2008 — the highest monthly average ever, even compared to the post-Katrina crack spread spike.

**FIGURE 7: DAILY OIL PRICES ($ PER BARREL)**




Through the restructuring efforts of the past few years, Delta and Northwest have achieved the lowest mainline non-fuel cost of the full-service network carriers. Restructuring required substantial sacrifices by our employees in terms of lost positions, reduced pay, and reduced benefits. Our employees have made those sacrifices to give Northwest a chance to survive and grow.

Yet, given the rapid fuel increases over the past few years, we remain financially challenged. During the first quarter of 2008 alone, we spent $445 million more on fuel to operate virtually the same planes flying the same routes. We anticipate having to spend over $1.4 billion more for fuel this fiscal year than we did during the previous fiscal year due to price effects alone. And while it may seem that airlines are continuously raising fares to share these increased costs with consumers, the reality is that, thus far, consumers have covered significantly less than our incremental fuel cost increases. Today, fuel is the single highest expense of Delta and Northwest, significantly eroding the benefits of restructuring. Northwest recently reported a net first quarter 2008 loss of $191 million (excluding impairment charges and losses related to marking-to-market fuel contracts that settle in future periods) compared to a $73 million profit for the quarter last year. This difference represents a swing of $264 million from a year ago.

Because Delta and Northwest have already gone through bankruptcy and dramatically lowered costs, both carriers face fewer opportunities for further cost-cutting on a stand-alone basis. We have assured our employees that we will not ask them for any additional pay cuts. The significant synergies of this transaction enable Delta and Northwest to offset more effectively the dramatic increase in fuel costs in a way we could not achieve individually. In short, the combination of Delta and Northwest creates a company with a more resilient business model that can withstand volatile fuel prices more effectively than either could on a stand-alone basis.

**Open Skies and Consolidation in the Global Market Have Substantially Strengthened the Competitive Position of Foreign Flag Carriers.**

Competition is growing from foreign airlines based in Europe, the Middle East, and Asia as Open Skies agreements and mergers are making foreign airlines stronger competitors. The Open Skies agreement between the United States and the European Union, effective last month, has expanded aviation markets around the world. Now any European or U.S. airline can fly between any city in the European Union and any city in the United States, giving European carriers greater access to U.S. markets. Open Skies increases competition between European carriers and highly fragmented U.S. legacy carriers. Foreign flag carriers have been able to invest in new aircraft and improved service offerings and amenities because they have not been confronted with the same economic challenges facing U.S. carriers and because they pay their fuel bills with stronger currencies.

Delta/Northwest creates a global carrier with a first-rate international network, positioning the new carrier to compete effectively against foreign airlines. This international expansion could not be undertaken organically. Northwest could not establish a European and Latin American presence to rival Delta's without substantial fleet expenditures and the renegotiation of restrictive bilateral agreements in Latin America. A Delta/Northwest merger permits Northwest customers to access Delta's extensive European and Latin American networks in a cost-efficient way.

Similarly, Delta could not unilaterally recreate Northwest's significant Asian presence because of restrictive bilateral agreements, slot constraints, and the need for substantial fleet expansions. Northwest and United, alone among U.S. carriers, possess grandfathered rights under the 1952 U.S.-Japan bilateral that afford extensive access to Japanese markets and the ability to connect passengers through Japan to other markets in Asia. A Delta/Northwest merger will allow Delta's customers to benefit from greater access to Northwest's three Japanese markets and eleven other Asia/Pacific markets.

Combining the complementary international networks of Delta and Northwest creates the comprehensive global network that customers value. By consolidating, Delta and Northwest will be able to compete more vigorously and effectively with foreign competition.

## III. DELTA/NORTHWEST: A WIN FOR AMERICAN CUSTOMERS

Combining Delta and Northwest will offer customers greater choice, more competitive fares, and a superior travel experience. The combined airline will provide convenient connections between more destinations in the United States and around the world than any other airline. As a stronger, more financially stable company, the combined airline will be more able to reinvest in upgrading its fleet and enhancing the services that make flying more convenient and enjoyable for customers.

**The Combined Carrier Will Offer More Choices Worldwide Than Ever Before.**

The combined carrier will offer a true global network. The new carrier will offer service to over 390 worldwide destinations in 67 countries, including more than 140 small communities across America. Customers also will have access to 840 destinations in 162 countries through the SkyTeam Alliance.

Combining the networks of Delta and Northwest also paves the way for new route offerings. For example, Northwest Airlines is the preeminent U.S. airline serving routes between the United States and Asia, particularly Japan. However, our Asian network would be better utilized if it were connected to a domestic network of larger scale. For example, several years ago, Northwest discontinued service from Tokyo to New York because we did not have enough of a presence in New York to sustain that route. Delta, in contrast, has a strong presence in New York. The combined passenger volume of the two carriers will support re-entering the non-stop JFK-Tokyo route.

**Delta/Northwest Will Create the World's Largest Frequent Flyer Program.**

The merger will create the world's largest frequent flyer program. Because customers will be able to fly to more destinations and enjoy enhanced schedule options, they will have more opportunities to earn and redeem frequent flyer miles. Members of the existing frequent flyer programs of both Delta and Northwest will keep their current mileage and customer status post-merger.

**Delta and Northwest Are Uniquely Positioned for a Smooth Integration Process.**

Delta's and Northwest's complementary networks and common membership in the SkyTeam alliance will minimize the integration risk that has complicated some airline mergers. The carriers' frequent flyer programs, customer lounges, airline partner networks, and IT platforms already have been partially integrated through the SkyTeam alliance in which both Delta and Northwest participate. Thus, the carriers' previous investments in integration will allow for a more efficient and seamless integration process.

Heightened cooperation scheduled to occur in the transatlantic will further enhance the integration process. Last month, the Department of Transportation preliminarily granted antitrust immunity for a four-way joint venture among Northwest, Delta, Air France, and KLM. The combination of Delta and Northwest will facilitate an accelerated implementation of this joint venture, creating significant benefits for consumers.

We have already commenced a transition planning process to ensure a smooth integration. A task force has been established including senior leadership from all of the key operational departments of both companies. The task force has as its mandate to identify the best systems and best processes -- so that immediately after closing we will be in a position to proceed with integrating the companies.

## IV. Delta/Northwest Will Continue to Deliver Exceptional Service to American Communities

Because Delta and Northwest bring together complementary route networks with only minimal service overlaps, the combined company will preserve all of its hubs and serve more domestic and international destinations than any other airline. The new carrier will continue Delta's and Northwest's proud traditions of providing extensive service to small and rural destinations across the country. By combining, we will build on this decades-long history by providing small communities with service to hubs from which they will be able to directly connect to an even wider array of destinations on a single airline.

In the first half of 2008 alone, record fuel prices have forced the industry to reduce by more than 1.6 million the number of seats available to passengers. By the end of the year, Delta will have cut capacity by 10 percent, and Northwest by 5 percent. The merger, by producing a stronger competitor, will make service cutbacks less likely than if Delta and Northwest were to remain separate.

**The Combined Carrier Will Make Service to Smaller Communities More Secure.**

We take our commitment to serve customers in small communities very seriously. Together, Delta and Northwest will serve over 140 small communities, nearly double the amount of our next largest competitor.

By aligning our network strengths, we can enhance service from small communities to new international destinations. Indeed, 48 Northwest small communities will gain better access to 83 Delta international destinations. Post-merger, over 390 global destinations will be available on a single airline to each small community we serve, up from 250 on Northwest alone and 327 on Delta alone. Businesses in the upper Midwest will gain access to South America and expanded access to Europe, while businesses in the Southeast will gain better connectivity to Asian markets. Potential new economic development, trade, and tourism benefits from enhanced global access to and from cities and towns across the United States will arise due to the merged company's unprecedented international network.

Furthermore, the cost savings achieved by the merger will enable the new carrier to continue serving routes that the stand-alone carriers would have had to cut. Thus, the merger creates a more stable and secure platform for service in an airline environment plagued by volatility. By combining, Delta and Northwest will make existing service to small communities more secure.

**All Hubs Will Be Maintained**

The Delta/Northwest network formed by our seven geographically balanced U.S. hubs is the combined carrier's greatest asset. We have no intention of dismantling any hubs, and have committed to maintaining Atlanta, Cincinnati, Detroit, Memphis, Minneapolis/St. Paul, New York-JFK, and Salt Lake City. These hubs do not exist because they were selected at random by an airline planner throwing darts at a map. They exist because there was a strong local market that justified the development of hub service, and an air carrier with the resources to develop it.

Delta and Northwest made different – but sound – business decisions in developing hubs in the cities where they exist today. Furthermore, each hub has unique service points, which add value to the hub and to the network. (See Figure 8).

**FIGURE 8: UNIQUE REGIONAL SERVICE POINTS**


The merger provides the opportunity for Delta and Northwest to make better use of their hub infrastructure investments by generating additional traffic flows throughout the broader combined network. Because this is an end-to-end merger and because sound economics underlie our hub operations today, there is no need for hub closures.

*Detroit (DTW)*

Detroit is Northwest's largest hub and will continue to serve as Delta's premier hub in the Great Lakes region with connections across the globe. The state-of-the-art McNamara terminal, combined with vast airside capacity, provides an efficient connecting complex that has won high acclaim with consumers. Detroit's northern tier geography (which is shared by Minneapolis) places it along the optimal great circle path for service from many U.S. cities to points in both Asia and Europe.

Even though Detroit is a large hub with extensive service throughout the heartland region, Detroit has relatively few flights to the Southeastern United States, where Delta provides comprehensive network coverage, and Detroit has no service to South America, where Delta is a major player. Customers in Detroit, and especially the unique cities served in Detroit's large Midwest catchment area, will benefit from access to the Delta network. In terms of domestic ASM's, Northwest devotes 49 percent of its capacity to the North Central region, and just 17 percent to the Southeast. Conversely, Delta offers only 10 percent of its capacity in the North Central region, and 39 percent in the Southeast. Combined, the respective hubs of Delta and Northwest form a better balanced nation-wide network.

*Minneapolis/St. Paul (MSP)*

The added traffic from Delta's larger U.S. domestic network will help to strengthen and promote the development of Northwest's Minneapolis/St. Paul hub, including its international services. Northwest recently added non-stop service from MSP to London Heathrow and Paris. Delta is a major player in Europe, and the deepening partnership with our common SkyTeam partners Air France and KLM will contribute to the long-term success and development of non-stop international services from MSP. We are committed to retaining significant airline jobs, operations, and facilities in the Twin Cities, and the combined carrier will continue to be an important part of the Minneapolis/St. Paul community.

*Memphis (MEM)*

Memphis will continue to play an important role for the combined carrier. Memphis is a smaller but efficient and well-performing hub. The demand for air travel to and from Memphis – which has sustained a major airline hub for more than three decades – is not going to disappear simply because there is a neighboring Delta hub 330 miles to the East at Atlanta (ATL). Northwest's Memphis hub has existed alongside Delta's Atlanta hub since its inception, and the merger is not cause for its elimination. By coordinating and optimizing schedules across the complementary multi-hub network, the new carrier can improve operating results and offer greater frequency and better routing choices for its customers. Memphis provides an important opportunity for future growth when economic circumstances permit. Even with its fifth runway, Atlanta is operating at capacity. Memphis is a flexible and less congested alternative hub.

**CONCLUSION**

Northwest Airlines has carefully considered the effect of this transaction on our shareholders, our employees, our customers, and the communities we serve. We have concluded that the merger is a win for each of these stakeholders in our company. This merger is about paying employees fair wages, reinvesting in new products and services for customers, earning a return for shareholders who have committed their capital, and being a good corporate citizen. An unprofitable airline cannot do any of these things.

The combination of Delta and Northwest will offer customers greater choice, competitive fares, and a superior travel experience. It will maintain all of Delta's and Northwest's hubs and serve more domestic and international destinations than any other airline, including service to more than 140 small communities in the United States.

At this time, I would be pleased to answer any questions you may have.

**U.S. House of Representatives**
**Committee on Transportation and Infrastructure**
**Washington, DC 20515**

James L. Oberstar
Chairman

David Heymsfeld, Chief of Staff
Ward W. McCarragher, Chief Counsel

John L. Mica
Ranking Republican Member

James W. Coon II, Republican Chief of Staff

May 29, 2008

Mr. Douglas M. Steenland
President and Chief Executive Officer
Northwest Airlines Corporation
1212 New York Avenue, N.W., Suite 200
Washington, D.C. 20005

Dear Mr. Steenland:

On May 14, 2008, the Subcommittee on Aviation held a hearing on the "**Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger between Delta Air Lines and Northwest Airlines.**"

Attached are questions to answer for the record submitted by Rep. Daniel Lipinski. I would appreciate receiving your written response to these questions within 14 days so that they may be made a part of the hearing record.

Sincerely,

Jerry F. Costello
Chairman
Subcommittee on Aviation

JFC:pk
Attachment

**May 14, 2008**
**Subcommittee on Aviation**
**HEARING on**

**Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines**

**Questions for the Record**
**To:**

**Mr. Douglas M. Steenland**
**President and Chief Executive Officer**
**Northwest Airlines Corporation**

Mr. Steenland, thank you for your participation in the House Subcommittee on Aviation's hearing examining the impact of consolidation in the aviation industry. I appreciate you taking the time to respond to the following questions:

1. It has been widely reported in the media, and discussed at the hearing, that attempts were made to reach seniority and contract agreements with both pilot groups prior to the merger announcement. Were similar efforts made with the four other unions representing Delta and Northwest employees? If not, why, and what are the plans for working with these groups if the merger moves forward?

2. How does Delta plan to go about a fair and equitable integration of seniority lists?

3. At the hearing, I believe you stated that no hubs would be closed as a result of the merger. However, hub operations at Memphis largely duplicate those at Atlanta, and hub operations in Cincinnati duplicate those in Detroit. If these hubs are to remain fully operational, how can this merger result in cost savings?

4. Finally, the workers at Northwest airlines have a secure defined benefit pension plan. What will happen to their pension if Northwest merges with Delta Airlines?

NWA NORTHWEST AIRLINES

**Douglas M. Steenland**
President and
Chief Executive Officer

Northwest Airlines, Inc
2700 Lone Oak Parkway
Eagan MN 55121-1534
nwa.com

June 13, 2008

The Honorable Jerry Costello
Chairman, Subcommittee on Aviation
Committee on Transportation and Infrastructure
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Costello,

I appreciated the opportunity to appear before the Subcommittee on Aviation to discuss the benefits and rationale of the Delta/Northwest merger transaction. In response to your letter of May 29, 2008, I offer the attached written responses to the questions submitted by Rep. Daniel Lipinski for inclusion in the record.

Sincerely,

Enclosure

Questions #1 and #2 are answered together:

**1. It has been widely reported in the media, and discussed at the hearing, that attempts were made to reach seniority and contract agreements with both pilot groups prior to the merger announcement. Were similar efforts made with the four other unions representing Delta and Northwest employees? If not, why, and what are the plans for working with these groups if the merger moves forward?**

**2. How does Delta plan to go about a fair and equitable integration of seniority lists?**

We will honor our commitment to all U.S.-based, frontline employees to provide a process for the integration of seniority in a fair and equitable manner.

"Regarding seniority protection for the frontline employees of Delta and Northwest, Delta took the initiative last year when our Board of Directors adopted a policy to provide a process for fair and equitable seniority integration for employees of both companies in any merger. We pledged to use the seniority integration provisions from the former Civil Aeronautics Board's ruling in the Allegheny-Mohawk merger. Delta and many other carriers have used the Allegheny-Mohawk provisions in prior mergers, and they are also provided for in many collective bargaining agreements in the industry. Last December Congress passed legislation that required the use of the Allegheny-Mohawk seniority integration provisions in airline mergers. Delta successfully fought to assure that the law as passed protected all employees, whether union or non-union. We carried these principles through our negotiations with Northwest and have provisions in our merger agreement that provide for seniority protection."

Anderson Statement to House Judiciary Committee Task Force on Competition Policy & Antitrust Laws April 24, 2008

Merger negotiations are traditionally conducted between the management of the two firms. This is true not just for airline mergers, but for mergers across all industries. The merger discussions in this merger were unremarkable in that sense. However, in past airline merger transactions, companies have waited until closing before making an effort to integrate the pilot contracts and other labor agreements. We undertook an effort to do things differently this time. At the request of both pilot groups, during the negotiation of the transaction the pilot groups got together, worked on negotiating a new pilot agreement, and worked on negotiating a combined seniority list at the same time as merger negotiations were proceeding. A new pilot agreement was in fact reached, but the pilots working between themselves were unable to reach new seniority agreement. If that had happened it would have been revolutionary.

Although we decided to announce a transaction, we have indicated that we are committed to continuing that process of getting the seniority list finished and a combined agreement completed prior to the closing, which would also be precedent setting.

We are confident that with good-faith negotiations we will be able to reach agreement with labor in other areas of the combined company. The process with the pilots illustrates how difficult it is to do this all in advance. There is a commercial imperative to getting this transaction accomplished, but, as we have emphasized, fair treatment of all employees is very important and we are going to work with them to ensure a smooth integration process.

**3. At the hearing, I believe you stated that no hubs would be closed as a result of the merger. However, hub operations at Memphis largely duplicate those at Atlanta, and hub operations in Cincinnati duplicate those in Detroit. If these hubs are to remain fully operational, how can this merger result in cost savings?**

The Delta/Northwest network formed by our seven geographically balanced U.S. hubs is an asset of the combined carrier's. We have no intention of dismantling any hubs as a result of the merger. Our hub operations do not "duplicate" each other in Memphis and Atlanta and in Cincinnati and Detroit. The hubs exist because there was a strong local market that justified the development of hub service, and an air carrier with the resources to develop it. Delta and Northwest made different – but sound – business decisions in developing hubs in the cities where they exist today. No one can predict the future price of oil and consumer demand, which will impact the service levels and operations of all carriers irrespective of the merger. However, we think that the merger provides the best opportunity for Delta and Northwest to preserve and expand on their hub infrastructure investments by generating additional traffic flows throughout the broader combined network.

Let's look at Memphis and Atlanta as an example: Memphis is a smaller but efficient and well-performing hub. The demand for air travel to and from Memphis – which has sustained a major airline hub for more than three decades (and has survived two mergers) – is not going to disappear simply because there is a neighboring Delta hub 330 miles to the East at Atlanta (ATL). Northwest's Memphis hub has existed alongside Delta's Atlanta hub since its inception, and the merger is not cause for its elimination. By coordinating and optimizing schedules across the complementary multi-hub network, the new carrier can improve operating results and offer greater frequency and better routing choices for its customers. Memphis provides an important opportunity for future growth when economic circumstances permit. Even with its fifth runway, Atlanta is operating at capacity. Memphis is a flexible and less congested alternative hub.

Another key consideration is the business relationship and important corporate customers we have in our respective hub cities. FedEx, headquartered in Memphis, is one of Northwest's largest customers. We carry their sales people, their executives, their pilots, and other of their employees throughout our global network. The existence of Northwest's hub in Memphis actually has helped FedEx to grow and to expand. And they help us by sharing costs at the airport, which makes the Memphis airport a very attractive place for us to do business. FedEx is a critical customer and a great partner of Northwest. And they'll be a great partner of the merged airline going forward. The combined carrier has strong incentives to maintain service at all of the hubs.

**4. Finally, the workers at Northwest airlines have a secure defined benefit pension plan. What will happen to their pension if Northwest merges with Delta Airlines?**

"We will maintain the existing pension plans of both companies, both for current employees and for those already retired."

Anderson Statement to House Judiciary Committee Task Force on Competition Policy & Antitrust Laws April 24, 2008

# U.S. House of Representatives
## Committee on Transportation and Infrastructure

James L. Oberstar
Chairman

David Heymsfeld, Chief of Staff
Ward W. McCarragher, Chief Counsel

Washington, DC 20515

May 19, 2008

John L. Mica
Ranking Republican Member

James W. Coon II, Republican Chief of Staff

Mr. Douglas M. Steenland
President and Chief Executive Officer
Northwest Airlines Corporation
1212 New York Avenue, N.W., Suite 200
Washington, D.C. 20005

Dear Mr. Steenland

On May 14, 2008, the Subcommittee on Aviation held a hearing on the "**Impact of Consolidation on the Aviation Industry, with a Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines.**"

Attached are questions to answer for the record submitted by Rep. David Wu. I would appreciate receiving your written response to these questions within 14 days so that they may be made a part of the hearing record.

Sincerely,

Jerry F. Costello
Chairman
Subcommittee on Aviation

JFC:pk
Attachment

**MAY 14, 2008**
**SUBCOMMITTEE ON AVIATION**
**HEARING ON**
**"IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES"**

**QUESTIONS FOR THE RECORD**
**TO:**

**Mr. Douglas M. Steenland**
**President and Chief Executive Officer**
**Northwest Airlines Corporation**

1. Given your expressed interest in maintaining transpacific service for your Oregon customers, are you aware of the extreme importance of transpacific air service to the economy of Oregon? And are you aware of the history of intermittent international air service the state has had? Does the surviving company plan to maintain transpacific air service from Portland International Airport? Is the surviving company willing to make a binding commitment to continue transpacific services from Portland for a meaningful, post-merger period of time?

2. Just this spring Northwest Airlines started nonstop service to Amsterdam, Holland. Considering the importance of this flight to Oregonians who need to travel Europe, would the surviving company from this proposed merger be willing to make a binding commitment to maintaining this service for a meaningful period of time?

3. I would like to reiterate the request of the Port of Portland that representatives of the merging companies travel to Portland and talk to their customers about their concerns. Do members of your companies plan on visiting Portland for this purpose?

NORTHWEST AIRLINES

Douglas M. Steenland
President and
Chief Executive Officer

Northwest Airlines, Inc.
2700 Lone Oak Parkway
Eagan MN 55121-1534
nwa.com

May 29, 2008

The Honorable Jerry Costello
Chairman
Subcommittee on Aviation
2165 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Costello,

I appreciated the opportunity to appear before the Subcommittee on Aviation to discuss the benefits and rationale of the Delta/Northwest merger transaction. In response to your letter of May 19, 2008, I offer the attached written responses to the questions submitted by Rep. David Wu for inclusion in the record.

Sincerely,

**1. Given your expressed interest in maintaining transpacific service for your Oregon customers, are you aware of the extreme importance of transpacific air service to the economy of Oregon? And are you aware of the history of intermittent international air service the state has had? Does the surviving company plan to maintain transpacific air service from Portland International Airport? Is the surviving company willing to make a binding commitment to continue transpacific services from Portland for a meaningful, post-merger period of time?**

**2. Just this spring Northwest Airlines started nonstop service to Amsterdam, Holland. Considering the importance of this flight to Oregonians who need to travel to Europe, would the surviving company from this proposed merger be willing to make a binding commitment to maintaining this service for a meaningful period of time?**

Portland is an important international gateway for Northwest, and we fully expect Portland to continue to play an important role for the combined carrier after the merger with Delta. We need the continued valued support of the Portland business community to make full advantage of the international service offered at the airport by putting local traffic on these flights. Moreover, in the era of $135 per barrel oil, with unprecedented fuel price volatility, there is enormous pressure and stress on the airline industry and we cannot responsibly make binding commitments about the continuation of any flights in our network. What we can say is that the combined company will be stronger and better positioned to meet these challenges and will have a better chance of being able to preserve and expand international service than Northwest would on a stand-alone basis. We will have a stronger balance sheet and anticipate over $1 billion in annual cost and revenue benefits from the merger. There is a sound underlying business justification for both of our long-haul international flights from Portland, whether across the Pacific or the Atlantic, but the business cases that initially justified these flights assumed much lower fuel costs.

Portland-Narita: One of the reasons Northwest and Delta are merging is for Delta to gain better access to Asia. The Tokyo Narita hub is the centerpiece of Northwest's Asia network -- and the Portland-Tokyo flight is an integral part of that operation. Portland-Tokyo links into Northwest's Tokyo hub and provides onward connections to 12 important destinations in Asia including Shanghai, Beijing, Hong Kong, Seoul and many others. Delta, on the other hand, did not enjoy Northwest's unique ability to offer connecting service "beyond" Tokyo. Delta had no hub at Tokyo and lacked the right to carry local Tokyo passengers under the U.S. aviation agreement with Japan. The relatively small size of the Portland local market and the inadequate feed from Delta's mini-hub did not provide enough traffic to sustain Delta's stand-alone service on the Portland-Tokyo route. After the merger, the new Delta will enjoy the advantages of the Tokyo hub in addition to a larger domestic network which will help to support the flight.

Portland-Amsterdam: Portland-Amsterdam is a new undertaking, and there are no plans to terminate service; however, seasonal service adjustments may be necessary depending on the level of demand and the price of oil. Like Portland-Tokyo, the Amsterdam flight feeds into a large and well developed hub, which is home to Northwest's long-time transatlantic joint venture partner, KLM. Northwest/KLM together offer nonstop service from Amsterdam to more than 80 points in Europe, Africa, the Middle East and India. The DOT recently granted expanded antitrust immunity to Northwest, Delta, KLM and Air France to form an expanded transatlantic alliance. Portland-Amsterdam is one of the routes anticipated to be included in the expanded joint venture alliance with Delta and our European partners.

**3. I would like to reiterate the request of the Port of Portland that representatives of the merging companies travel to Portland and talk to their customers about their concerns. Do members of your companies plan on visiting Portland for this purpose?**

As noted, Portland is an important international gateway city for Northwest. We have regular and ongoing contact with the Port of Portland and our key corporate customers in the area. Northwest's regional sales manager is stationed in Portland. Immediately after the merger, the Port Director and Northwest's Senior Vice President, International discussed the merger and the continuation of Northwest's Portland operations. In addition, a letter was sent to all corporate customers, and we have responded to all questions and inquiries we have received about the merger. Northwest's largest customer in Portland, Nike, has stated that it supports the merger. If there are outstanding and unresolved issues identified by the Port, Northwest executives would be pleased to travel to Portland.

WRITTEN TESTIMONY OF
CAPTAIN DAVE STEVENS
CHAIRMAN, NORTHWEST AIRLINES MASTER EXECUTIVE COUNCIL
AIR LINE PILOTS ASSOCIATION, INTERNATIONAL
SUITE 875, 7900 INTERNATIONAL DRIVE
BLOOMINGTON, MINNESOTA 55425
952.853.2307

BEFORE THE
HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

REGARDING
"IMPACT OF CONSOLIDATION ON THE AVIATION INDUSTRY, WITH A FOCUS ON THE PROPOSED MERGER BETWEEN DELTA AIR LINES AND NORTHWEST AIRLINES"

May 14, 2008

STRONG · FOCUSED · SAFE
ALPA 75 Years
OF PILOTS IN COMMAND

Thank you, Mr. Chairman and members, for holding this hearing and providing me with the opportunity to testify with regard to the proposed merger between Northwest Airlines and Delta Air Lines.

I am Captain Dave Stevens, and I am Chairman of the Master Executive Council of the Air Line Pilots Association at Northwest Airlines. I am a 23-year Northwest pilot, previously employed by People Express and proudly served in the U.S. Air Force as an active and reserve pilot. There are currently over 5,000 ALPA-represented pilots flying for Northwest Airlines. The pilots at Northwest have undertaken an ongoing review of the proposed merger. We recognize that the combined company has the potential of becoming a stronger and more viable airline. However, the Northwest ALPA Master Executive Council and our pilots strongly oppose the merger as it now stands. The total economic potential of the combined corporation will not be achieved without a joint pilot contract, which is the only way for all of the predicted revenue enhancements and cost savings to be realized. A joint contract would also resolve potential labor discord which is counterproductive to achieving economic success. Given the current high cost of fuel, the broad economic downturn and the substantial costs related to an airline merger, the future viability of the combined company will be in question if it is unable to take advantage of every revenue opportunity.

A critical evaluation of the economics of the proposed merger is in the best interest of all groups affected by this merger. Management of the two airlines has stated that the merger will produce greater profitability as a result of a series of "synergies" that allow increased revenue and reduced costs. They will predict a financially stronger airline, one better able to serve all its stakeholders, including its customers. According to management, these synergies will result from an end to end merger rather than a traditional overlap reduction merger. However, many of the synergies and therefore much of the economic benefit management is counting on will be unavailable without a common contract that includes Northwest pilots. Indeed, for the new combined Delta/Northwest to have any chance of fully realizing its potential, all employee groups must be treated fairly regardless of their pre-merger carrier. Why is this true? Without a joint pilot contract, the two airlines' flight operations must remain separate, and without a single airline operation, much of the needed revenue growth and cost savings will not be achieved. Layer in the bad will created by contractually treating Northwest employees as "B scale", and matters will be even worse.

We appreciate Delta management's statements of optimism that we can obtain a common contract and an integrated seniority list prior to the date of corporate closing. However, we believe actions speak louder than words. To date, we have no negotiating sessions scheduled. Furthermore, Delta management has found the time to reach a tentative agreement with Delta pilots effective on the date of closure that excludes Northwest pilots. The more we review this document, the more questions we have as to Delta management's intent. We feel there is no reason to have several of the provisions in the new Delta pilot contract if the intent is truly to have a joint contact before closing. We are concerned that the reason for this agreement may be to put economic pressure on Northwest pilots to agree to an unfair seniority list. We will not do that. Contract terms can be changed, seniority is forever.

We agree with the statement of the Delta pilots that in their analysis a merged Delta-Northwest airline is stronger than a Delta standalone airline. However, our review shows that, as currently structured, the same is not true for Northwest. Given the current structure of this merger, we believe a standalone NWA is stronger than a merged Delta and Northwest. Our review also shows that Northwest Airlines is the best placed of any legacy carrier to weather the current high cost of fuel and economic downturn. Northwest has an enviable route system that includes a Pacific hub, flexible fleet, a fuel efficient order book of B787 aircraft and the most relative cash on hand of the legacy carriers.

We also appreciate that Delta Air Lines and Delta ALPA have proud traditions. We acknowledge that Delta Air Lines began in Monroe, Louisiana in 1925 serving the Mississippi Delta and has grown into a world-class airline. Delta ALPA has provided outstanding leadership to ALPA pilots over the years. Unfortunately, both Delta management and Delta ALPA seem to have forgotten that we at Northwest have our own proud traditions. The wings I wear say U.S. Air Mail reflecting that Speed Holman, our founder, began by carrying U.S. mail to the northwest United States in 1926. Furthermore, Northwest pilots have provided ALPA leadership from the very beginning. The ALPA Minneapolis Council for Northwest pilots bears the designation of *ALPA Council #1* because Northwest pilots were leaders in establishing the Association in 1931. That leadership continues as the most immediate past President of ALPA National was a Northwest pilot.

The seniority list integration of two pilot groups is always challenging. We understand that Delta ALPA seeks to protect the career expectations of Delta pilots. We have the same goal for our pilots. The union which represents both pilot groups, the Air Line Pilots Association, has a long-standing policy which establishes a process to integrate two seniority lists. Unfortunately, Delta management has sought to interfere in this process in support of the Delta pilot group. This support has created an unstable platform from which to achieve a successful merger because the Northwest pilots will not accept or agree to an unfair merged seniority list.
We understand that integrating the operations of these two large carriers will require a delicate balancing act to minimize employee discontent and maximize the employee harmony required to access the proposed synergies necessary for the merged carrier to be successful going forward. However, the steps to date will largely have the effect of maximizing employee discord. Rather than a joint statement by Mr. Anderson and Mr. Steenland that the new carrier was committed to a fair and equitable integration of work forces, we have only the statement of Mr. Anderson that he will protect the seniority of Delta employees, with the implication being that current Northwest employees will have to fend for themselves. Rather than negotiating a joint pilot contract, Delta Air Lines chose to negotiate contract improvements only for Delta pilots.

Notwithstanding the events leading to this point, the officers and representatives of the Northwest MEC are willing to negotiate with Delta management and Delta ALPA. However, time is critical. There is a small window of opportunity remaining in which to conclude a joint contract and a joint seniority list outside the traditional merger process.

I have tried in this statement to explain to you Northwest ALPA's concerns about the current situation. I ask that you evaluate this merger in the current context. I urge you to critically examine management's "promises" and statements of their "present intentions." Will the company meet its financial obligations and manage to abide by its promises to maintain current service and hubs, or will it shrink and shed thousands of jobs? What will the loss of those jobs mean to the broader economies of the states and regions affected? Will this merger work if management cannot achieve the expected synergies? In short, what happens if the merger does not succeed? We believe the market place shares our concern as evidenced by the tremendous loss of value to the share price of both companies since the merger announcement.

In our view, the proposed merger is risky for Northwest and Delta passengers, communities and employees. With the price of oil, the weak economy, the closed credit markets and the huge costs of combining the two companies, there will be no margin for error. As it now stands, the combined company will not have access to all the predicted synergies due to the lack of a joint pilot contract. The same lack of a joint contract is likely to cause pilot labor friction. Labor friction in other employee groups is also possible. The net result may be a weak combined carrier in a terrible economic environment. We all must seek to avoid this result.

Finally, there is an old saying that goes, "Fool me once shame on you, fool me twice shame on me." Are airline owners and managers about to fool us again? Past airline mergers have rarely, if ever, occurred as managements predicted. Remember, the fabulous claims American Airlines made about what they would do upon acquiring TWA assets? Similarly, Northwest made promises about jobs in northern Minnesota and a corporate headquarters in Minnesota when it needed cash from the State of Minnesota in the early 1990s. In both cases, their later conduct differed from their statements. Northwest and Delta management have already laid the ground work for reneging on their current promises with respect to the pending merger. They have left ample room to claim that any future reduction in service or jobs will not be due to the merger but, instead, will be due to high oil prices or a weak economy, etc. Where will that leave consumers, tax payers and employees?

Again, Mr. Chairman and members, thank you for calling this hearing and for providing me with the opportunity to testify regarding the Northwest pilot perspective on the proposed Northwest-Delta merger. I stand ready for any questions you may have.

Testimony of the Aircraft Mechanics Fraternal Association

United States Senate Commerce, Science and Transportation Committee
Aviation Operations, Safety and Security Subcommittee

"The State of the Airline Industry and the Potential
Impact of the Delta/Northwest Merger"

May 7, 2008

**SAFETY IN THE AIR BEGINS WITH QUALITY MAINTENANCE ON THE GROUND**

I am Steve MacFarlane, National Director of the Aircraft Mechanics Fraternal Association (AMFA), a craft union representing 4,200 aviation mechanics and related at Alaska, ATA, Southwest, Northwest (NWA), Mesaba, and Horizon. AMFA represents over 900 mechanics at NWA, and over 200 at Mesaba - one of NWA's regional subsidiaries. I am writing to share my organization's concerns regarding mergers and consolidation within the airline industry, specifically the proposed deal between Delta and Northwest. Having worked in the airline industry for twenty-five years and lived through two mergers, Hughes Airwest/Republic and Republic/Northwest, I can attest first hand to the harm that can befall workers caught up in airline mergers.

AMFA understands that consolidation within the industry is likely, and we are not necessarily opposed to consolidation *per se*, however, AMFA believes there are facts surrounding the Delta-NWA pairing that need to be addressed. These issues include, but are not limited to:

- The 500 NWA mechanics currently on furlough, whose last opportunity to return to work will expire on November 6, 2008.
- Current and potential future union representation at the combined carrier
- Billions of dollars in outstanding pension obligations
- The potential wave of mergers stemming from the approval of the Delta-NWA deal
- Promises made by management teams to garner political favor for deals that turn out to cause great harm, such as pledges to keep all hubs, employees, and small community air service.

Having endured devastating job losses and drastic reductions in pay and benefits coerced from airline workers throughout the industry over the past five years, we can't help but flinch at the prospect of another corporate tactic that has the potential of delivering yet another blow to the livelihoods of airline workers. Prior to the attacks of 9/11, AMFA represented nearly **10,000** mechanics and related at NWA. Immediately after the attacks, tens of thousands of frontline airline employees at numerous carriers were laid off, including about half of AMFA's NWA population. Today, the number stands at 910. AMFA members in Minnesota numbered over 6,000 during the late 90's alone. These workers earned above average wages, owned homes, and contributed significantly to the economy of Minnesota and the nation as a whole. There are now 615 AMFA NWA mechanics at MSP and 300 in Detroit (DTW). Most of them own homes in other states.

AMFA currently has approximately 400 Technicians and a little less than 100 cleaners on non-voluntary furlough. In order for us to support the merger NWA needs to insure these employees are given the opportunity to return to work for the "New Delta". Many of these furloughed employees were working for NWA long before Mr. Steenland or Mr. Anderson joined NWA; some of these men and women have 20 plus years at NWA. NWA and Delta have been unwilling to even sit down with AMFA to discuss our concerns. It seems they feel the only group they need to get buy-in from is the pilot group. Thousands of other employees and their representatives have needs and concerns that need to be addressed as well.

On November 6th, 2008 the approximate 500 employees on non-voluntary furlough will be terminated as a result of the expiration of their recall rights. NWA arbitrarily reduced the recall period from five years to two years in our strike settlement agreement. The "New Delta" could show some good faith to support their claims that they intend to protect jobs by:

- Reestablishing the original five-year recall rights which would extend by three years the November 6th, 2008 termination deadline currently looming over the heads of hundreds of NWA employees. Unless this action is taken approximately 500 NWA mechanic and related employees will be terminated in November of this year. By taking this action these long time NWA employees would simply be given the opportunity to bid for a job as they became available.
- Offer the furloughed employees that have recently reached the age of 55 the opportunity to return to work for one day in order to retire active, which would increase their pension payments by hundreds of dollars per month. NWA has been given a freeze on benefit accruals and many years of relief from the government to fund their pension obligations. The "New Delta" should be required to at least live up to their end of the agreement by paying the full value of the pension and not receive yet another opportunity to short change their retirement eligible employees by terminating them.
- Offer the rule-of-60 flight benefits to those currently on furlough (age + yrs of service = 60). This action would result in lifetime retired employee flight benefits, something offered to all employees that chose to resign but not those who chose the furlough.

Former mechanics have, in many cases, moved on to lower-paying jobs and turned to refinancing homes or other forms of debt to sustain their families. This scenario shows that for all the numbers thrown around about how vital an airline is to an economy - both micro and macro - the benefits must be more than residents with proximity to a certain airport being able to fly to Mexico City via Salt Lake City. With no economic base to support leisure travel, and the forecasted "15-20% rise in ticket prices[i]" needed to offset soaring fuel prices, the current crisis in the industry will, by this logic, expand to the point where no one will be able to fly.

The government has provided great assistance to the airline industry after 911 and during difficult times, in the form of the ATSB, whereby $5B in taxpayer dollars was given to the industry without any guidance as to how the airlines were to spend the money. Another $10B was made available for loans to assist the ailing industry. While this is laudable, no help was forthcoming to the tens of thousands of workers who lost their jobs.

Additionally, federal bankruptcy laws, never intended to be used as a strategic tool for competitive purposes, were turned against workers as federal judges aided executive management teams in extracting severe, painful, and permanent concessions from American airline workers. Pensions were defaulted, work rules changed, workforces reduced by thousands, wages slashed, and on and on. We acknowledge the value and benefit of having a viable airline industry that provides great mobility and swift commerce for our nation; however, the other part of the equation is a stable and productive middle class that contributes to the economic vibrance and tax base of the American economy.

Now, as we enter the era of Open Skies and mega-carriers, the need for scrutiny grows. NWA and Delta claim that employees will be given a 4% stake in the merged company. Employees at United Airlines can attest to the perks of ESOP programs, where $125,000 in stock yielded a $1,800 payout. This merger does nothing to allay concerns of future bankruptcy filings, and future financial distress. In fact, the cost of merging has been reported to be somewhere near $1 billion. Given the combined $10 billion in losses by NWA and Delta in the first quarter of 2008, it seems the carriers need all the

[i] Delta CEO Richard Anderson quoted by Associated Press. USA Today April 22, 2008

money they can get. Even without "one-time" costs of $6 billion for Delta and $4 Billion for NWA, the two combined to lose just short of $500 million in the quarter - largely due to $115/bbl oil.

Oil and refined fuel commodity prices will not decrease with the formation of the largest airline in the world. With this merger, the company will have a fleet of over 800 aircraft, with the only overlap in aircraft type being the Boeing 757-200 (Delta - 131; NWA - 71)[ii]. This means the combined carrier will have 19 different and unique aircraft, and a fleet that will be one of the oldest in the industry. The companies have said that the carrier will be able to right size aircraft to specific routes, and park older airplanes, but both airlines have stated their individual intentions to do this in the next year anyway, as well announcing cuts in mainline capacity. The costs of the merger procedure fly in the face of the actions the companies are taking independently.

Earlier in the month, Delta, NWA, Air France-KLM, CSA Czech Airlines and Alitalia were granted antitrust immunity for their international code-share alliance operations as part of the SkyTeam Alliance. This, combined with Stage I of the US-EU Open Skies Agreement (OSA), appears to be leading to the creation of global mega-carriers, and with it, the gradual erosion of the traditional airline employee. If not for US ownership and "actual control" restrictions, perhaps trans-Atlantic consolidation would have been realized already. In fact, Stage I of the OSA stipulates that if the US does not liberalize its ownership requirements for a Stage II agreement, Stage I will be negated and withdrawn.

While many employees would likely welcome being part of the world's largest air carrier, that endorsement cannot come without some tangible benefits. Airlines have lost $29 billion since 2001, defaulted or deferred over $20 billion in pension obligations, and laid off over 150,000 employees. These facts show that something fundamental *must* change. But, how does this merger, and the likely wave of mergers to follow afterward, change anything? It seems more likely a continuation down the same pothole-laden path.

Again, AMFA is not against Delta and Northwest merging, but we are hard pressed to see how this betters the industry and provides stability to its employees. At a minimum, Delta's mechanics must be

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[ii] Aviation Week & Space Technology Aerospace Sourcebook 2008. Pgs 364 & 372

given a fair chance to vote on representation. AMFA has received a significant number of NMB cards, and stands to vie for representation in the event that this merger is approved. If the workers of the merged carrier choose no representation through a vote, then so be it. But, we feel that in the current environment, the mechanics at a combined Delta will see that as at-will employees, they will have little recourse in the event of another severe industry downturn.

We hope that all the promises made by Mr. Steenland and Mr. Anderson come to fruition and this merger works well for everyone involved. But sadly, rank and file airline employees have been down this road before, and historically it has ended with thousands of layoffs for airline workers and a few golden parachutes at the top for executives..

C4CC
Consumers for Competitive Choice

May 16, 2008

Subcommittee on Aviation
Transportation and Infrastructure Committee
U.S. House of Representatives
2165 Rayburn House Office Building
Washington, DC 20515

RE: Subcommittee Hearing "Impact of Consolidation on the Aviation Industry, with Focus on the Proposed Merger Between Delta Air Lines and Northwest Airlines"

We would like to thank Chairman Costello and all the members of the House Subcommittee on Aviation for allowing us to submit this written testimony in support of the merger between Delta Air Lines and Northwest Airlines.

Consumers for Competitive Choice (C4CC) is an alliance of consumer organizations with one million members throughout the United States, which are committed to the development of a competitive and vibrant consumer market. Our goal is the creation of an open, diverse, pro-consumer market that will stimulate price, expand choice and improve service. We are a 501(c) 4 non-profit organization with a membership of over one million consumers who are consumers and small business owners.

Certainly we are very concerned about competition and choice among airlines, particularly given events in recent years. More than 150,000 jobs and $29 billion have been lost since 2001. With a slowing U.S. economy and rising fuel costs, the challenges facing airlines hold the potential to disrupt service and limit options for consumers. That is why we believe mergers such as this one, which is motivated by growth, financial stability and a desire to more effectively compete for international travelers, serve the interests of consumers through the creation of a stronger, more reliable airline.

Perhaps the most important factor to consider is the complementary route networks between Delta and Northwest. Delta competes most effectively in the South, Mountain West, Northeast, Europe, Africa and Latin America, while Northwest is stronger in the Midwest, Canada and Asia. Among more than 1,000 non-stop city pairs, only twelve are served by both airlines, and eight of those pairs are still served by other competitors. Only two percent of Delta's seats are currently in direct competition with Northwest. Regarding route options, the merger will leave the competitive landscape virtually unchanged.

Consumers will have more choices and scheduling flexibility with the new airline. Domestically, Delta will serve more than 140 small communities after the merger. The combined airline will better serve smaller and less profitable airports and create more seamless connections for travelers by matching the right planes to the right routes. The new airline will feature over 390 destinations in 67 countries, as well as access to 840 destinations in 162 countries through the SkyTeam Alliance. The world will be a smaller place for travelers.

The continued presence of discount carriers, which have increased their market share from 24 percent in 2000 to 34 percent in 2007, will assure competitive pricing. Discount airlines account for 60 percent of outstanding narrow body aircraft orders, guaranteeing their further expansion. Southwest will still have the largest domestic capacity, and similar airlines will continue to compete with Delta's seats much in the same way as they do now. And no airline will have more than a 20 percent share of domestic passengers once the transaction closes.

Delta will emerge from the deal as a stronger competitor in terms of customer service and the travel experience. Higher volume and additional revenue will allow the airlines' to reinvest in their infrastructure. Both airlines plan to accelerate upgrades in refurbished cabin interiors such as lie-flat seats and on-demand entertainment. Furthermore, new technology on the ground will facilitate easier self-service and better bag handling. While discount carriers will keep pricing low, the post-merger Delta will up the ante industry-wide in terms of the quality of flying. Consumers will win on all counts.

Lastly, one of the airlines' major objectives in pursuing this merger is to better compete with international carriers. The domestic market is already saturated in many ways, but the best chance for growth is for the long-haul business traveler and tourists coming to and from the United States. The European Commission has promoted more efficient and stable airlines on that continent through such mergers. This merger allows an American airline to more effectively compete with foreign airlines in a global economy.

We do not believe the merger raises significant concerns regarding its impact on the consumer and competition within the market place. Quite the contrary, a more financially stable airline with the scale and scope to compete in today's economic climate creates significant benefits for consumers.

Both of these airlines have had their financial challenges, which they can overcome with this merger. Bankruptcies and layoffs have become too prevalent in the industry. Skybus, ATA and Aloha have all failed in recent months; Frontier has cut service in bankruptcy.

Any merger concerns must be counterbalanced with the reality that defunct airlines benefit no one. Consumers would do far better with a financially stable airline that could offer service to hundreds of destinations worldwide, provide state-of-the-art travel experience and continue to compete with discount carriers in terms of pricing. That is what the Delta/Northwest merger will produce. Thank you.

Committee on Transportation & Infrastructure
Subcommittee on Aviation

Hearing on:
Impact of Consolidation
On the Aviation Industry
with a Focus on the Proposed Merger between
Delta Air Lines and Northwest Airlines

May 14, 2008

Testimony for:

Detroit Regional Chamber
Sarah Hubbard
517.372.2278

DetroitRegionalChamber
*Powering the economy for Southeast Michigan*

**Testimony before the U.S. House Aviation Subcommittee Regarding Impact of Consolidation on the Aviation Industry With a Focus on the Proposed Merger between Delta Air Lines and Northwest Airlines By The Detroit Regional Chamber May 14, 2008**

Chairman Costello, Congressman Petri, members of the Committee, thank you for the opportunity to appear before you today.

With 23,000 members, the Detroit Regional Chamber is the largest local chamber of commerce in the country. Our mission is carried out by attracting new business to our community, through public policy advocacy, strategic partnerships and by providing quality products and services for our members.

Northwest Airlines has been – and remains – a very positive force for economic development in the Detroit area. The presence of a Northwest hub since 1986 and their leadership in constructing the world-class Ed McNamara terminal at the Detroit Metropolitan Airport is a testament to their commitment to our region. Northwest Airlines is a respected and admired member of the Detroit regional business community.

The Chamber believes the Delta and Northwest merger will enhance the Detroit Region's ability to compete for new business development, for tourism and as both a destination and waypoint for travelers. The prospects for this merger are very complementary to the logistics hub and aerotropolis initiatives being aggressively pursued by our business community. These plans envision leveraging the region's air, land and sea resources to establish a major transportation center for moving people and goods around the globe. Being a strong hub for a true global carrier will better help the region realize this goal.

Detroit Metropolitan Airport is one of our region's strongest economic development assets. We believe the Northwest-Delta merger will position us to serve as the centerpiece of Delta's Midwest network and – through that expanded network – improve our access to destinations throughout the globe. The combined airline will reach more cities than any other airline and will be better positioned to compete for travelers on a global basis. Those travelers, in turn, will enjoy a greater exposure to the business and leisure benefits our region can offer.

Delta and Northwest currently generate more than $11.5 billion in combined annual economic benefit and employ approximately 9,150 people in Michigan. Since this is a merger of addition (not subtraction) it is our belief that the economic impact on our region will grow.

Current non-stop service to Japan, Gatwick airport in London and planned direct service to Heathrow airport in London and Shanghai, China provide needed service for our region's automotive industry.

Northwest's new nonstop service to Shanghai will benefit key Midwest manufacturing interests with growing trade and growing ties to China. Michigan and Northern Ohio are home to 25 Fortune 500 companies and there are 23 Chinese firms doing business in Metro Detroit. The U.S. auto industry is in the process of reinventing itself to become more competitive and more efficient in the global marketplace, and Detroit auto manufactures have been investing in China. This burgeoning trade relationship creates substantial China passenger and cargo demand in Detroit and throughout the Midwest Heartland.

The Wayne County Airport Authority estimates the benefit of new Shanghai service to the Michigan economy to exceed $160 million, and nonstop Beijing service to produce an additional $105 million in benefits, for a combined total of $265 million.

We are pleased that the combined airline is committed to maintaining Detroit as a hub airport and we believe that its larger network will make additional international routes possible. We look forward to an expansion of direct service to destinations in great demand by our business community as a result of the merger. We expect the combination to eventually open up opportunities for direct connections from Detroit to Latin America and South America – areas of great interest to businesses throughout our region.

The merger combines Delta's strengths in the South, Mountain West, Northeast, Europe and Latin America with Northwest's leading positions in the Midwest, Canada and Asia. At the same time, we agree with the observation that competition will be preserved and enhanced. Detroit Metro Airport is currently served by 17 domestic and international airlines, including five discount carriers; that situation will not change appreciably as a result of this merger. In addition, Northwest and Delta currently operate complementary networks with relatively little overlap.

Building on both airlines' long history of serving small communities, the new Delta will improve worldwide connections to small towns and cities across the U.S., enhancing their access to the global marketplace. Following the merger, Delta will serve more than 140 small communities in the United States - more than any other airline. In Michigan, the airline will serve Detroit, Lansing, Kalamazoo, Flint, Grand Rapids, Muskegon, Saginaw, Traverse City, Alpena, Pellston, Sault Ste. Marie, Marquette, Escanaba, Iron Mountain, and Hancock. Many of our smaller cities in Michigan are dependent on the continued strength and growth of Northwest Airlines; we believe the merger is good for these communities and for all of Michigan.

The merger will strengthen the combined airline and our community by giving it a greater ability to withstand the crushing effect of high oil prices. As oil continues to set new all-time highs practically on a daily basis, American companies must find creative management strategies to remain competitive internationally. The merger will make the cost of fuel a smaller percentage of the over-all cost structure of the firm and will allow them to participate in greater long-term price hedging strategies.

Again, thank you for this opportunity to comment on the proposed merger of Delta and Northwest Airlines. We fully support the merger and would hope that the members of the Committee will join us in that position.

If you have any questions, please do not hesitate to contact Sarah Hubbard, Vice President, Government Relations at shubbard@detroitchamber.com or 517.372.2278.

Committee on Transportation & Infrastructure
Subcommittee on Aviation

Hearing on:
Impact of Consolidation
On the Aviation Industry
with a Focus on the Proposed Merger between
Delta Air Lines and Northwest Airlines

May 14, 2008

Testimony for:

Memphis Regional Chamber

Memphis Regional Chamber

**TESTIMONY OF THE MEMPHIS REGIONAL CHAMBER AND THE MEMPHIS/SHELBY COUNTY AIRPORT AUTHORITY BEFORE THE HOUSE AVIATION SUBCOMMITTEE DELTA / NORTHWEST AIRLINES MERGER**
**May 14, 2008**

**Introduction**

The Memphis Regional Chamber and the Memphis/Shelby County Airport Authority firmly believe that approval of the proposed merger of Northwest and Delta is the best way to secure and promote Memphis's status as a major airline passenger hub. The combination of the two carriers will create America's premier global airline. The new airline will have the financial strength and a better network to serve the Memphis community, provide greater job security and growth, make the aviation industry more stable, and benefit the U.S. economy overall.

It is no coincidence that two major airlines have established hubs in Memphis. Northwest and its Airlink carriers operate more than 230 daily passenger flights, and FedEx has developed Memphis into the world's busiest air cargo hub. Memphis is ideally located in the south central United States -- near the center of the U.S. population base. Moreover, Memphis has a strong regional economy and skilled workforce, which contributes to the success of our two airline hub operations.

Northwest is our hometown passenger carrier, and has served the Memphis community well for over two decades. It is important to remember, however, that Memphis became a Northwest hub by virtue of Northwest's merger with Republic Airlines in 1986. And, before that, Republic was created when Southern and North Central merged in 1979. Simply put, mergers, acquisitions (and airline failures) have been a prominent feature of the airline industry since deregulation. Yet, Memphis has endured as a hub. Based on the "business case" of MEM as a proven and successful hub -- as well as the specific assurances we have received from Delta and Northwest that there will be no hub closures -- we fully expect Memphis to continue to play an important role to the combined carrier after the merger.

With mounting pressures from low cost carriers, as well as sky-high oil prices, many believe that consolidation among the major legacy carriers is inevitable. From Memphis's perspective, the end-to-end combination of Northwest and Delta creates the greatest opportunity for stability and growth, with the least amount of overlap. The merger will allow for more efficient use of the companies' combined strategic assets and thereby strengthen the economies of the communities served by the two airlines. The scale and strength of the new global airline will make jobs more secure and provide a better quality of life for employees.

**The proposed merger will help to secure jobs and airline activity at the Memphis Hub**

Together, Northwest and Delta employ about 4,000 people in Tennessee, the vast majority of whom are frontline employees working in Memphis. According to the two airlines, these employees of both airlines are protected by a promise of no involuntary furloughs and a commitment that any employee who wants to stay with the combined airline will have a job.

The biggest threats to airline jobs are not mergers but bankruptcies and high oil prices. Since 2001, the airline industry has lost over 150,000 jobs through bankruptcy and recession; and, in the first half of this year, fuel prices have permanently grounded five U.S. airlines. The proposed merger helps mitigate those threats.

**The merged airline will connect Memphis and the Mid-South Region to the world.**

The combined company will offer service to more destinations around the world than any other U.S. carrier. By combining Northwest's leading positions in Canada and Asia with Delta's strength across the Caribbean, Latin America, Europe, the Middle East and Africa, customers and communities will benefit from enhanced access to destinations worldwide. Even with its new runway, Atlanta is operating at capacity. Memphis provides the combined carrier with a flexible and less congested alternative to transport connecting passengers throughout the Southeastern United States. Moreover, the expanded network of the combined carrier will provide Memphis and the surrounding areas with potential opportunities for economic development, new investment and increased tourism.

Northwest provides Memphis with its only nonstop passenger service to Europe (Memphis-Amsterdam). We are very pleased that the Department of Transportation recently approved antitrust immunity to Delta, Northwest, and their respective European partners, Air France and KLM. By creating a merger with the SkyTeam Alliance, the potential for service disruptions is minimized.

**Competition among carriers in Memphis will continue to thrive.**

The combination of Delta and Northwest will not change the competitive environment for customers in Memphis. Delta has 14 daily departures from Memphis, while Northwest has 233, demonstrating that the companies have complementary route networks and very little overlap. Two discount carriers, AirTran and Frontier serve Memphis, and the only overlap route between Northwest and Delta (Memphis-Atlanta) has competitive low cost service on AirTran.

**Memphis is a diverse and growing community that is highly dependent on air service.**

Memphis is one of the most significant cities in the central United States for several fundamental reasons. It is large, with a current metro population of more than 1.2 million which is forecast to exceed 1.3 million by the end of this decade. It has a vibrant and growing economy on many levels. Average personal income for residents of the Memphis Metropolitan Statistical Area ("MSA") is expected to continue its strong annual growth of 4.0%, reaching $42,017 by 2010. Memphis experienced $16.5 billion in retail sales for 2005, and those sales are expected to surpass $20.5 billion by 2010 based on the continuation of its impressive decade-long growth rate of 4.4% per year.

Given its central location at the intersection of Interstates U.S. 40 and U.S. 55 (two of the principal highways in the central United States), Memphis

International Airport, service by five of the six U.S. class-one railroads and the Mississippi River, Memphis has become one of the world's leading intermodal transportation hubs – often being described as "America's Distribution Center." Specifically, Memphis provides water-to/from-rail, water-to/from-truck, rail-to/from-truck, and air-to/from-truck linkages. More than 300 motor freight companies operate in the Memphis MSA, from which 152 markets are served overnight, more than from any other city in the U.S., while 45 states can be reached with two-day truck service. More than twenty container depots are located in Memphis, and there are two Foreign Trade Zones with multiple sites. More than $10 billion in goods clear customs in Memphis each year through twelve full-service customs brokers.

Passenger access enables so much of Memphis's economic vitality from Fortune 500 companies to NBA basketball to curing childhood diseases. Memphis is home to the world headquarters of FedEx, AutoZone, International Paper, and ServiceMaster. Memphis's St. Jude Children's Research Hospital is internationally recognized for its pioneering work in finding cures and saving children with cancer and other catastrophic diseases. Memphis is the nation's second-largest center for the manufacturing of orthopaedic devices. The Downtown Memphis area is enjoying a rebirth, with growth in businesses, restaurants, and commercial and residential properties to complement its diverse arts and cultural communities. Its historical and ongoing contributions to the music industry – Home of the Blues, Birthplace of Rock & Roll, and Graceland – are world-renowned. Memphis is home to NBA basketball's Memphis Grizzlies.

In addition, our community has embarked on a major economic development initiative to ensure Memphis has a strong and diverse economy, fosters innovation and entrepreneurship, and advances the region's global leadership in the bioscience, music/film and logistics industries. This will ensure the strength of our growing economy and citizenry.

The Memphis International Airport has played a vitally important role in making Memphis the economically vibrant and attractive community it is. In the 2006 Fiscal Year, Memphis International Airport handled 10,853,934 passengers and an unsurpassed 4,009,413 tons of cargo making it the largest air cargo hub in the world. Given this commercial and trade activity, it is not surprising that the Memphis International Airport's contribution to the local economy is substantial. Cargo operations alone generated a total impact of more than $19.5 billion in 2004 and supported a total of 155,872 jobs with total earnings of nearly $5.6 billion.[1] The direct and indirect economic impact of passenger services was almost $1.2 billion, supporting almost 10,000 jobs with total earnings in excess of $340 million. In total, in 2004, the Memphis International Airport generated over $10 billion in direct expenditures and created an economic impact output of more than $20.7 billion and 165,500 jobs.[2] Community leaders are determined to continue the strength of the airport by amplifying Memphis's position as America's Aerotropolis.

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1 "The Economic Impact of Memphis International Airport," prepared by Sparks Bureau of Business, University of Tennessee, May 2005, at 7.

2 Id., at 12.

**Conclusion**

The Memphis Regional Chamber and the Memphis/Shelby County Airport Authority welcomed the news of the Delta/Northwest merger announcement. This is, as the carriers have said, "a merger of addition, not subtraction." Memphis has a strong economy, a skilled labor force, and the airport infrastructure to attract and sustain air service. We look forward to continuing to play a vital role as a hub city for the new Delta.

John W. Moore
President and CEO
Memphis Regional Chamber

Larry D. Cox
President
Memphis/Shelby County
Airport Authority

Committee on Transportation & Infrastructure
Subcommittee on Aviation

Hearing on:
Impact of Consolidation
On the Aviation Industry
with a Focus on the Proposed Merger between
Delta Air Lines and Northwest Airlines

May 14, 2008

Testimony on behalf of:

Minnesota Chamber of Commerce
Minneapolis Regional Chamber of Commerce
Saint Paul Area Chamber of Commerce
Metropolitan Coalition of Chambers

**TESTIMONY**
**ON BEHALF OF THE MINNESOTA PARTIES[1]**
**BEFORE THE HOUSE AVIATION SUBCOMMITTEE**
**MAY 14, 2008**
**DELTA / NORTHWEST AIRLINES MERGER**

**Introduction**

Chairman Costello, Congressman Petri, members of the committee, we submit this testimony on behalf of the Minnesota Chamber of Commerce, the Minneapolis Regional Chamber of Commerce, the Saint Paul Area Chamber of Commerce and the Metropolitan Coalition of Chambers representing thousands of businesses throughout the state of Minnesota. Thank you for the opportunity to file testimony on a matter of great importance to all of the residents of the Twin Cities and Minnesota.

The Twin Cities business community was a driving force behind the growth and development of Northwest Airlines. The carrier took flight in 1927 thanks to the determined efforts of civic leaders who recognized the importance of good air service for the progress of the Twin Cities and the development of its economy. From its first flights as a mail carrier and over the next 82 years, Northwest has contributed to the Twin Cities' and Minnesota's economy far beyond even the bold visions of its founders. Today, Northwest operates 475 daily flights from Minneapolis/St. Paul International Airport to more than 150 destinations, including nonstop international service to Tokyo, Amsterdam, London, and beginning this month, Paris.

It's impossible for proud Minnesotans like us to not have mixed emotions about last week's merger announcement. Northwest is as much a part of our state as our lakes, our winters and our hockey. Even so, Minnesota businesses recognize that this merger is an economic necessity for both airlines in an era of unprecedented pressures from record oil prices, economic distress and competition.

[1] This testimony is offered on behalf of the Minnesota Chamber of Commerce, Minneapolis Regional Chamber of Commerce, Saint Paul Area Chamber of Commerce and the Metropolitan Coalition of Chambers, representing thousands of businesses throughout the State of Minnesota

We also recognize and expect that, while the Northwest name may cease, the air service that drives billions of dollars of economic activity will go forward under the Delta banner. Minneapolis/St. Paul will continue as a major, primary and growing airline hub, providing economic benefits to the Twin Cities and the entire upper Midwest region. Both Delta and Northwest have pledged to grow – and strengthen – our hub, to maintain substantial management and line operations in Minnesota and to continue to be one of our largest employers. The new Delta has the opportunity to use its financial strength and the superior network to serve Minnesota better; to provide greater job security for its employees; and, to catalyze economic activity statewide.

The MSP hub has been and will continue to be critical to the ongoing development of our economy. The benefits of the hub – frequent, non-stop service to a wide range of domestic and international destinations – makes it easy for our citizens to travel for business and leisure and – even more importantly – for the world to come to Minnesota to do business with us and to experience our natural and cultural beauty.

The numbers, Mr. Chairman and members of the Committee, are compelling.

In 2004, the most recent data available, our airport generated 153,000 jobs, $6.0 billion in personal income, $10.7 billion in business revenue, $1.3 billion in sales, and $626 million in local/state taxes.[2] In 2000, 2001, 2002, and again in 2004, the International Air Transport Association named MSP "the Best Large Airport in North America", as measured by overall consumer satisfaction. In 2004, J.D. Power and Associates ranked MSP as the 3rd best large airport in the world, after Frankfurt and Denver.

According to the U.S. Census Statistical Abstracts (2007), Minnesota's compound annual growth rate (in terms of Gross State Product) ranked 9th among the 20 largest states, ahead of states with much larger gross state products like New York, Illinois, and Pennsylvania. Minnesota is also home to large, world-class companies, including the headquarters of 19 Fortune 500 public companies (2007) and 12 Forbes 500 private corporations (2007) representing a broad spectrum of industries. 3M, U.S. Bancorp,

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2 Minneapolis-St. Paul Metropolitan Airports Commission, Economic Impact Statement, March 7, 2005.

Target, General Mills, United Health Group, Cargill, and Medtronic each call Minnesota home, and many of these large companies have business interests or operations in foreign countries – in part because of the ease of travel across the Northwest network. Not surprisingly, the strong metropolitan, statewide, and regional fundamentals – the product of a well-diversified economy and an economic base of world-class corporations – generate substantial demand for air service.

There are, of course, many factors that make our state's economy what it is, but a necessary ingredient for our success is the hub and particularly its health and continued growth. Its current status and future growth are secured by the commitments of the merged airline's board of directors and management.

Implementation of this promise will rest with thousands of front-line employees who work on the ground and in the air. These employees are protected by a promise of no involuntary furloughs and a commitment that any employee who wants to stay with the combined airline will have a job. Bankruptcies and high oil prices present a much greater threat to airline employees than mergers. In fact, the airline industry has lost over 150,000 jobs since 2001 (USDOT Form 41 data) through bankruptcy and recession. Five U.S. airlines have failed so far this year due to high fuel prices and a struggling economy. The combined airline will be better able to meet those challenges.

**The merged airline will provide Minneapolis/St. Paul and the upper Midwest with a superior global network**

The new Delta will be America's premier global airline with service to more destinations around the world than any other carrier. Combining Northwest's heritage in Canada and Asia with Delta's network throughout the Caribbean, Latin America, Europe, the Middle East and Africa creates a larger, more attractive network than either airline can offer alone. This "network effect" as it's called makes it easier for the new airline to enter new and underserved markets and attracts new customers who want the convenience and familiarity of a single global airline. The expanded Delta network will strengthen and preserve the primacy of our Twin Cities hub by making it economical to serve more destinations and provide more schedule options.

Hubs are particularly valuable because of the international service they support. Nonstop international air service is very important to our state and region, and the combination of Northwest's and Delta's global networks will enhance its ability to sustain and – we expect – expand those services. It's worth noting – and it certainly hasn't escaped the notice of both Northwest's and Delta's leadership – that MSP is the northernmost hub airport in the eastern half of the United States, making it geographically desirable for non-stop service to Asia.

**Delta/Northwest will not change the competitive landscape in Minneapolis/St. Paul**

Northwest has 475 daily departures, whereas Delta has about 17 daily departures from Minneapolis/St. Paul. The disparity in service at MSP illustrates the overall complementary nature of these route networks, which have very little overlap. Minneapolis/St. Paul is served by three discount carriers and by the four other major legacy carriers. Accordingly, we do not believe that the combination of Delta and Northwest will have any appreciable effect on customers.

**The Minneapolis-St. Paul Metropolitan Area and the State of Minnesota Are a Large, Prosperous, and Growing Community That Depends on Air Travel Service**

Minneapolis-St. Paul is a large, dynamic, and prosperous metropolitan area with a long history as a major transportation hub. Our rivers and railroads were the transportation networks of their times and the forerunners of today's global air travel network. Minnesota is home to hundreds of international companies, to a long list of distinguished colleges and universities – including one of the most productive research universities in the world in the University of Minnesota –and is an important center for tourism with attractions ranging from Mall of America to the region's extraordinary wilderness and natural grandeur. Our community has enjoyed substantial growth and economic prosperity in recent times largely because our means of "making a living" has evolved constantly. A key ingredient to that evolution has been the hub at MSP. For our economic evolution and success to continue, we must be able to reach the world and the world must be able to reach us – reliably and at a competitive price. We believe this merger increases our chances of being able to do just that well into the future.

**Conclusion**

We know that much of our good fortune over the years has been the product of being a transportation hub. We believe our future is best guaranteed by continuing to play that role for our businesses and citizens who call Minnesota home, for those who want to do business with us; for those who want to visit; and, for those who simply want an efficient and convenient waypoint on their journeys. We will miss and remember the Northwest name as it gives way to Delta; we will credit it for creating and sustaining the hub at MSP; and we will benefit from its legacy every time we board a Delta flight for a nonstop domestic or international destination. For these reasons, we believe a merger between Delta and Northwest can create the synergies to help fuel the development and growth of our economy.

Thank you.

David C. Olson, President
Minnesota Chamber of Commerce

Todd Klingel, President
Minneapolis Regional Chamber of Commerce

Kristofer Johnson, President
Saint Paul Area Chamber of Commerce

Daron Van Helden, Chair
Metropolitan Coalition of Chambers