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CHALLENGES FACING HAWAII'S AIR SERVICE MARKET

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

APRIL 10, 2008

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ONE HUNDRED TENTH CONGRESS

SECOND SESSION

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CONTENTS

WITNESSES

APPENDIX

CHALLENGES FACING HAWAII'S AIR SERVICE MARKET

THURSDAY, APRIL 10, 2008

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

The Committee met, pursuant to notice, at 3:45 p.m., in room SR–253, Russell Senate Office Building, Hon. Daniel K. Inouye, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. DANIEL K. INOUYE, U.S. SENATOR FROM HAWAII

The CHAIRMAN. First, my apologies for being late. As you may be aware, we have had five consecutive votes that held us up.

As an island state, Hawaii is uniquely dependent on commercial aviation. Our state's economy requires a vibrant air service to connect us within the State, to the rest of the Nation, and to the world. Not only do our air carriers allow us to move passengers and goods in an efficient and timely manner, they help to unite us as a community and as a people. Simply put, aviation is vital to our lives and our citizens.

Unfortunately, the industry, and Hawaii's air carriers in particular, are facing substantial financial challenges. Oil prices have risen to record levels and ruthless competition in Hawaii's air service market has taken its toll. Last week alone, Hawaii's own Aloha Airlines, along with ATA, Skybus, and Champion, declared bankruptcy and ended commercial passenger service. Two of these airlines, Aloha and ATA, provided a substantial share of Hawaii's air service.

Despite these challenges, we must ensure that the air transportation system continues to serve our state effectively. At the same time, we must understand the impact airline instability has on our local communities and the economy.

Aloha Airlines, for example, has been an important institution in Hawaii for more than 60 years. Aloha provided transportation for nearly 4 million passengers annually in our State, with about 100 inter-island flights daily. Aloha also has served as one of Hawaii's largest employers, with more than 3,500 workers and an annual payroll exceeding $100 million.

Nearly everyone who lives in Hawaii has flown Aloha's inter-island flights for business or to visit friends or family. Many of us know people who work for Aloha. As a matter of fact, I worked for TransPacific Airlines for a time early in my career before it became Aloha Airlines. The Aloha workforce has served all the citizens of

Hawaii in a very dedicated fashion for a very long time. Now many of these employees face uncertain futures, and naturally I am deeply saddened by this unfortunate turn of events.

At this time it is critical we take action to support these loyal Aloha employees. In particular, it is my hope that local lending and financial institutions will recognize the difficult position in which the employees find themselves. I call on these institutions to consider the unique circumstances of what may well be the largest layoff in Hawaii's history and to provide whatever flexibility they can to customers in good standing. Providing temporary relief from penalties or late fees is just one way that former Aloha workers may be helped through this difficult time.

Aggressively looking at the possibility of hiring segments of a well-trained workforce is another option I hope many businesses in Hawaii will seriously consider.

On the Federal level, we have been working to ensure that the modernization of the Nation's air traffic control system results in efficiencies that will increase safety and effectiveness to benefit both the industry and citizens who depend upon that system. However, this is clearly a long-term solution to some of the problems that impact not only Hawaii, but also our Nation's air carriers.

In the near term, this Congress must determine what we can do at the Federal level to help the airline industry make it through what has become an increasingly difficult period. Unfortunately, some solutions that have been put forward may provide only temporary relief, as our weakening national economy and high fuel prices threaten to overwhelm any Federal initiatives.

We must also recognize that deregulation has dramatically altered the playing field for our Nation's air carriers. While deregulation has created substantial benefits for a number of communities, others have been less fortunate and do not have the same air transportation opportunities that were once provided. In Hawaii, these challenges are amplified as we have numerous small communities in a market that is geographically isolated.

Finally, I would note that new entrants into Hawaii's markets have made survival impossible for some. Aloha is the most obvious example of the impact of overly aggressive pricing in the marketplace. Congress must deliver on the promise of providing affordable, secure, and quality air service to all Americans regardless of geographic location. This is the promise of deregulation and we must find a way to deliver on past commitments.

This afternoon we have a panel of experts that should help tell us why we came across this problem. On this panel we have the Acting Assistant Secretary of Transportation for Aviation and International Affairs, Michael Reynolds; the Deputy Director for Operations, Pension Benefit Guaranty Corporation, the Honorable Vince K. Snowbarger; the Chief Executive Officer of Aloha Airlines, Mr. David Banmiller; the Owner and Chairman, Island Air, Mr. Charles Willis; accompanied by Ms. Lesley Kaneshiro, Chief Financial Officer of Island Air; the President and Chief Executive Officer of Air Transport Association, Mr. James C. May; and the Chief of Staff of Governor Linda Lingle of Hawaii, Mr. Barry Fukunaga.

May I first call upon our illustrious and distinguished Member of the House, the Honorable Mazie Hirono.

STATEMENT OF HON. MAZIE K. HIRONO, U.S. REPRESENTATIVE FROM HAWAII

Representative HIRONO. Thank you, Mr. Chairman. It is always good to see you. Senator Smith. Thank you for holding this important hearing on air service in Hawaii and for this opportunity for me to express my concerns.

Like so many others in Hawaii, I was shocked to learn that Aloha Airlines was ending passenger operations after 61 years serving our public. Aloha had sought bankruptcy protections in the past, as have many other airlines over the years, but to completely shut down its passenger service with no resurrection on the horizon brought home the precariousness of Hawaii's situation and her reliance on stable air service.

My immediate concern, as is yours, is of course for the 2,050 employees who have lost their jobs, as well as for the travelers who have been adversely affected. I know that we will work together to provide all available assistance to these workers and their families.

While intrastate air travel is important throughout the United States, Hawaii with seven inhabited islands, all of my district, does face some unique challenges. Residents of and visitors to Hawaii cannot simply drive or take a train to another island. Hawaii's economy, which is powered in large part by our visitor industry, with over 7 million visitors yearly, depends on reliable air passenger service between all our islands. Our residents, meanwhile, are worried about being able to get inter-island flights for business needs and to visit family members on other islands. With Aloha gone from the scene, this is both an availability and affordability issue for our residents.

The State of Hawaii's Department of Business, Economic Development, and Tourism has estimated recently that the Aloha-related job losses could push the state's unemployment rate up almost a full percentage point to 3.8 percent compared to 3.0 percent in February of 2008.

We have heard a number of reasons for the failure of Aloha, including predatory pricing by a new competitor, high and rapidly increasing fuel costs, and the ups and downs of the local, national, and international economy.

Airlines throughout the country are struggling to deal with rapidly rising fuel costs. My staff recently met with representatives of United Airlines who reported that each increase of $1 in the price of oil translates into an increase of $60 million in expenses on an annual basis for that airline. United paid an average of $72 a barrel for oil in 2007. Today the price is around $105 per barrel which translates to another $1.98 billion in additional fuel costs.

More than 20 U.S. airlines have filed for Chapter 11 protection between 2001 and 2006, including four of the six largest network carriers. How will the industry deal with these higher fuel costs as well as with all of the other challenges facing this industry?

One factor that played an important role in driving Aloha Airlines again into bankruptcy was the fare war generated by the entry of Go Airlines into the Hawaii market. Go offered air fares as low as $1, and its standard one-way inter-island airfare was about half that charged by Aloha and Hawaiian Airlines. Aloha and Hawaiian felt compelled to match the lower fares. Aloha lost $81 million in 2007 and $11 million in January 2008. Go Airlines lost $20 million in its first 16 months of operations in Hawaii.

I understand that the Department of Transportation has jurisdiction over competition in the airline industry and has the authority to require that carriers refrain from unfair pricing practices. I would be very interested in Assistant Secretary Reynolds' views on what role he feels the DOT should play in preventing predatory pricing, ruinous competition, or pricing below the cost of service in this industry.

Does the DOT monitor airline prices and investigate in cases where prices appear to be designed to drive a competitor out of business, or does it only react if there is a specific complaint?

I would be very interested in seeing a survey of pricing practices in the airline industry and wonder if DOT currently monitors and evaluates these practices.

There is currently a proposal in the Hawaii State legislature to establish a regulatory scheme for the regulation of Hawaii inter-island air carriers. While this bill raises significant legal and Constitutional issues, I certainly understand the desire to exercise control over what has been a very unstable situation in Hawaii's airline industry.

In the context of the ongoing turmoil in the aviation industry and 25 years of deregulation, one wonders whether increased regulation at the national level is now warranted. The Airline Deregulation Act of 1978 made substantial changes to the economic regulatory environment of the U.S. commercial aviation industry. The Civil Aeronautics Board, CAB, awarded a certificate of public convenience and necessity before an airline could begin regular commercial service. Airlines could not add or abandon any route without CAB approval. The CAB set fares to prevent carriers from engaging in damaging price competition. In making fare decisions, they determined what would be fair for the industry. Competition among airlines was based on the number of flights offered on the various routes, as well as amenities offered, such as free drinks and the quality of meals. Those days are long gone.

After deregulation, airlines have to compete in a completely different environment. Fares went down on many of the popular routes, but often went up for routes serving smaller communities. The primary form of competition seems to have settled on fare wars, which places pressure on the airlines to reduce costs wherever possible.

In a hearing held in the House Transportation and Infrastructure Committee last week, we heard of some disturbing failures in safety protocols by both the airlines and the Federal Aviation Administration. I worry about to what extent these safety violations were inspired, at least in part, by cost-cutting considerations. We also know that a good deal of airline maintenance work is being done in facilities outside of the country.

Hawaii's remaining major inter-island carrier, Hawaiian Airlines, has moved its reservations operations offshore. Outsourcing of jobs is a concern not only in the airline industry, of course, but affects many other industries in this global economy.

Faced with the loss of jobs caused by Aloha's passenger operations, the danger this closure brings to our state's economy, and the precarious financial situation faced by virtually all of our Nation's airlines, I am frustrated by the lack of apparent solutions. I know that some will say that the market will correct the situation, but how can we expect businesses to plan for the tremendous increases in fuel costs we have faced in the past year? How can we make sure that there is fair competition? What can we do to protect the thousands of consumers who are affected when an airline like Aloha or ATA abruptly stops flying, not to mention the recent groundings of flights for safety inspections, including today the grounding of 900 American Airlines flights?

The very complex nature of the industry and the high standards of safety expected and required lead me to question the wisdom of leaving so much in the airline industry to the vagaries of the free market system. I am hopeful that this hearing, as well as others to follow, will provide Congress with the critical information necessary to take appropriate action to protect the public and ensure air service in a volatile global market.

Thank you very much, Mr. Chairman.

The CHAIRMAN. I thank you very much, Congresslady. Your statement is a painful one, but very necessary. I appreciate your participation. And I am sorry we had to make you wait this long.

Representative HIRONO. Not at all. It was a pleasure to be able to speak to you.

The CHAIRMAN. The Committee has received two testimonies from Senator Akaka and Congressman Abercrombie. Without objection, they will be made part of the record.

[The prepared statements of Senator Akaka and Representative Abercrombie follow:]

PREPARED STATEMENT OF HON. DANIEL K. AKAKA, U.S. SENATOR FROM HAWAII

Thank you, Mr. Chairman. I appreciate your conducting this hearing today. The termination of Aloha Airlines' passenger service and the subsequent layoffs of employees deeply saddens me. Aloha Airlines provided essential transportation services and employment opportunities in Hawaii for more than 61 years. We must all work together to assist employees who have lost their jobs and to try to preserve vital passenger services.

As you know, Mr. Chairman, the people of Hawaii are dependent on inter-island air travel, which provides residents and visitors with access to commercial opportunities, medical care, and allows them to see their families. Tourism remains a vital component of Hawaii's economy and inter-island flights continue to be important in helping visitors enjoy the unique experiences found on each of the islands.

The loss of 88,000 seats per week for inter-island flights presents a great difficulty for island residents. Although the other airlines will add approximately 56,000 seats a week, there will still be reduced capacity for inter-island travel. For our residents, this could present additional barriers to health care, educational opportunities, and economic activity.

For Aloha pilots and other pilots whose pensions have been terminated, my bill, S. 1270, the Pension Benefit Guaranty Corporation (PBGC) Pilots Equitable Treatment Act, could help provide some financial relief. Mr. Chairman, I have greatly appreciated your tremendous support of this legislation. S. 1270 will lower the age requirement to receive the maximum pension benefits allowed by the PBGC to age 60 for pilots, who were mandated by the Federal Aviation Administration to retire before age 65. Retired pilots whose pensions are administered by the PBGC do not receive the maximum pension guaranty because they were forced to retire at age 60. My legislation ensures that pilots are able to obtain the maximum PBGC benefit without being unfairly penalized for having retired at 60, before the age limit was raised to age 65. I will continue to work with you, the Health, Education, Labor, and Pensions Committee, and other members to bring about enactment of this important legislation.

Thank you again for conducting this hearing, Mr. Chairman. I look forward to continuing to work with you on this vital issue. *Mahalo* again for your tremendous leadership on this issue and for all of your efforts to improve the lives of people in Hawaii.

PREPARED STATEMENT OF HON. NEIL ABERCROMBIE, U.S. REPRESENTATIVE FROM HAWAII

Chairman Inouye and Vice Chairman Ted Stevens, thank you for the opportunity to provide testimony before you today. As a member of Hawaii's Congressional delegation, I am exceptionally concerned with the effects of Aloha Airlines ceasing operations in our small island state and the continuing reverberations that will be felt for months, and most likely years, to come.

In the days leading up to Aloha's announcement, I spoke with many employees and officials for Aloha. One thing that particularly struck me was that although the airline was struggling in an inter-island market with two major competitors, it was sharply increased fuel costs that finally drove the airline to decide it had to cease operations. Similar explanations have been given by ATA which also ceased operations the same week as Aloha.

Smaller airlines such as Aloha, which tend to serve geographically isolated areas like Hawaii, are the ones that will feel the squeeze from increased fuel costs first. The larger airlines can cut costs by reducing or eliminating partnerships with smaller airlines. Larger airlines can more easily absorb fuel costs by grounding planes and adding fuel surcharges, which would be smaller per person for larger aircraft. This leaves smaller airlines with higher ticket prices because of higher fuel surcharges and they cannot afford to ground planes.

As a result, I have written to the President, (please see attached letter) to request a temporary release of crude oil from the Strategic Petroleum Reserve for the airline and cargo shipping industries. Although this would be a short term solution, I believe that the industry needs the relief now, because the airlines are in an emergency situation. The bankruptcy of Aloha, ATA and Skybus, almost in the same week, have shown the dire state that these small carriers are in.

In the long term, our country must look toward the future of sustainable domestic energy production to ensure we are not fleeced by skyrocketing imports. Environmentally sustainable exploration must occur to ensure our domestic supplies remain stable and as unaffected as possible by market speculation and international market forces for crude oil.

I regret that these efforts occur too late to assist Aloha Airlines. But I hope they will assist other small airlines, particularly those still operating in Hawaii and other isolated areas where profit margins are thin and passengers can't afford to pay more for Essential Air Service. In Hawaii, the only way for people who live on the neighbor islands to get to hospitals, VA hospitals or specialty clinics in Honolulu is by air. This vital and life saving transportation truly is essential service for the people of Hawaii.

The closure of Aloha Airlines not only limits transportation options among the main islands and to the U.S. mainland, it is affecting our people in Hawaii in their daily lives. Former Aloha Airlines employees call my office, not knowing how they are going to make their payments on their bills. Financial institutions, have, so far, been unwilling to work with them. That is why I have written a letter (attached) to the financial institutions, asking them to try to work with the now unemployed workers to structure payment plans so that they can afford to keep up with their bills.

It is my hope that this hearing will provide more ideas for assisting the people and businesses directly and indirectly affected by the closure of one of the oldest airline carriers in Hawaii. These efforts will not only assist Hawaii but hopefully forestall future closures by other airlines and ensure options for all people who fly.

Thank you, Chairman Inouye and Vice Chairman Stevens, for examining this situation and accepting my testimony today.

CONGRESS OF THE UNITED STATES, HOUSE OF REPRESENTATIVES
Washington, DC, April 9, 2008

Mr. JOHN STUMPF,
CEO,
Wells Fargo,
San Francisco, CA.

Dear Mr. Stumpf,

I am certain that you aware of the financial crises that have forced Aloha and ATA Airlines into bankruptcy, and shattered the lives of thousands of their employees in Hawaii. Their job loss came very suddenly, and most face the prospect of losing, not only their livelihoods, but their health benefits, after years with their employers. Many of these laid-off employees have contacted my office, some in tears, asking for help and not knowing what they were going to do. Many have contacted their financial institutions to ask for payment extensions or some other way of working out payment of their bills. But, so far, they report being denied any opportunity to restructure payments and remain current.

While I understand that their financial obligations are voluntary contracts between a company and an individual, I am writing to inquire about any flexibility that might be offered to these people, who are suddenly unemployed and struggling to make ends meet.

As our community faces continued economic uncertainties, many families in Hawaii find themselves in difficult straits. I believe that such times should bring out the best in all of us—individuals and businesses. It is important that we all take the time to show each other the understanding and *aloha* needed to keep our families and communities together and out of financial ruin.

I hope you share my belief, and my commitment to our *ohana;* to our community. I would love to hear from very soon about any assistance you might be able to offer.

Aloha,

NEIL ABERCROMBIE,
Member of Congress.

CONGRESS OF THE UNITED STATES, HOUSE OF REPRESENTATIVES
Washington, DC, March 31, 2008

Hon. GEORGE W. BUSH,
President of the United States,
Washington, DC.

Dear Mr. President:

Right now—today—our nation is reeling from the impact of an energy crisis on a U.S. economy already in or on the verge of recession. Retail sales are down. Unemployment is up. Home sales are down. Mortgage foreclosures are at an historic high, and the Federal Reserve intervened last week to keep Wall Street giant Bear Stearns front potential catastrophe.

Add to this the highest fuel prices in history, now more than $110 a barrel for crude oil and an average price at the pump of more than $3.30 a gallon for regular gas, and the impact on a petroleum-fueled economy is devastating.

I met last weekend with officials of Aloha Airlines in Honolulu, trying to find a way for one of Hawaii's leading corporate citizens, with 3,400 employees, to buy time to restructure debt and stay in business. Tragically, Aloha decided late Sunday to halt 61 years of air passenger service for the people of Hawaii. After attempting to fight off unregulated predatory pricing for 2 years, a $71 million increase in the cost of jet fuel pushed them over the edge. One thousand nine hundred people just lost their jobs today.

Aloha is not alone in being battered by this energy crisis. Other airlines are being forced to raise ticket prices or add as much as a $50 surcharge for fuel. According to the Air Transport Association (ATA), every penny increase in the price of a gallon of jet fuel means $190 million in annual fuel costs for U.S. Airlines—20 to 30 percent of their total operating expense. As you may be aware, ATA has today called on Secretary of Energy Samuel Bodman to authorize releases from the Nation's home heating oil reserves to help increase the supply of jet fuel.

The emergency, however, extends far beyond the airline industry. The effects of soaring fuel costs are rippling out through the economy. Oil and refined products fuel almost 97 percent of our Nation's transportation: automobiles, trucks, trains, and ships, as well as aircraft. This is how our Nation moves people and goods.

Fuel cost represents as much as 25 percent of total operating expenses for the Nation's motor carriers, second only to drivers' wages. Transport companies and independent truckers across the country are facing the prospect of parking their trucks because they simply cannot afford to buy diesel fuel. One operator reported costs of nearly $900 to fill up his rig. The impact of rising fuel costs on transport obviously means increasing costs for consumer goods. We are already seeing this in food prices and retail prices.

Organizations like the United States Postal Service and private sector delivery companies have no choice but to keep buying fuel for their delivery vehicles, no matter the cost. And that cost will be passed along to businesses, and ultimately, to consumers. Even as an independent government agency, the Postal Service cannot sustain such devastating cost increases for long without increasing rates.

Oil and natural gas are raw materials in more than 95 percent of manufacturing: plastics, medicines, machinery and all kinds of consumer goods. Energy is the third largest manufacturing cost for the forest and paper industry.

Mr. President, the instability of oil prices will continue to ripple through our economy. We are, quite clearly, in the midst of an energy emergency.

I am therefore requesting that you authorize a temporary release of crude oil from the Strategic Petroleum Reserve for the airline and cargo shipping industries. The average cost of crude in the reserve is approximately $27 per barrel. If a quantity of this oil can be released to the market and refined at lower cost than the current market-priced crude, it could generate a temporary supply of lower priced gasoline, diesel fuel and jet fuel for those industries that are totally dependent on fuel, and on which the U.S. economy is totally dependent.

Under the Energy Policy and Conservation Act of 1975, draw-downs from the Reserve are authorized if the President determines that there is a "severe energy supply interruption;" if that interruption has caused a severe increase in the price of petroleum products; and if such prices are likely to cause a major adverse impact on the national economy.

This step offers the prospect of temporary relief, and should not be seen by anyone as a long-term solution to the national energy emergency. But it may serve as an alarm to the American public that substantial and serious measures must be taken immediately to prevent further, even permanent, damage to the U.S. economy. It should also be the first substantive action by the Government of the United States to address the energy and economic crisis.

Mr. President, I believe those conditions which allow for a release from the Strategic Petroleum Reserve now exist, and I urgently request prompt action.

Aloha,

NEIL ABERCROMBIE,
Member of Congress.

The CHAIRMAN. I must apologize. I did not notice the presence of Senator Smith here. If I had known that, I would have called on you earlier. Please forgive me, sir. I am now privileged to introduce Senator Smith of Oregon.

STATEMENT OF HON. GORDON H. SMITH, U.S. SENATOR FROM OREGON

Senator SMITH. Mr. Chairman, I am here with no agenda other than an affection for Hawaii. I have been a regular user of Aloha, and every time I travel the 6 hours to Oregon, I think of my colleague, the Chairman, who has another 6 hours to go.

I regard Hawaii as a very treasured place and I am anxious to learn what has happened because I am anxious to find ways that I, who often advocate for routes to Oregon—how we can improve this system and make sure that Essential Air Service is there.

I am old enough to remember that when I used to get on an airplane, there used to be a lot of empty seats. I am mindful that there are many planes that are now grounded simply to make sure that every seat is filled in order to afford the fuel costs. If there was a silver bullet on fuel costs, we would shoot it. We would fire it. We would fix it. There is not.

In the meantime, we have got to make sure that remote places—and I come from a remote part of Oregon—have the ability to access essential infrastructure like airlines. Obviously, the Hawaiian Islands—you either get there by slow boat or by Aloha, Hawaii, or Go. ATA I guess has gone out as well.

And I am anxious to be here just to learn, to offer constructive insights, and to ask some questions. So thank you, Mr. Chairman.

The CHAIRMAN. If I may, on behalf of the people of Hawaii, I thank you for your presence here. It is most comforting. Thank you.

And it is now my pleasure to call upon the Assistant Secretary of Transportation for Aviation and International Affairs, the Honorable Michael Reynolds.

Will the others take their places?

STATEMENT OF MICHAEL W. REYNOLDS, ACTING ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS, U.S. DOT

Mr. REYNOLDS. Chairman Inouye, Senator Smith, with your permission, I would like to summarize my written statement which I ask be made part of the record.

The CHAIRMAN. Your full statement will be made part of the record.

Mr. REYNOLDS. Thank you for the opportunity to appear today to discuss challenges facing Hawaii's air service market. I can assure you that the Department is keenly aware of the unique role that air transportation plays in the State of Hawaii and that air transportation to and within Hawaii continues to be an important issue, particularly in light of the recent cessation of passenger services by Aloha Airlines and ATA Airlines.

Nonetheless, many of the challenges faced by the airline industry in Hawaii are similar to those facing all our airlines. In that regard, the outlook for the U.S. airline industry as a whole is hazy, despite a return to profitability in the last 2 years. Many carriers have cut costs and become more efficient in recent years only to see those gains offset by record fuel prices.

The industry faces major challenges in 2008: the high fuel prices that we are all well aware of, a potentially weaker economy, and labor cost pressures. These factors can severely affect airlines and the demand for air travel, particularly in discretionary markets such as Hawaii, which I now turn to.

As you know well, the six major islands depend heavily on air service. Aloha and Hawaiian Airlines have traditionally provided the bulk of the inter-island air service. In May 2006, Mesa's Go commenced service, and from that time until very recently, there were three high frequency jet operators in the market. Of course, smaller carriers such as Island Air and Pacific Wings also provide service and make up approximately 8 percent of the inter-island capacity.

The entry of Go came at a time when other structural economic developments exerted downward pressure on the demand for inter-island travel. For example, as the other islands have become more economically developed, the need for local residents to travel to Honolulu from the other islands for goods and services has decreased. In addition, since 2000, airlines have tripled their service from the mainland directly to the Big Island, Maui, and Kauai, which means fewer travelers require inter-island connections.

Also, Hawaii's critical international and domestic tourism market segments have been stagnant or declining over the past few years. In 2007, 7.4 million visitors arrived by air, which was a 1 percent decrease from 2006.

Clearly, sustaining three carriers in the main inter-island routes proved difficult. But even before Go entered the market, Hawaiian and Aloha had been in bankruptcy in the last few years.

Now, let me briefly discuss the recent airline shutdowns.

While the loss of Aloha and ATA Airlines has reduced capacity between Hawaii and the mainland by about 14 percent, it is important to note that there are still eight airlines providing various levels of service, including United, Hawaiian, American, Delta, Northwest, US Airways, Continental, and Alaska, most of which have added capacity to the market since Aloha and ATA ceased services.

In addition, Hawaiian and Go are adding aircraft capacity to the inter-island market, and several carriers have been offering special deals for passengers affected by the shutdowns.

Nonetheless, based on our internal analysis, as many as 9,000 Hawaii passengers have had travel plans disrupted by the sudden termination of air service by both Aloha and ATA.

On the positive side, most of these passengers are expected to be accommodated. Clearly, some passengers encountered more serious inconvenience and delays, especially in markets without alternate nonstop service. Because more than 90 percent of these passengers used credit cards to purchase their air travel, they should be able to recover from the credit card companies payments for any air transportation services that were not provided.

Finally, I want to touch on the issue of service to more remote points in Hawaii. The Department's Essential Air Service Program provides a safety net to ensure that eligible communities receive continuous, uninterrupted air service. After several years of receiving subsidized air service, last April the communities of Hana, Kalaupapa, and Kamuela began receiving air service without subsidy. I wish to point out that even though the communities no longer receive subsidized EAS, they are all still protected against losing service under the program.

That concludes my oral statement. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Reynolds follows:]

PREPARED STATEMENT OF MICHAEL W. REYNOLDS, ACTING ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS, U.S. DOT

Chairman Inouye and Members of the Committee:

Introduction

Thank you for the opportunity to appear before you to discuss "Challenges Facing Hawaii's Air Service Market." While there certainly are unique needs and characteristics in the Hawaii market, many of the challenges faced by the airline industry in Hawaii are similar to those facing our airlines in all markets, domestic and foreign.

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 precipitated by a fundamental change in passenger demand that began in the first half of this decade. Some large carriers have successfully restructured and adapted their business models, while other carriers have been slower to do so. Record fuel prices have offset the benefits that some carriers gained through cost reductions and other efficiencies achieved in restructuring, in and out of bankruptcy.

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. Going forward however, the outlook for airlines is hazy. The industry faces major challenges in 2008: high fuel prices, a potentially weaker economy, and labor cost pressures. These factors can severely affect demand for travel, particularly in discretionary markets, such as Hawaii.

Clearly the major challenge remains record high fuel prices, with crude oil hovering around $100 per barrel. Fuel cost 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 more for fuel on a system basis. This 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 3 years, the cost to the airlines becomes much more palpable. Between 2004 and 2007, jet fuel rose from an average of 86 cents per gallon to an average of $2.12 per gallon in 2007, non-inflation adjusted. This is a 248 percent increase in the cost per gallon of jet fuel. According to JPMorgan's analysis, every $10 increase in a barrel of oil requires $18 in additional air fare on average just to maintain a steady state. While the industry posted an operating loss of approximately $87 million in the fourth quarter 2007, it would have posted an operating profit of $1.35 billion in that quarter of 2007 had fuel prices remained at fourth quarter 2006 levels. Soaring fuel prices have masked the tremendous progress legacy carriers have made in reducing their costs to levels more competitive with low-cost/low-fare carriers and eclipsed gains that could have been used to fund essential long-term capital expenditures. Future fuel price uncertainty will continue to motivate industry-wide cost and capacity discipline.

There are other challenges facing the industry, including labor cost pressures and pressures from institutional investors to "unlock" shareholder value. As these other challenges are beyond the scope of this hearing, I will not elaborate on them today.

Nature of the Hawaiian Aviation Market

Next, I would like to summarize briefly the nature of the Hawaiian air service market.

Hawaii, of course, has six major islands that depend heavily on air service, and inter-island markets have been extremely competitive. While Aloha and Hawaiian Airlines have traditionally provided the bulk of inter-island air service, over the years there have been many smaller players that have entered and exited the market. In May 2006, Mesa's Go service commenced, and from that time until very recently, the inter-island market has been served by three high-frequency jet operators. Other smaller carriers like Island Air and Pacific Wings also provide service and make up approximately 8 percent of the inter-island capacity. There are also a number of air taxis that compete for traffic in these markets.

Historically, average fares for local travel in the inter-island markets have been quite low, averaging less than $50 in the 3-year period 2000 through 2002 for each inter-island city-pair market. Beginning in 2001, average fares began a gradual increase in all inter-island markets, and more so in the smaller ones, until the Department granted Aloha and Hawaiian antitrust immunity for a capacity cooperation agreement that was permitted under a special provision in the 2001 Aviation and Transportation Security Act. Shortly after the carriers implemented their capacity coordination agreement in 2002–2003, they discontinued the coupon distribution system for inter-island travel and implemented different pricing structures. Fares for both carriers rose significantly during the period in which capacity cooperation agreement was in effect. In 2005, Hawaiian's inter-island fares were about 7 percent higher across the board than Aloha's. In 2007, however, average fares for both carriers were about equal.

In general, average fares in the inter-island markets have been lower than average fares in markets of comparable distance and density (the number of people traveling in the market) in the continental United States, including markets served by low-fare carriers such as Southwest, JetBlue, and AirTran. For example, the Honolulu-Kona market at a distance of 163 miles had an average fare at the end of third quarter 2007 of $50. By comparison, Southwest's fare in comparable markets ranged between $80 and $111. In the Kona-Lihue market, the average fare was $81, whereas average fares for Southwest in markets of comparable distance ranged from $91 to $116.

Prior to Go's entry in the market in 2006, the number of flights and capacity offered in the inter-island markets had been slightly declining. A large decrease in service occurred right after September 11, 2001 and did not start to rebound until the third quarter of 2004.

After Go's entry into Hawaii and before Aloha's cessation of service, inter-island fares fell 27 percent to levels not seen since 2000, a time when fuel was one-quarter the price and inter-island passenger traffic was nearly 14 percent greater (capacity was 29 percent higher). Load factors on inter-island services have averaged between 65 percent and 70 percent prior to Aloha's shutdown.

The entry of Go into the inter-island markets came at a time when other structural economic developments exerted downward pressure on the demand for inter-island travel. First, as the other islands became more economically developed, the need for local residents to travel to Honolulu (Oahu) from the other islands for goods and services decreased. In addition, since 2000, carriers have tripled their service from the mainland directly to the Big Island, Maui, and Kauai, which means fewer travelers require inter-island connections. For example, the nearly two million visitors to Hawaii from California now have direct links from their state to Kahului, Kona, Hilo, and Lihue.

Second, Hawaii's critical international and domestic tourism market segments have been stagnant or declining over the past few years. In 2007, 7.4 million visitors arrived by air—a 1 percent decrease from 2006. The biggest decline was a 5-percent decrease by non-U.S. visitors to Hawaii. Approximately 70 percent of non-U.S. visitors come from Japan, a country whose economy continues to stagnate. Also, emerging tourist markets in Asia have exacerbated the situation as many Japanese are vacationing closer to home. In the future, tourists from China could replace those from Japan as rising incomes and a booming economy enable more Chinese citizens to travel. The Department has been aggressively seeking to liberalize the restrictive Chinese bilateral air services agreement to increase the numbers of flights permitted between the U.S. and China. One bright spot is Canada. While Canada accounts for just 4 percent of all visitors to Hawaii, the number of Canadian visitors to Hawaii rose over 5 percent between 2006 and 2007. Meanwhile, the number of U.S. visitors to Hawaii has remained flat. Importantly, however, the figure for visitors from California, who make up 25 percent of Hawaii's tourist market, fell more than 3 percent in 2007. This is partially explained by the downturn in the housing market, which has hit California particularly hard. In short, fewer tourists mean fewer inter-island trips.

As indicated above, unlike the inter-island markets, many other airlines offer service between the West Coast and one or more of the Hawaiian Islands. While the loss of Aloha and ATA Airlines has reduced capacity between Hawaii and the mainland (including Alaska) by about 14 percent, there are still eight airlines providing various levels of service including United, Hawaiian, American, Delta, Northwest, US Airways, Continental, and Alaska.

This market overview clearly shows that the large, inter-island markets have been highly competitive and the most negatively impacted by structural changes in tourist and traffic flows. Record high fuel prices have exacerbated the situation. From time to time, there has been entry by a third carrier focusing on inter-island traffic (Mid-Pacific and Discovery in the 1980s, Mahalo Air in the 1990s, and Go in this decade) in Hawaii. Sustaining three major carriers operating service on the main inter-island trunk routes has proven difficult. According to press reports, Go has lost as much as $20 million since it began service on these routes 2 years ago.

In part as a result of the substantial structural changes in the aviation markets to/from and within Hawaii over the past decade, both Aloha and Hawaiian have experienced financial difficulties. In the past few years, the carriers have held merger discussions, but the two management teams and their various owners have never been able to agree on how to blend the two airlines. Furthermore, Hawaiian was in bankruptcy from 2003 to 2005, and Aloha was in bankruptcy from 2004 to 2006 prior to going in again last month.

Role of Government

Having outlined the challenges facing the airline industry in general and the Hawaiian markets in particular, I would like to discuss the appropriate role of government in the industry's ongoing restructuring. By deregulating the airline industry in 1978, Congress set the Department permanently on the path away from intervention in the air transportation marketplace. Many, including the Department of Transportation, have a long-held view that deregulation has been a success, producing an abundance of service with low fares—at the same time the industry has achieved a spectacular safety record. Indeed, the fundamental restructuring that we have observed over the last 6 years is largely the result of market forces that were set in motion prior to the September 11th terrorist attacks. The architects of airline deregulation predicted that new, innovative airlines would enter the marketplace, 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; though it happened differently and somewhat later than expected. With respect to aviation, deregulation has become the default policy around the world.

Airline Industry Restructuring

Since the passage of the Airline Deregulation Act in 1978, which opened our domestic air services to the free market, Congress recognized that the risk of airline failures was possible. Deregulation stimulated air travel, lowered air fares, and created a highly competitive, efficient, and viable air transportation system in the United States. Yet, it is an industry fraught with risks—an industry sensitive to an unstable economic environment, jet fuel prices, and cyclic swings in the economy. The public has benefited from competition provided by new entrant carriers who acquired the aircraft of bankrupt airlines and implemented a new business model with low fares to attract customers. In fact, over the past 30 years, we have seen many air carrier failures. In an uncertain economic environment and with record jet fuel prices, it is not shocking that air carriers—which depend so heavily on fuel—are having difficulty surviving in today's price competitive aviation environment.

The Government Accountability Office in a September 2005 Report to Congress said that bankruptcy "is endemic to the airline industry owing to long-standing structural challenges and weak financial performance in the industry." Indeed, bankruptcies in the airline industry are not uncommon. Since airline deregulation 30 years ago, there have been more than 170 airline bankruptcies, averaging almost six a year.

During the last 2 weeks, three airlines have filed or expect to file for bankruptcy protection. Aloha Airlines, ATA Airlines, and Skybus Airlines have shut down and stopped passenger air services. They attributed their business failure to rising fuel costs and a slowing economy. These carriers could not make a business case to attract more capital in the current economic environment.

In this context, let me briefly outline the recent situations at Aloha Airlines and ATA Airlines.

Immediate Impact of Aloha's and ATA's Cessation of Scheduled Passenger Service

In order to assess the ability of other carriers to assist stranded Aloha and ATA passengers based on existing schedules, we reviewed available services of U.S. and foreign carriers that compete with Aloha and/or ATA on their inter-island routes and between Hawaii and the U.S. mainland. During April, we estimate that just over 90,000 passengers will travel to/from Hawaii or about 3,000 per day. There is competitive service on many of the Aloha and ATA routes between the Mainland and Hawaii. Based on our internal analysis, as many as 9,000 Hawaii passengers were inconvenienced by the sudden termination of air service by both Aloha and ATA. This figure does not take into account the additional seat capacity that was added to the Hawaii market by competing carriers in response to the Aloha and ATA shutdowns.

Despite the high load factors experienced by competing carriers in these markets, most Aloha and ATA passengers were expected to be accommodated, perhaps some taking circuitous and multi-stop routings. Clearly, some passengers encountered more serious inconvenience and delays, especially in the three markets without alternate nonstop service, namely Oakland-Lihue; Las Vegas-Maui; and Oakland-Hilo.

Aloha informed the Department that, on the day it stopped service, about 700 Aloha strandees would need transportation to or from the mainland, and steadily decreasing numbers of such passengers would need to be accommodated each day through April 12.

American, United, Delta, Continental, US Airways, Hawaiian, and Go added aircraft capacity to the market, to help minimize the impact on Aloha's stranded passengers. Hawaiian and Go carried Aloha's inter-island passengers on a standby basis for free for the first 4 days after Aloha's shutdown and on a confirmed basis for $49 through April 7.

Alaska Airlines recently announced plans for new daily service to Hawaii from Seattle and seasonal service from Anchorage.

Federal Government's Efforts To Address the Situation in Hawaii

There are no requirements for other airlines to accept the tickets of an air carrier that ceases operations. However, when an airline shuts down the Department moves immediately to contact other carriers providing service on those routes to ascertain their policies with respect to carriage of the passengers of the failed airline, to make it clear that consumer harm should be minimized, and to make information about the airline policies readily available to consumers. We then distribute information to affected consumers about their options. This is accomplished via our website and in responses to telephone and other inquiries.

When the Department learned of the Aloha and ATA shutdowns, my office and the Department's aviation consumer office gathered information from these two carriers via teleconferences and e-mail. The aviation consumer office then contacted other airlines serving the affected markets and posted information and advice on its website for affected consumers. In general, this involves information about alternate transportation, claiming a refund from the consumer's credit card company under the Fair Credit Billing Act, and filing a claim for a cash refund or baggage claim settlement in any bankruptcy proceeding that may take place.

Other carriers appear to recognize that voluntarily providing affected passengers reasonable options for alternate transportation is in their interest. Carriers are motivated to do this as a competitive initiative, in part as a market-development strategy to attract business travelers and frequent flyers. For example, in connection with the recent shutdown of ATA Airlines, most major carriers are or were offering affected passengers standby transportation for $100 per non-stop segment and/or waiving their own advance purchase requirements on discount fares. In the case of Aloha Airlines, Hawaiian Airlines and Go were offering free standby seats to Aloha passengers for the first 4 days after the Aloha shutdown (*i.e.,* through April 3). Through April 7, Hawaiian was offering a special $49 fare for inter-island flights. Hawaiian also immediately added 6,000 seats per day to its schedule. United Airlines is offering special discounts to Aloha's Hawaii-mainland passengers, on a confirmed basis, through April 30.

In the case of both ATA and Aloha, as required by contract and by DOT policy, their codeshare partners are honoring tickets issued in that partner's name by providing transportation on a confirmed basis with no additional fare collection where possible. Where that is not possible, those codeshare partners are providing a full refund.

Both carriers indicated that well over 90 percent of their passengers used credit cards to purchase air travel. Those passengers should be able to recover from the credit card companies payments for any air transportation services that were not provided.

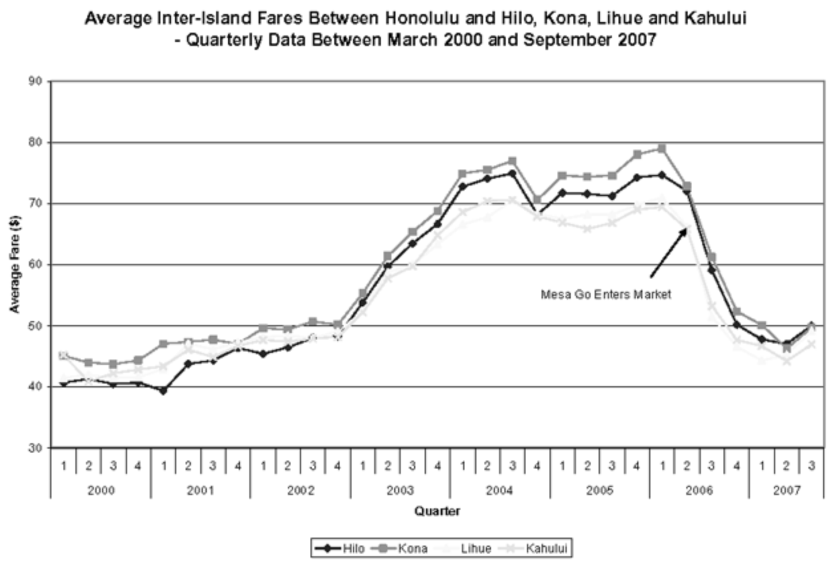
Essential Air Service Implications

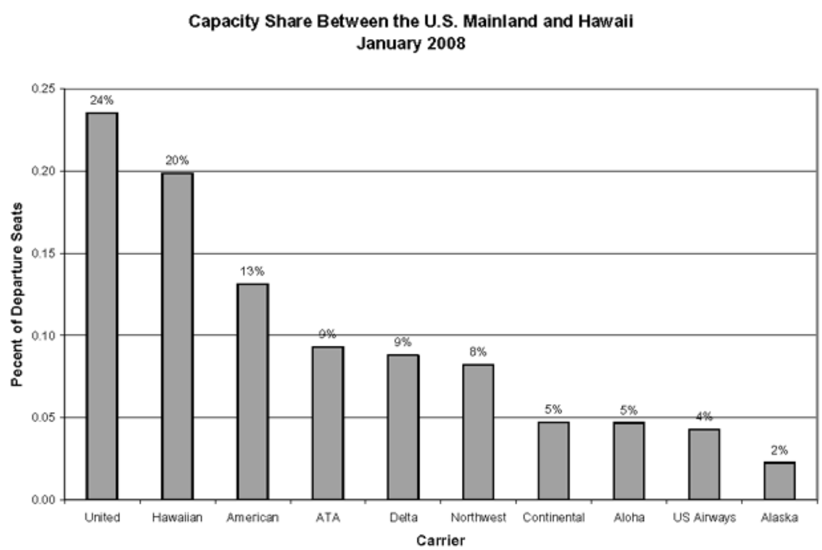
We have also examined Aloha's shutdown in the context of the Essential Air Service program and find that there are no issues. All five communities that Aloha served—Hilo, Kona, Kauai, Kahului, and Honolulu—are served by at least two other carriers, Hawaiian and Go. No market will be without service. The smallest market in terms of service (Hilo-Honolulu) has at least 13 non-stop round trips per day.

Also in the context of EAS, the Department is fully aware of Hawaii's dependence on air service, and the EAS program provides a safety net to ensure that eligible communities receive continuous, uninterrupted air service. Up until April 1, 2007, the communities of Hana, Kalaupapa and Kamuela had received subsidized service under the EAS program for about 6 years. As the end of the then-current EAS contract was nearing, the incumbent carrier, Pacific Wings, announced that it would continue to serve all three communities, but without the need for further Federal subsidy. I wish to point out that, even though the communities no longer receive subsidized EAS, they are all still protected against losing service. That is, even if the incumbent carrier wanted to suspend service, it would first have to file a notice of intent to suspend service and we would hold the carrier's service in place while we sought and procured replacement service.

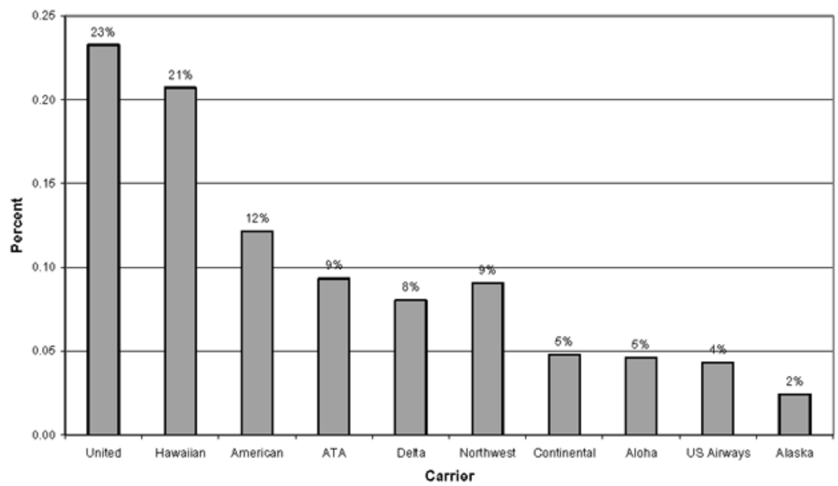
Thank you, and I would be pleased to take any questions.

ATTACHMENT: 5 CHARTS

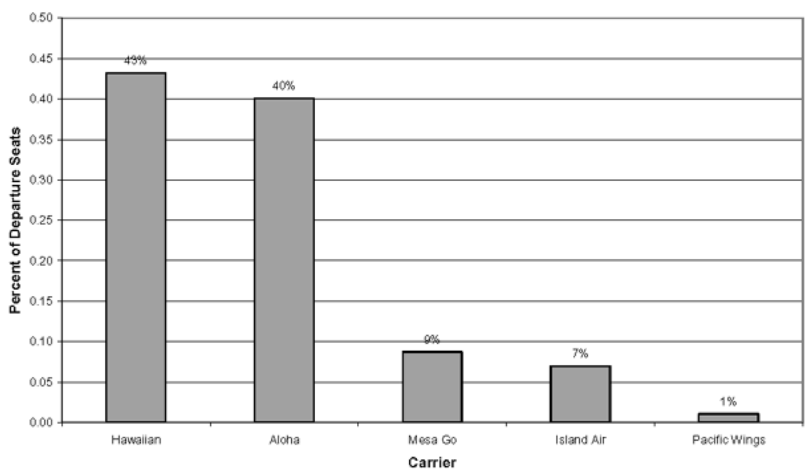


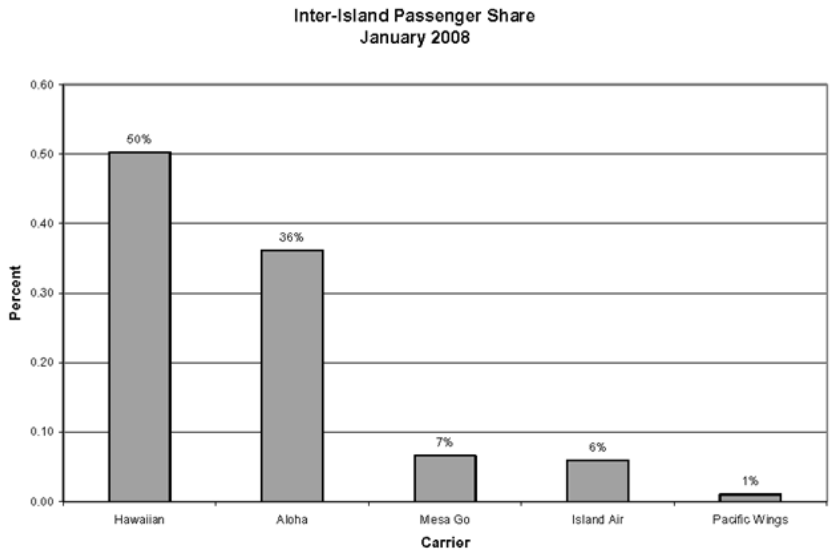


Passenger Share Between the U.S. Mainland and Hawaii
January 2008



Inter-Island Capacity Share
January 2008





The CHAIRMAN. I thank you very much, Mr. Reynolds.

Now may I call upon the Deputy Director of Operations of the Pension Benefit Guaranty Corporation, the Honorable Vincent Snowbarger?

STATEMENT OF HON. VINCENT K. SNOWBARGER, DEPUTY DIRECTOR FOR OPERATIONS, PENSION BENEFIT GUARANTY CORPORATION

Mr. SNOWBARGER. Thank you, Chairman Inouye and Senator Smith. My name is Vince Snowbarger, and I am the Deputy Director of Operations at the Pension Benefit Guaranty Corporation, otherwise known as PBGC.

ERISA, the Employee Retirement Income Security Act of 1974, created PBGC to guarantee pensions when underfunded defined pension plans like Aloha's are terminated.

We want to thank you for the opportunity to appear today before the Committee to discuss the challenges facing Hawaii's air service market. My remarks will focus on matters impacting the participants and beneficiaries in the four defined benefit pension plans sponsored by Aloha Airlines. Aloha employees may have other retirement plans that PBGC does not insure.

In December 2004, Aloha filed for bankruptcy. As a part of the settlement reached in February of 2006, PBGC assumed responsibility for the pensions of nearly 4,000 workers and retirees who were participants in three of the four defined benefit plans at Aloha. It was the plan for non-unionized employees, the plan for employees represented by International Association of Machinists, and the pilots' plan. In that agreement, Aloha agreed to maintain a fourth plan for its dispatchers.

In the three plans that were terminated, we estimate that the plans had \$177 million in assets to cover \$346 million in promised benefits. That means the plans were only 51 percent funded with $169 million in total underfunding. PBGC will be able to guaranty about $119 million of that underfunding, but participants will lose about $50 million in promised benefits that PBGC cannot pay under Federal law.

My written testimony provides more information on each of these plans.

PBGC is currently paying estimated benefits to these Aloha retirees. We are in the process of making final benefit determinations for the Aloha plans. It is a complex process that takes about 3 years normally. PBGC expects to send final benefit determinations to Aloha participants next year.

On March 20, Aloha again filed for bankruptcy. The airline has one plan remaining subject to PBGC jurisdiction. The plan for Aloha's dispatchers covers about 50 participants. It is underfunded by about $1 million. As the current bankruptcy case develops, we will continue to work with Aloha, its creditors, and the court to protect the benefits of those participants.

As I mentioned earlier, there are other benefits that PBGC does not insure, including health benefits. However, participants who are aged 55 or older and who receive PBGC benefits may be eligible for the Health Coverage Tax Credit. I have provided information in my written testimony for the HCTC customer contact center. It is a program operated in conjunction with the IRS.

PBGC is always available to help participants. We let them know when they are eligible to apply for benefits, and we provide them with any help they need in completing applications. They can also access our website at *www.pbgc.gov,* and there they can request an estimate of benefits, apply for benefits, set up or change Federal tax withholding, and so forth. There are also pages on the website for each of Aloha's terminated plans. We keep participants updated through newsletters and our website, and they can also call our customer contact center at 1–800–400–7242.

PBGC is committed to paying all workers and retirees the benefits they are entitled to under law, and we try to make our benefit determination process as efficient and customer-friendly as possible. I want to assure you that we will continue to carry out our mission to pay benefits to participants, including the Aloha workers.

And I want to thank you again for the opportunity to appear today, and I would be pleased to answer any questions.

[The prepared statement of Mr. Snowbarger follows:]

PREPARED STATEMENT OF HON. VINCENT K. SNOWBARGER, DEPUTY DIRECTOR FOR OPERATIONS, PENSION BENEFIT GUARANTY CORPORATION

Chairman Inouye, Vice Chairman Stevens, Members of the Committee, my name is Vince Snowbarger and I am the Deputy Director for Operations at the Pension Benefit Guaranty Corporation ("PBGC" or "the Corporation").

Thank you for the opportunity to appear before the Committee today to discuss the challenges facing Hawaii's air service market. My testimony will focus on matters impacting the 4,000 participants and beneficiaries in the three defined benefit pension plans sponsored by Aloha Airlines that were assumed by PBGC in April 2006 following the carrier's emergence from an earlier bankruptcy. A fourth plan sponsored by Aloha for its dispatchers, covering about 50 participants, remained ongoing after the bankruptcy.

Pension Benefit Administration

PBGC was created by the Employee Retirement Income Security Act of 1974 ("ERISA") to guarantee pensions when an underfunded defined benefit plan is terminated. When PBGC assumes an underfunded plan, the Corporation pays benefits up to ERISA guarantee limits. For insured plans that terminated in 2005 such as Aloha's, the maximum guaranteed benefit is $45,613 per year ($3,801 monthly) for PBGC payments beginning at age 65. The maximum is actuarially adjusted for benefits beginning earlier or later, or if a benefit will be payable to a surviving beneficiary.

When PBGC becomes trustee of a plan, retirees initially receive the same monthly benefit amounts that the plan was paying. Once PBGC obtains plan data and makes a preliminary analysis, benefit payments are reduced if necessary to an estimate of the amount payable under Federal law. We also inform participants that any overpayments will be subject to recoupment (the process by which participants return any overpayments).

In order to make final benefit determinations, PBGC applies various statutory provisions that include:

- calculating the benefit under the specific plan provisions;
- applying the statutory maximum guarantee;
- phasing in the guarantee of benefit increases within 5 years of plan termination; and
- allocating plan assets and recoveries from employers available to pay non-guaranteed benefits.

Because plan provisions and the statutory rules noted above are complex, it takes about 3 years to complete final benefit determinations. When this process is finished, PBGC sends a letter to each participant explaining the calculations and the changes, if any, in their estimated benefit amount. Participants have 45 days to appeal this final determination.

At every step in the process, the Corporation is available to answer participants' questions and to help them apply for benefits. For larger plans, PBGC holds participant meetings to provide both general and plan-specific information about the termination process. We also send an annual newsletter to participants receiving benefits and semiannual newsletters to those not yet retired. Participants can get additional information about PBGC and the pension insurance program at *www.pbgc.gov* or by calling PBGC's Customer Contact Center at 1–800–400–7242.

Airline Pensions

Airline plans have accounted for more than $14 billion in claims since 1974—approximately 40 percent of all claims from failed companies. Since 2001, PBGC has assumed responsibility for the pension plans of TWA, US Airways, United Airlines, and the pilots of Delta Air Lines. In addition, as of the end of calendar year 2006, there was another $12.6 billion in unfunded pension liabilities in ongoing defined benefit plans in the airline industry.

Aloha Airlines

On December 30, 2004, Aloha Airlines filed for bankruptcy. PBGC tried to compel Aloha to keep its plans ongoing. However, as part of the bankruptcy settlement reached in February 2006, the Corporation was appointed trustee for the pensions of nearly 4,000 workers and retirees who were participants in three of Aloha's defined benefit plans: the Pension Plan for Non-Represented Employees, the Pension Plan for Employees Represented by the International Association of Machinists (IAM), and the Pilots' Fixed Retirement Plan. A fourth plan, the Pension Plan for Dispatchers, survived the bankruptcy.

The termination date for the three trusteed plans was December 14, 2005. PBGC's most recent estimate is that the three plans on an aggregate basis were 51 percent funded with $177 million in assets to cover $346 million in promised benefits. Of the $169 million in total underfunding, about $119 million was guaranteed. Plan participants thus will lose about $50 million in unfunded, non-guaranteed benefits that cannot be paid under Federal law.

PBGC has sent estimated benefit statements to participants in the three trusteed plans. As specified below, more than 90 percent of participants in the Non-Represented Employees Plan and the IAM Employees Plan continue to receive their full benefit payment; the remaining participants in these two plans are now receiving reduced benefits as determined by statutory limits. In the Pilots' Fixed Retirement Plan, about 58 percent of participants are now receiving reduced benefits, primarily due to the previously-noted maximum guaranteed benefit under ERISA ($45,613 for plans that terminated in 2005). Participants in all three plans should expect to receive final benefit determination letters in 2009.

Non-Represented Employees Plan

The plan for non-represented employees covers about 900 participants. The plan was 39 percent funded, with $21 million in assets to cover $54 million in liabilities. However, about 840 of those participants (93 percent) are receiving their full benefits and are not affected by ERISA guarantee limits. The remaining 60 participants (7 percent) have had their benefits reduced by an average of about $170 per month (a 21 percent reduction). These reductions were required because salary concessions reduced the wages on which benefits are based.

IAM Employees Plan

The Aloha IAM plan covers about 2,600 participants. The plan was 58 percent funded, with $87 million in assets to cover $151 million in liabilities. However, like the non-represented employees, about 2,350 IAM participants (90 percent) are receiving their full plan benefits. The remaining 250 participants (10 percent) have had small reductions in their benefits averaging about $33 per month (a 3 percent reduction). These reductions were primarily the result of the phase-in limit on recent benefit increases under ERISA; generally, this five-year formula guarantees benefit increases at 20 percent for each year in effect.

Pilots' Fixed Retirement Plan

The pilots' plan covers about 450 participants. The plan was 49 percent funded, with $69 million in assets to cover $141 million in liabilities. About 190 participants (42 percent) are receiving their full plan benefits. The remaining 260 participants (58 percent) have had their benefits reduced primarily due to the maximum guaranteed benefit under ERISA that imposes an annual dollar cap (again, $45,613 for 2005 plan terminations). The average benefit reduction for these participants is about $1,050 per month (a 42 percent reduction). However, based on the most recent information available, the assets in the plan will be sufficient so that those Aloha pilots who were retired (or were eligible to retire 3 years prior to plan termination) are expected to receive about 60 percent of their promised benefits.

Dispatchers' Plan

As noted, Aloha currently sponsors one ongoing defined benefit plan for dispatchers covering about 50 participants, and which PBGC estimates as being underfunded by about $1 million. As Aloha's current bankruptcy plan develops, PBGC will take appropriate steps to ensure that none of the plan's participants is put at risk.

Health Care

An issue that often arises in conjunction with business failures is the loss of employer-provided health care coverage for workers and retirees. By law, PBGC guarantees do not cover health insurance. However, certain PBGC benefit recipients who are age 55 or older and are covered by qualified health insurance are eligible for the Health Coverage Tax Credit (HCTC). For more information, participants can call the HCTC Customer Contact Center at 1–866–628–HCTC (4282).

Conclusion

PBGC is committed to paying all workers and retirees the full benefit amounts they are entitled to under law, and we are making every effort to make the benefit determination process as efficient and customer-service oriented as possible. I want to assure you and the participants in all defined benefit plans insured by PBGC that the Corporation stands ready to carry out its mission to pay benefits to participants, as it is now doing for Aloha participants and as it has done since the enactment of ERISA. Thank you for the opportunity to appear here today, and I would be pleased to answer any questions you may have.

The CHAIRMAN. I thank you very much, Mr. Director.

And now may I call upon the Chief Executive Officer of the Aloha Airlines, David Banmiller? Mr. Banmiller?

STATEMENT OF DAVID A. BANMILLER, PRESIDENT AND CEO, ALOHA AIRLINES

Mr. BANMILLER. Thank you, Mr. Chairman, Senator Smith. Good afternoon and *aloha*.

Today is a very sad time for Aloha Airlines, for the State of Hawaii, and indeed, the entire airline industry.

See, what we do touches everyone's lives in this country. Airlines drive local economies. They provide employment directly and indirectly, and they speed travelers on their way to make business deals, go on holiday, attend weddings, and enjoy the benefits of an open economy.

How things have changed in our industry.

My humble beginnings in commercial aviation came as a management trainee with one of the great airlines of U.S. aviation history, TWA. About 40 years ago, I was on the front lines as a ticket agent. Thanks to TWA I learned a lot about customer service from the ground up, writing tickets and handling baggage. The ticket counters next to me belonged to another giant of the industry that seemed equally invincible at the time, Eastern Air Lines. They are both long gone, along with Pan Am and other pioneering airlines.

Today America's airlines are more challenged than they have ever been. When it comes to airlines, change is constant. Or as the authors of *Over the Hedge* put it, "The more things change, the more they remain insane."

What once was a proud industry that lured lifetime employment of dedicated workers who strived to exude exceptional customer service and focused on taking care of their traveling patrons has now become an industry filled with chaos and uncertainty.

The Airline Deregulation Act of 1978 opened the playing field for competition. At the outset, deregulation was supposed to yield positive outcomes, especially for the large hub markets. But for the smaller regional markets like Hawaii, deregulation has proved to be potentially harmful in achieving stability in air transportation service.

For example, since the Deregulation Act, Hawaii has witnessed the collapse of a number of airlines, including Mid Pacific, Mahalo, and Discovery, as well as two bankruptcy filings for Hawaiian Airlines and Aloha Airlines.

Why? Because deregulation only opened up the revenue side of the business. It did not touch the cost side. And despite deregulation some 30 years ago, the industry continues to be one of the most heavily taxed and regulated of industries in this country.

Today I will focus on the unfortunate situation of Aloha, a mainstay of Hawaii's tourism-dependent economy for more than 60 years. I plan to share with you the challenges we faced and the cause of our passenger service shutdown.

The two main factors that caused the company to cease its historic passenger business were unfair competition and the soaring cost of jet fuel. The latter continues to pose a real threat to the air transportation industry, both in the United States and around the world.

I also want to touch upon a few global trends that continue to threaten Hawaii because of its geographic isolation and its dependence on air transportation more than any other State in this Nation.

What you are seeing today with the recent collapse of Aloha's passenger business, along with the shutdown of ATA, Skybus, Champion, and MAXjet before that, is just the tip of the iceberg. Industry observers are asking who is next.

The cost of fuel continues to rise with wild abandon, unchecked by government even as oil companies reap enormous profits. When I was at TWA in the 1960s, fuel represented 5 percent of an airline's costs. Today it is 45 percent and currently surpasses labor as the number one expense for most airlines.

Throughout the 1990s, the average cost of a barrel of crude was under $20. By 2004, it was $40. Now it is $111 a barrel. Inconceivable even a year ago, and every $1 costs about $400 million to our industry in this country.

Aloha shares with our industry colleagues in calling for swift Federal action on a 21st century air traffic control system upgrade to make air transportation more efficient by eliminating the archaic ground-tracking systems which makes for longer than necessary routing and landing patterns. We strongly believe that if our air traffic control system were upgraded to satellite tracking, we could be saving a lot of fuel.

Our fear is that without major strides toward modernizing ATC and spreading the cost burden to all the users, states like Hawaii that are solely dependent on air transportation stand to lose more vital air service. And keep in mind, the average American suffers as a consequence of what happens to airlines.

Now, the public has become accustomed to think that it is normal for airlines to go into and out of bankruptcy. But it does not always work out that way. In our first bankruptcy, cutting costs was job number one. With our self-help program, we involved the dedicated employees of our company and cut across the board, including 20 percent salary cuts. Working 24/7, we were able to put that complicated process together, frankly with the support and cooperation of the fine employees of our company and their labor leaders. We also paid back the Federal ATSB loan in full.

At the same time, we forestalled demands from aircraft lessors to take our airplanes and we skated around onerous covenants and found permanent financing. I thought it was hard to find investors back then. Little did I know then what I know now.

Emerging from our first bankruptcy, we were optimistic that we had a viable plan, one that could bring profit, even in the tough inter-island market. In September 2005, we signed an agreement with the Yucaipa Companies, a well-respected private equity firm, for a substantial equity infusion, $98 million, including $63 million in equity and $35 million in debt financing.

On the very day that Aloha signed the new investment agreement came the announcement that Mesa Air group, an Arizona company, planned to compete in the inter-island market with its own low-cost carrier. We believe this improper because Mesa had come to Aloha as a potential investor and Mesa had also looked at Hawaiian's books while they were in bankruptcy. It is pretty clear to us that the timing of Mesa's announcement was intended to scare off investment in Aloha, something it did not do.

Mesa launched Go Airlines in June 2006 with an advertised introductory fare of $39. In its first 18 months of operation, those fares went from $39 to $29, $19, $9, and $1.

A study done for Aloha by Sabre Airline Solutions soon after they entered the market indicated that with a 62 percent load factor, which was roughly what Go was operating at, they needed $67 a ticket minimum—now with fuel it is over $70—versus $50 a ticket to break even for Aloha and $55 for Hawaiian. We at Aloha Airlines were, in fact, the low-cost per-seat operator in the islands.

So we began asking people in government, business, and the media, just about anyone that would listen to us these questions. Why would Mesa charge less for a seat than it costs to produce it? Why would Go start at $39 and go all the way down to $9 and $1 when it cost $70 to fly a seat? Why would any manufacturer or provider of services do such a thing for 2 years?

Now, everybody loves a bargain, particularly in air fares, but even so, Mesa's strategy of below-cost pricing raised eyebrows. Even bargain lovers began to ask, why is somebody not doing something about this?

Well, you know, we did not sit by idly. We spoke to elected Federal, State, and county officials and every editorial board that would listen to us. We came to Washington to ask the Department of Transportation and the Department of Justice to look into Mesa's predatory practices in Hawaii and to do something about it. We spoke to various lawmakers on the Hill.

Everyone told me that predatory pricing is hard to prove. I believe that if there is ever textbook definition of predatory pricing, this is it.

Not one, but both of Hawaii's legacy inter-island carriers have sued Mesa.

In February, Hawaiian filed a lawsuit asserting claims against Mesa for breach of a nondisclosure agreement that Mesa had executed.

In January 2007, Aloha filed suit against Mesa alleging misuse of confidential information and deliberately sought to drive Aloha out of business in violation of Federal antitrust laws. In fact, court documents show that Mesa's chief financial officer stated in an e-mail that rather than wait for Aloha to die, Mesa should enter the inter-island market and give Aloha the last push.

Due to this pending litigation, I prefer not to go into any further detail on that matter.

Now, in spite of the legal challenges, Mesa continues to operate in Hawaii at $49 inter-island fares.

For the year 2007, Aloha lost $81 million on revenues of $407 million, and in January 2008 alone, we lost $10.6 million on $34 million in revenue.

In March of this year, after 2 years of escalating fuel prices and cutthroat competition, Aloha's lead investor opted to stop funding Aloha Airlines after they had put in another $100 million. This came on the day that we noted fuel prices at $111 a barrel.

Faced with that reality, we worked round-the-clock in search of a new investor, including other airlines. We felt that a strategic investor, an airline, might be interested, but we found out they have their own problems, as you know. And with fuel rising the way it was and an inter-island fare war, there was no one there.

Our senior management, our owners, and the board anguished over that decision to terminate passenger service and did so only after our lenders could not provide any further funding and after all other alternatives were exhausted.

No one wanted to believe that a passenger airline with a 62-year history of serving Hawaii could disappear or that 2,000 of our people who supported passenger operations could lose their jobs overnight. Without any further financing, we had to make the hard decision.

We are continuing round-the-clock efforts to save our cargo and contract services operation in order to preserve more than 1,000 remaining jobs. We also hold out hope that investors will look at resurrecting Aloha's entire passenger operation in the future.

What impact does this have on Hawaii? Aloha Airlines was the state's 10th largest private employer. We offered frequent, reliable passenger service, 100 inter-island flights a day, linking Hawaii's four counties and key cities. We flew 4 million passengers a year, including 1 million visitors and residents between Hawaii and the West Coast. We served the largest tourism markets in southern California and had the most non-stops from the West Coast to Maui.

We supported hundreds of nonprofit organizations throughout the State. For example, in 2006, we spearheaded the annual fundraiser for the March of Dimes and raised over $500,000.

Cargo and contract services continue to operate, pending the sale of those business units, and they remain a vital part of the air transport system in Hawaii.

Aloha also holds the majority of U.S. contracts with Hawaii for the mail and carries about 85 percent of perishable, sensitive consumer goods.

We also continue to provide passenger and maintenance service for a number of other carriers in the market.

Following the shutdown of Aloha's service to five Hawaiian and six Mainland destinations, ATA shut down. At this point in time, there is no daily nonstop service out of Orange County or Oakland to any of the cities in Hawaii. And 20 aircraft have been pulled out of Hawaiian service on the West Coast, and we were offering about 15 percent of the traffic at that time between the two carriers.

State tourism officials are expressing concern that Hawaii does not have enough seats in key visitor markets and that the loss of airlift could cost the state up to half a million visitors a year. Analysts say the average fare from the mainland to Hawaii could rise by $200 round trip, and inter-island fares, I can assure you, will go up to pre-Mesa levels, if not higher.

To date, we have terminated more than 2,000 employees and estimate the cost to the State of Hawaii in unemployment of over $50 million.

This company was started in 1946 and the men and women of our company were involved in many community affairs and supported so much beyond just air travel itself. Aloha's employees were not just good people like you will find throughout the airline industry. They were warm, wonderful people who shared a unique spirit of compassion and care for customers and coworkers. We call it the Aloha Spirit.

I could say more about them, but let me show you this.

[Video shown.]

Mr. BANMILLER. As a testament to these fine people, let me share with you the DOT's most recent air travel consumer report, which just came out. Since it began monthly reporting last April, Aloha has consistently been one of the Nation's best airlines in punctuality, baggage delivery, fewest cancellations, and fewest customer complaints. Last week's DOT report placed Aloha as the number one carrier in on-time performance and fewest passenger complaints.

There may be other airlines serving Hawaii, but there will never be another like Aloha Airlines.

Thank you, sir.

[The prepared statement of Mr. Banmiller follows:]

PREPARED STATEMENT OF DAVID A. BANMILLER, PRESIDENT AND CEO, ALOHA AIRLINES

Mr. Chairman, Vice Chairman, Members:

Good afternoon and *aloha!*

This is a very sad time for Aloha Airlines and indeed the entire airline industry. What we do touches everyone's lives in this country. Airlines drive local economies, they provide employment directly and indirectly; and they speed travelers on their way to make business deals, go on holiday, attend weddings and enjoy the benefits of an open economy.

How things have changed in our industry!

My humble beginnings in commercial aviation came as a management trainee with one of the great airlines of U.S. aviation history: TWA.

About 40 years ago, I was on the front lines as a ticket agent. Thanks to TWA, I learned a lot about customer service from the ground up, writing tickets by hand, and handling baggage.

By the way, the next ticket counters over from ours belonged to another giant of the airline industry that seemed equally invincible at the time—Eastern Air Lines. They're both long-gone, along with Pan-Am and other pioneering airlines.

Today America's airlines are more challenged than they have ever been. When it comes to airlines, change is the constant. Or as the authors of "Over the Hedge" put it: "the more things change, the more they remain insane."

What once was a proud industry that lured lifetime employment of dedicated workers, who strived to exude exceptional customer service, and focused on taking care of their traveling patrons, has now become an industry filled with chaos and uncertainty.

The Airline Deregulation Act of 1978 opened the playing field of competition. At the outset, deregulation was supposed to yield positive outcomes especially for the large hub markets. But for smaller regional markets, like Hawaii, deregulation has proved to be potentially harmful in achieving stable air transportation service.

For example, since the Deregulation Act, Hawaii has witnessed the collapse of a number of airlines including Mid Pacific, Mahalo and Discovery, as well as two bankruptcy filings by Hawaiian Airlines and two bankruptcy filings by Aloha Airlines.

Why? Because deregulation only regulated the revenue side of the business, not the cost side. And despite deregulation 30 years ago, the airline industry continues to be one of the most heavily regulated and taxed businesses in America.

Today I will focus on the unfortunate situation at Aloha Airlines, a mainstay of Hawaii's tourism-dependent economy for more than 60 years.

I plan to share with you the challenges we faced and the cause of our passenger-service shutdown.

The two main factors that caused the company to cease its historic passenger business were unfair competition and the soaring cost of jet fuel. The latter continues to pose a real threat to the air transportation industry, both in the United States and around the world.

I also want to touch upon a few global trends that continue to threaten Hawaii because of its geographic isolation and its dependence on air transportation more than any other state in the Nation.

What you're seeing today with the recent closure of Aloha's passenger business—along with the shutdown of ATA Airlines, Skybus, Champion, and MAXjet airways before that—is just the tip of the iceberg. Industry observers are asking, who's next?

Fuel Costs

The cost of fuel continues to rise with wild abandon, unchecked by government even as oil companies reap enormous profits.

When I was at TWA in the Sixties, fuel represented 5 percent of an airline's costs. Today it's 45 percent and currently surpasses labor as the number one expense for most airlines.

Throughout the 1990s, the average cost of a barrel of crude was under $20. In the year 2004, it rose to $40. Earlier this year, oil sold for $111 a barrel, a price that was inconceivable even a year ago. For every $1 increase in the price of crude, the cost of jet fuel to the airline industry is in excess of $400 million a year. And, unfortunately, there is no such thing as a hybrid jet.

Aloha has joined our industry colleagues in the Air Transport Association in calling for swift Federal action on a 21st century air traffic control system upgrade to make air transportation more efficient by eliminating America's archaic ground-tracking system, which makes for longer than necessary routing and landing patterns.

We strongly believe that if our air traffic control system were upgraded to satellite-tracking, we could be saving a lot more fuel.

Our fear is that without major strides toward modernizing ATC and spreading the cost burden to all users of the system, states like Hawaii that are solely dependent on air transportation, stand to lose more vital air service. And keep in mind, the average American suffers as a consequence of what happens to airlines.

Bankruptcy

The public has become accustomed to think that it is normal for airlines to go into and out of bankruptcy. But it doesn't always work out that way.

In our first bankruptcy, cutting costs was job number one. Our self-help program involved a lot of dedicated people, especially Aloha's employees across the board—who wound up taking a 20-percent pay cut.

Working 24/7 and across six time zones, we brought Aloha out of a complicated bankruptcy in a little more than 1 year. In order to succeed, we worked hard to win the confidence and support of Aloha's unionized labor groups and saved thousands of jobs while maintaining the company's reputation for exceptional customer service.

We also paid our Federal ATSB loan in full and on time.

At the same time, we forestalled demands from aircraft lessors who threatened to pull back Aloha's aircraft. We secured interim DIP financing at a cost, and we skated around onerous covenants while seeking permanent financing to take the company forward. I thought it was hard to find investors back then. Little did I know then what I know now.

Emerging from our first bankruptcy, we were optimistic that we had a viable business plan, one that could bring profits even in the traditionally low-fare inter-island market.

Mesa Air Group

Back on September 22, 2005, we had signed an agreement with the Yucaipa Companies, a well-respected private equity fund, for a substantial equity investment in Aloha. The $98 million agreement included $63 million in equity and $35 million in debt financing.

However, on the very same day that Aloha signed the new investment agreement came the announcement that Mesa Air group, an Arizona, company, planned to compete in the inter-island market with its own low-cost carrier.

We believe this improper because Mesa had come to Aloha as a potential investor and Mesa had also looked at Hawaiian's books when they were in bankruptcy. It was pretty clear to us that the timing of Mesa's announcement was intended to scare off investment in Aloha, something it did not do.

Mesa launched its inter-island carrier go! Airlines on June 9, 2006, with an advertised introductory fare of $39 one-way. In its first 18 months of operation, go! lowered fares to $29, $19, $9 and on down to $1.

A study done for Aloha by Sabre Airline Solutions soon after go! entered the market, indicated that with a 62 percent load factor, which was the average load reported then by go!, Aloha needed $50 a ticket to break even, Hawaiian needed $55 a ticket to break even, and go! needed about $67 a ticket to pay for the basic costs of its operation.

We began asking people in government, business, and media, and just about anyone who would listen, these questions:

> Why would Mesa charge less for a seat than it costs to produce it?

> Why was go! charging $39, $29, $19 or $1 for a seat that cost them as much as $70 to fly?
>
> Why would any manufacturer or provider of services offer their product for less than what it cost to produce it, for almost 2 years?
>
> Now everyone loves a bargain, particularly in air fares, but even so, Mesa's strategy of below-cost pricing raised some eyebrows. Even bargain-lovers began to ask, "Why doesn't somebody do something about it?"

We did not sit idle. We spoke to elected Federal, state and county officials and newspaper editorial boards.

We came to Washington to ask the United States Department of Transportation and the United States Department of Justice to look into Mesa's predatory pricing practices in Hawaii, and do something about it. We spoke to various lawmakers on the Hill.

Everyone told me that predatory pricing is hard to prove. I believe that if there is a textbook definition of predatory pricing, this is it.

Lawsuits

Not one but both of Hawaii's legacy inter-island carriers sued Mesa.

On February 13, 2006, Hawaiian Airlines filed a lawsuit asserting claims against Mesa for breach of a non-disclosure agreement that Mesa had executed in April 2004, during Hawaiian's bankruptcy proceedings.

On January 9, 2007, Aloha Airlines filed suit against Mesa alleging that Mesa had misused Aloha's confidential information and deliberately sought to drive Aloha out of business in violation of Federal anti-trust laws.

In fact, court documents show that Mesa's chief financial officer stated in an e-mail that, rather than wait for Aloha to die, Mesa should enter the inter-island market and give Aloha "the last push."

Due to this pending litigation, we will not go into further detail.

In spite of the legal challenges, Mesa continues to operate in Hawaii with $49 inter-island fares.

Second Bankruptcy

For the year 2007, Aloha lost $81 million on revenues of $407 million. In January 2008, we lost $10.6 million on $34 million of revenue.

In March of this year, after nearly 2 years of escalating fuel prices and cutthroat competition, Aloha's lead investor opted to stop funding Aloha Airlines, after a further infusion of approximately $100 million. This came on the day that fuel prices hit $111 a barrel.

Faced with that reality, we worked round-the-clock in search of new investment for all or part of Aloha Airlines. We approached numerous airlines that we felt would have a strategic interest in Aloha. But we couldn't find one willing to take us on, with fuel prices what they are, and the fare war still raging.

None agreed to finance Aloha's passenger business, leading to its shutdown on March 31, 2008.

Our senior management and owners anguished over that decision to terminate passenger service and did so only after our lenders would not provide further financing and after all alternative sources of funding were exhausted.

No one wanted to believe that a passenger airline with a 62-year history of serving Hawaii could disappear. Or that 2,000 of our people who supported passenger operations could lose their jobs overnight. But without further financing, it had to happen.

We are continuing round-the-clock efforts to save Aloha's air cargo and contract aviation services operations in order to preserve more than 1,000 jobs.

We still hold out hope that investors would look at resurrecting Aloha's entire passenger operation in the future.

Impact on Hawaii

What impact does our situation have on Hawaii?

Aloha Airlines was the state's 10th largest private employer.

We offered frequent, reliable passenger service—100 inter-island flights a day—linking Hawaii's four counties and major population centers.

We flew nearly 4 million passengers a year, including 1 million visitors and residents between Hawaii and the West Coast. Aloha served Hawaii's largest tourism market in Southern California and had the most non-stop flights from the West Coast to Maui.

In support of Hawaii's statewide airports system, Aloha ranked 2nd overall in airline revenue-landing weights, and 3rd in paying state airport-revenue charges.

We supported hundreds of nonprofit organizations throughout the state. For example, in 2006, Aloha spearheaded the annual fund-raising event for the Hawaii Chapter of the March of Dimes and helped them raise a record $500,000.

Cargo and contract services continue to operate, pending the sale of those business units. They remain a vital part of air transportation in Hawaii.

Aloha holds the majority of U.S. mail contracts in Hawaii, and carries more than 85 percent of the state's non-mail air cargo, including time-sensitive consumer goods, fresh produce and baked goods, agricultural exports, and emergency medical supplies;

And we provide ticketing, baggage and ground-handling services for multiple domestic and international carriers as their agent.

Following the shutdown of Aloha's service to five Hawaii, and six Mainland destinations, ATA Airlines abruptly shut down its Mainland-to-Hawaii routes. As a result, Oakland, California, and Orange County, California, have no non-stops to Hawaii.

In total, 20 aircraft have been pulled out of Hawaii service from the West Coast. Together, Aloha and ATA carried 15 percent of visitor traffic to Hawaii from the West Coast.

State tourism officials are expressing concern that Hawaii doesn't have enough seats in key visitor markets and that the loss of airlift could cost the state up to half a million visitors this year.

Analysts say the average fare from the mainland to Hawaii could rise by $200 a round-trip; and inter-island fares will certainly escalate to pre-Mesa levels.

To date, we have terminated more than 2,000 employees. It's been estimated that the State of Hawaii will have to pay out as much as $50 million in unemployment claims. Even so, the full impact of Aloha's situation has not yet been felt and the ripples continue to flow throughout the state.

Aloha Airlines was begun in 1946. Since then, the men and women of Aloha Airlines have been totally involved in the community, volunteering their time for hundreds of community events each year, and the company itself gave generously.

Aloha's employees weren't just good people like those you find throughout the airline industry. They were warm, wonderful people who shared a unique spirit of compassion and caring for customers and co-workers. We call it the Aloha Spirit. I could say more about them but let me show you.

As a testament to these fine people, let me share with you the U.S. Department of Transportation's most recent air travel consumer report, which came out just last week.

Since it began monthly reports in April 2006, Aloha Airlines has consistently been one of the Nation's best airlines for punctuality, baggage delivery, fewest cancellations and fewest customer complaints. Last week's DOT report placed Aloha in the Number One position for on-time performance and Number One for fewest customer complaints.

There may be other airlines serving Hawaii but there will never be another like Aloha Airlines.

Thank you for your kind attention.

The CHAIRMAN. I thank you very much, Mr. Banmiller. I realize it was not easy testimony, but I thank you for the record.

Our next witness is Mr. Charles Willis, Chairman of the Board of Island Air.

STATEMENT OF CHARLES F. WILLIS IV, OWNER AND CHAIRMAN OF THE BOARD, ISLAND AIR, ACCOMPANIED BY LESLEY KANESHIRO, CFO, ISLAND AIR

Mr. WILLIS. Mr. Chairman, thank you very much, and also Members of the Committee. I appreciate the opportunity to have Ms. Kaneshiro and myself address you.

I would like to begin by saying that I echo Mr. Banmiller's sentiments emphatically. I certainly have known the gentleman for many, many years. I have been around the airline business my whole life.

I just want to give you a brief, sort of where we were, where we are, and where we are going.

Island Air is a regional airline that has provided service within the State of Hawaii for 27 years. Between 2004 and the first half of 2006, the company expanded significantly by adding eight nonstop routes and over 150 employees. We complemented the jet service and did not compete directly with either Aloha or Hawaiian, and we carried roughly 14 percent of the market.

In early 2006, we brought in the modern and fuel-efficient Bombardier Q400 aircraft, which we still believe is the right aircraft for the market.

Go Airlines started service and initiated a fare war on the Islands at $1, $9, $19, and $29, and even free tickets. No airline or aircraft type makes money or breaks even at those prices.

Where we are currently: Since 2006, we have reduced our workforce by over 150 employees statewide. That is 40 percent. To date, we have lost approximately $5 million. We have ceased nonstop service in eight neighbor Island markets and have been unable to reinstate lost service. We reduced total scheduled flights by 38 percent. We have closed freight service to and from Lihue, Kona, Maui, and Hilo. We have realized a 30 percent reduction in our revenues and experienced an 80 percent increase in fuel cost per gallon.

We are being squeezed on the bottom by the FAR 135 single-engine airplane carriers who are semi-regulated and not subject to the same regulatory requirements and airport fees as we are. We are also squeezed on the top by the mammoth airlines, Hawaiian, who operate trans-Pacific flights and, thus, can absorb and transfer those costs over a larger system.

Implications of the Aloha bankruptcy: You could possibly end up with one strong airline in the marketplace, Go with their viability in question right now in a press release that was just issued yesterday. A consolidation of carriers has resulted in massive job cuts, fewer choices, with resulting economics, as well as a reduction or cessation of service to many communities.

Without assistance Island Air will be marginalized with a potential reduction or elimination of service to small communities and point-to-point markets.

The plan going forward: Our intent is to hire laid-off Island Air and Aloha employees and reinstate lost service to the eight market pairs that we previously serviced and subsequently deserted due to the fare wars. We are further interested in adding more point-to-point routes as scheduled service, for example, Kamuela, Barbers Point, Hana, and Kalaupapa.

We are presently negotiating with aircraft manufacturers to bring in up to three Dash–8–400s before the summer and bring back the Bombardier Q400s by mid to late summer or earlier if support is provided and demand is warranted. We want to complement and provide service where demand for jets is not cost effective.

How you can assist is to show immediate support of the loan guaranty bill, HB–509, and the aviation fuel tax exemption from GE [General Excise] tax, HB–2860, in the Hawaii State Legislature. I believe it passed the Senate 2 days ago and is off to the House. Time is of the essence.

We need an inter-island cooperation agreement between ourselves and the existing incumbents to stabilize and to be able to reinstate service, rehire employees, as well as reclaim a modern and safe aircraft.

Understand the seriousness of the air travel plight in Hawaii: The increase in unemployment, lack of service to rural communities within the State, potential of future reduction in air carriers in Hawaii.

Mr. Chairman, we need your support now. This is not an Aloha type situation. But if it is not rectified, we certainly will face greater challenges in the future.

Thank you, Mr. Chairman, and I will be more than happy to answer any questions at this point.

[The prepared statement of Mr. Willis follows:]

PREPARED STATEMENT OF CHARLES F. WILLIS IV, OWNER, HAWAII ISLAND AIR, INC.

Dear Senator Inouye and Honorable Committee Members:

My name is Charles Willis IV, and I am the Owner of Hawaii Island Air, Inc. dba Island Air. We are a regional airline that operates within the State of Hawaii.

In today's market of rising prices all airlines are faced with the challenge of covering costs and meeting customers expectations. The recent inter-island fare wars, the conduct of which is currently subject to litigation has resulted in a dramatic and severe loss of revenues to inter-island carriers. This is coupled with increasing fuel costs has resulted in significant losses by all the inter-island carriers.

The results of the fare wars and increase in costs have caused great hardship to Island Air and to those employees who were the casualty of workforce reduction, and a terrible disservice to all of Hawaii's residents and visitors. Since the fare wars began in 2006, Island Air has:

- Ceased non-stop services in eight neighbor Island markets and have been unable to reinstate service to those markets.
- Reduced total scheduled flights by 38 percent.
- Closed freight service to and from Lihue, Kona, Maui and Hilo.
- Reduced its workforce by over 150 employees statewide (40 percent).
- Realized a 30 percent reduction of revenues.
- Experienced an 80 percent increase in fuel cost per gallon.

These factors have caused financial instabilities in the marketplace resulting in the reduction of services that Island Air can offer.

The unfortunate closure of Aloha Airlines provides Island Air with the opportunity to position itself in the marketplace to expand routes and service where demand exists.

Thank you for allowing Island Air to present this testimony.

The CHAIRMAN. I thank you very much, Mr. Willis.

Ms. Kaneshiro, do you have anything to add?

Ms. KANESHIRO. No.

The CHAIRMAN. Thank you very much.

And now may I call on the President and CEO of the Air Transport Association, Mr. May?

STATEMENT OF JAMES C. MAY, PRESIDENT AND CEO, AIR TRANSPORT ASSOCIATION OF AMERICA, INC.

Mr. MAY. Thank you, Mr. Chairman. It is always an honor to be before you, and Senator Smith, it is a delight to be with you as well today.

I do not think that I can add a great deal to what has already been said this morning, and given the lateness of the hour, I will forgo a formal statement. I would like to emphasize a few points and suggest to you a couple of at least lead bullets, if not silver bullets, to the circumstances we face as an industry.

I have great affection for Dave Banmiller. He has been a loyal board member of ours and a good personal friend. I have huge affection for the islands of Hawaii. I have been traveling there for 30 years on vacation every year.

And I think what has happened there, while it is terrifically unfortunate is also a precursor to what the whole industry faces, as has been suggested here already this morning. This industry is beset by an $18 billion a year tax bill, principally to the FAA and to the TSA. We are beset by $55 billion a year in fuel costs projected for 2008. That is about $14 billion more per year than we paid a year ago. That is the equivalent of 330 new fuel-efficient aircraft. That is the equivalent of 440,000 employees.

And we are taking as an industry all of the dramatic actions that you have heard David and Mr. Willis talk about already this morning. We are laying off employees, unfortunately. We are offering early retirement to large numbers of employees. We are eliminating some destinations altogether, and those are principally smaller destinations. We are cutting frequencies. We are doing everything we can to recoup additional revenue. It has been well publicized. Some of the revenue measures that the carriers are pursuing for additional fees for bags and so on and so forth. And the unfortunate reality is that we have cut, through previous bankruptcies and the loss of some $35 billion as an industry early on in this century, most of that low-hanging fruit, if you will, and there is very little room or fat to cut in the operations.

And the principal factor for that, as I said a minute ago, is fuel. It is overwhelmingly our number one cost center today. Yesterday New York Harbor crude, which is a good benchmark of what we have to do in this industry, hit $150 a barrel—1-5-0. And we were paying just a few short years ago $20–$25 a barrel. It is outrageous and it is extraordinary.

I would suggest to you there are three or four things that this Committee can pursue that would be of short-term or immediate benefit to the circumstances we find ourselves in.

First and foremost, I would urge you to ask the Administration not to continue to fill the Strategic Petroleum Reserve when prices are as high as they are. We have a more than adequate reserve in play today. I think the number is 70 billion barrels of fuel in that reserve today. And yet we continue to fill that at today's prices which are outrageously high. It makes no economic sense or security sense whatsoever.

The second thing I would recommend that this committee consider urging the Administration to do is to release about 10 million barrels from that SPR. That all by itself is not going to have a huge impact on oil prices, but I think it sends a signal to the speculators that they are likely to get short and that this administration will take action to try and drive prices down. And I think it will have some kind of meaningful effect.

At the same time, there is a New England Heating Oil Reserve that is about 2 million barrels. The crisis time for heating in New England has passed for this calendar year, and I think they could release that into the market to make a very real difference in supply.

The next thing—and it is not a new subject to this Committee by any circumstances—but do no harm. Try and make sure that the TSA and the CBP and others do not continue to add additional burdens onto this industry which are terribly burdensome and are, quite frankly, the responsibility of the Federal Government to begin with.

The third thing is pass meaningful FAA reform, and by meaningful FAA reform, I would encourage this Committee not to do—you have done well in drafting that legislation and passing that legislation out of Committee thus far, but we need to make sure that before it goes further, it has a good, clear, clean, balanced, and fair funding formula. The vast majority of that $18 billion a year that we spend in taxes as an industry and that our passengers are charged is a direct result of the fees that we pay to the FAA, and those need to be rebalanced. That in turn, I think, will yield a much more modern and positive air traffic control system that allows us, as Mr. Banmiller said, to fly more efficiently and productively, cutting our fuel costs to the extent that we can.

Mr. Chairman, we have a long history of working with this Committee under your leadership and that of Co-Chairman Stevens, and we look forward to continuing to work with you. We will be happy to answer any questions you may have.

[The prepared statement of Mr. May follows:]

PREPARED STATEMENT OF JAMES C. MAY, PRESIDENT AND CEO, AIR TRANSPORT ASSOCIATION OF AMERICA, INC.

Good afternoon, Mr. Chairman and Members of the Committee.

I appreciate your urgent concerns about the future of air service in Hawaii. Air transportation is essential to the economic health and social fabric of the state and of all Hawaiians. Without a question, the shutdown of passenger service and auction of its air cargo business by Aloha Airlines is painful, not only for its employees and their families, but also for the overall ease of travel and shipping throughout the islands. People depend on air travel to meet their needs and support the state's vibrant tourism industry in a fundamental, unique way.

Truth be told, my affinity for Hawaii goes back some 25 years. My wife and I visit Hawaii every year and have traveled extensively among the islands. It is hard for me personally to imagine a more idyllic paradise, so I am keenly interested in the state's well-being.

Although I would like to reassure you that the recent service disruption is nothing more than a passing anomaly in an otherwise stable airline industry, nothing could be further from the truth. Some analysts view Hawaii as just the beginning of a sea change in the *Nation's* air transportation network.

And change will come because U.S. airlines are facing overwhelming odds: U.S. airlines' significant increases in taxes, fees, security burdens and environmental costs; ongoing labor concerns; staggering capital costs for new aircraft and infrastructure improvements; and unprecedented fuel prices. From 2001 to 2006, the industry lost $35 billion and more than 20 carriers filed for bankruptcy (including four of the six large network carriers), employee benefits and numbers were cut; planes were parked; and the industry scrimped to cut costs.

In 2007, the future looked somewhat brighter. With a modest profit, the airlines seemed to have turned the corner. But in 2008, our shaky recovery hit a brick wall: the economy deteriorated and jet fuel prices went through the roof. Today the forecast is grim.

Record-high fuel prices were the breaking point for some airlines. This year the industry likely will pay $55 billion for fuel—$14 billion more than last year—*a staggering 35 percent increase.* That's the equivalent of employing 440,000 airline workers full-time or purchasing 330 new wide-body airplanes. Last week, jet fuel averaged $135 per barrel—*a 30 percent-plus increase since January.* In Hawaii, some pay a premium for jet fuel that increases the financial hit.

Mr. Chairman, yesterday brought even more discouraging news. The price of home heating oil in the New York Harbor a well-accepted price marker for jet fuel—jumped to over $150 per barrel. That's a record that *shocked* even the most seasoned analysts.

With the brutal jet fuel costs and elimination of the low-hanging, "cost-saving" fruit gone, airlines large and small again are forced to take painful steps that have painful consequences for their customers, employees and shareholders. Airlines are literally fighting for survival as they:

- *File for Bankruptcy:* Three carriers filed in the past 2 weeks—Aloha Airlines, ATA Airlines and Skybus. Champion Air, a charter operator, will stop service at the end of May. After 61 years and facing severe financial difficulties, Aloha shut down passenger service—laying off some 2,000 employees and terminating aircraft and ground-support leases. The impact on Hawaii's economy, its passengers and shippers, is abrupt and widespread.
- *Cut Employees:* Delta offered early retirement to 30,000 employees—half of its workforce—to eventually reduce headcount by 2,000; American and Northwest announced hiring freezes.
- *Charge for Amenities:* Carriers are imposing additional fees for extra and oversize bags; telephone reservations, onboard meals; unaccompanied minor service; and pet transport. Some carriers also have added fuel surcharges, particularly on international routes.
- *Cut Unprofitable Service:* United, Delta, Northwest and others are parking planes; carriers are reducing service on marginal routes and eliminating service on unprofitable routes. Delta will end service to several small communities and US Airways cut 30 percent of its overnight flights into Las Vegas. *If demand softens as the economy weakens, more unprofitable routes may be cut*.

None of these changes are popular with our passengers. As airlines try to pass on their increased operating costs, the number and volume of complaints will jump even higher.

In short, we're doing everything we can to get ourselves out of this tailspin. *But there is a limit to how much more we can cut costs and increase revenue.*

The Nation's economy depends on a vibrant national air transportation network with secure access to a stable, rationally priced fuel supply. *That is not what we have today.* The only solution is for the Federal Government to develop a national energy policy and a forward-looking aviation policy. As these policies takes shape, we've asked the administration to do what it can *now* to alleviate the pressure on fuel prices. We've asked the Department of Energy to stop filling the Strategic Petroleum Reserve that takes fuel out of the marketplace and increases costs, and for a release from the Home Heating Oil Reserve to remove the premium for jet fuel.

In closing, record-high fuel costs touch passengers and shippers in ways they do not like—the people of Hawaii will feel the demise of Aloha as their everyday lives are impacted. One key component of the national air transportation system has been hit hard. The Federal Government must take some bold steps very soon, or the entire system will suffer.

Thank you.

The CHAIRMAN. I thank you very much, Mr. May. Your suggestions, as they relate to the reserve system, I think are deserving of further inquiry. If I may, I would have my staff call upon your staff to see if hearings are justified.

Mr. MAY. Mr. Chairman, we would be happy to participate. We would be happy to suggest some experts in the area of fuel. It is not, as Senator Smith suggested, a pure silver bullet, but it is certainly something that will have an impact.

When we are averaging $135 a barrel in this industry—and that is because the so-called crack spread, the refining premium, Jet A, is so terribly, terribly high. It has gone up just as much on a percentage basis as the cost of the raw product to begin with. And it is those middle distillates in that barrel that are so terribly expensive. Diesel fuel here, if you happen to drive a diesel car—and the truckers I am sure you are hearing from—it is just amazing.

And anything that can be done is a marginal benefit because we have lost five carriers. We are going to lose more. Small communities are going to lose service. 50-seat RJ's are the least efficient planes in the fleet. So Bend, Oregon and other places are going to be very much at risk. And we cannot help it with fuel being as expensive as it is today.

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

Our final member of the panel is Mr. Fukunaga. Do you have anything to add here?

STATEMENT OF BARRY FUKUNAGA, CHIEF OF STAFF, OFFICE OF GOVERNOR LINDA LINGLE, STATE OF HAWAII

Mr. FUKUNAGA. Thank you, Chair Inouye and Senator Smith. I do realize that we were a late addition to the panel, and I do not have written testimony as a result. But I do appreciate the opportunity to join this august body and to appear before you.

My prior experience was I was a director at the Hawaii State Department of Transportation before my current position. In my earlier life, I did 25 years at the international airport, 15 of which I was the manager there.

The situation that we see today is certainly profound. It is not like anything that I have ever experienced in my time at the airport. And I certainly sympathize with the plight that is faced by the air carriers.

When all of this came about, we certainly had a real concern about the impact that the shutdown of a carrier like Aloha would have on our State, simply as an island economy. We are so dependent on connectivity by air. As a result, we quickly rode to help the employees and certainly the stranded passengers, and I think the industry as a whole in Hawaii, our travel partners, made that possible for us to do that.

But looking forward, we do not see the ability to really entice or encourage a significant amount of increase, and that is an area of concern for us.

Nevertheless, I think we really need to work closely with the carriers that do service our islands so that we can continue to embrace and embody travel opportunities for those not only who reside in our state, but also those that come to visit us.

The Administration has certainly been concerned about the reliance on air alone. So we introduced the support of Hawaii's Superferry, and hopefully we will be able to offer at least options and alternatives, if they can be successful in providing their trade.

The Airports Division has taken on an airport modernization program in collaboration with the air carriers that operate in Hawaii. It is a $2.3 billion effort. Certainly it is intended to not only upgrade and improve our facilities, but to make it easier so that the carriers and operators and the users of our facilities find themselves able to do so more efficiently and thereby reduce some of their operating costs.

It is important that we continue to recognize that our system is unique in terms of airports. We operate all of our major airports throughout the State. We are unique in that respect and, as a result, have been able to provide service to our neighbor islands over and beyond what they would otherwise be able to do if they were left only to themselves and the traffic that they generate.

As a result, we continue to retain a differential in our fees and charges to our inter-island air carriers such that they can be able to operate at a lower cost than what would otherwise be the norm because we can subsidize these operations through the activity that is conducted through Honolulu International Airport.

We provide a preferential hold room price. It is about 64 percent of what the others would be charged using that same facility for inter-island carriers, and the same thing with a joint facility utilization charge. These things, I think, certainly help and encourage that.

And yet, we see the reduction in inter-island airlift primarily because, as was mentioned earlier, of the direct flight by overseas carriers to our neighbor islands. Yet, we still need to maintain that connectivity between our islands for our residents and for the visitors that have the opportunity to move between our islands. And we certainly would like to see more support in that area, and it is certainly something that we would be involved with.

It was mentioned that the EAS service does benefit three of our smaller communities, but what we experienced with the EAS program is that the company that was awarded the bid essentially indicated that they no longer needed the subsidy. That action alone resulted in their raising rates, and we saw some drop-off in service. There have been numerous complaints about that activity, the fact that they did not provide the kind of frequency that was anticipated or expected. And that creates a problem.

The fact that they are providing service means that the DOT will not open up a bid opportunity again. And we feel that it was important to do that. We need to provide service to these communities that would otherwise be held hostage without it.

It was mentioned early in a news release that the cost to go to Hana was equivalent to the same travel between Hawaii and the West Coast. Now, that certainly cannot be, and that is a problem. Communities like Hana, which only have a roadway to connect them, and a long one at that, depend on it. The hotel there provides employment to a remote community that helps sustain that particular economy. So it is important that we try to get that kind of service. As small as it may be, it talks about the problems that we face and the challenges that we encounter in trying to maintain and provide for our communities throughout our State.

So going forward, I think it was mentioned about the pending legislation. We are coming down to a crunch where it is going into committees, and we need to see these bits of legislation passed. We had mentioned to the State legislature that the loan agreement would need some adjustments. There is no provision in our current administrative budget to provide the kind of funding that would be needed to underwrite these loans. We need about 25 percent of what the loan would be offering. The legislature will have to make that adjustment to the state's budget so that we can do that.

Second, the fuel surcharge that would be levied on our inter-island carriers—we are supportive of that measure as well.

So the Governor has always made it known that she is interested and open to exploring any possibility that is out there in terms of programs, but we would do so judiciously and in concert and discussion with our operating partners to make sure that what we do put into play does not adversely or inadvertently create a problem bigger than the solution that it seems to want to offer.

So with that, I certainly appreciate the opportunity again for being here and having the chance to join this group. Certainly I am available for questions. Thank you.

The CHAIRMAN. I thank you very much, Mr. Fukunaga.

Now, if I may, I would like to ask Mr. Banmiller a few questions.

Mr. BANMILLER. Yes, Mr. Chairman.

The CHAIRMAN. Is Aloha Airlines doing anything to assist employees in transitioning to other employment?

Mr. BANMILLER. Yes, Mr. Chairman. I discussed this issue last week with the CEO of First Hawaiian Bank and the mayor. And there was a job fair that was held yesterday at the Blaisdell Center. And I am pleased to report that there were almost 200 employer groups set up there to interview our employees, I think, in part a testament to the quality of our employee population. And 50 businesses were actually turned down because they ran out of space, and last reports were 1,600 people were in there interviewing and talking about employment.

We had separately set up resume services in that same facility to assist people in developing their resumes.

We have separately been in touch with the State Department of Labor and have set up separate groups to work directly with our employees to educate them on things like health care, COBRA, and there is a separate website that has grown out of the job fair to assist employees in linking them up with employers.

So we feel, even under these difficult circumstances, Mr. Chairman, that there is a lot of very positive activity going on in terms of the employment of these fine people.

The CHAIRMAN. So are you confident that most, if not all, of your employees will have new employment?

Mr. BANMILLER. Sir, that word "confidence" I used to have more of until I got into the past couple years in this business, but I think the answer is yes. Between some requirements that Hawaiian Airlines is going to have, coupled with a fairly low unemployment level, particularly in certain of the locations, our people will be mostly absorbed. And it is our job to facilitate that.

The CHAIRMAN. In your statement, you indicated that cargo operations are continuing.

Mr. BANMILLER. Yes, sir.

The CHAIRMAN. Is your intention to continue or to sell this?

Mr. BANMILLER. In the current process, all of the assets of Aloha Airlines are up for sale through the Chapter 11 process. When you look at the four divisions that we operated, cargo was the most profitable, in part because we were able to manage our own fuel situation and our customers. The second was contract services where we service other carriers. That is modestly breakeven and employs about 1,000 people.

The passenger service inter-island and the ones on the mainland were both most vulnerable to fuel and Mesa's activity inter-island.

As a result, when we ran out of money, we found nobody that was willing to support the passenger end of the business.

We did, however, in terms of our responsibilities to the lenders, who now have a focus on the assets of the company, see what we needed to do to sell the various assets of the company. If someone were to come in during this process, which is going on over the next several weeks, supervised by the bankruptcy court, and wishes to buy the entire operation, including the name, that is certainly a possibility. I do not see that indication, but it is a possibility.

There are many people interested in the cargo operation. We have maybe 40 interested entities of which I would characterize five as extremely serious. And their view would be to step in and take over the cargo operation as we run it today.

The CHAIRMAN. Are you considering any prospects for future passenger operations?

Mr. BANMILLER. We are, Chairman. The problem is with the conditions in the marketplace and the subprime problem, the access to money, the investor that we found several years ago we do not believe is out there. We could be surprised. We still are having talks with several people, but I am not optimistic.

The other was strategic opportunity with other airlines, and frankly, in those discussions the airline executives have said to us, in addition to the fare war inter-island, the cost of fuel is such a problem for the industry in general that where several years ago joining forces with us might have been an opportunity, it really is not today. So we hold out some hope, Chairman, but we see no active participants on the passenger side at this point.

The CHAIRMAN. You have heard Mr. May in his opening remarks about the Reserve.

Mr. BANMILLER. Yes, sir.

The CHAIRMAN. Do you agree with him?

Mr. BANMILLER. Yes, I do, and especially at the price point that we are looking at today, those of us in the industry going through the daily problems of keeping the ship afloat and having to furlough people, combine operations, and faced with all of our daily challenges, to put it frankly, look at an administration that does not seem as sensitive to our current plight and to hear not just the woes of Aloha Airlines, but within the industry, and look the other way, I personally do not understand it. And I support Jim May in his observations and I suspect every airline CEO would say the same.

The CHAIRMAN. I have further questions, but I will yield now to Senator Smith.

Senator SMITH. Thank you, Mr. Chairman.

Mr. Banmiller, I want to make sure as a preface to my questions you do not take this as any criticism of you or your airline, but I am going to be asking these based on my own desire to learn more about the problem of deregulation.

You made the comment that you started with TWA. You shared counters with Eastern and Pan Am. These were great marquees of my boyhood memory, and they are gone. Are they gone because of deregulation?

Mr. BANMILLER. I think if you were carrier-specific, it would be better to isolate the dilemmas. As an example, you can put the blame on certain carriers on management, ownership changes, aggressive behavior, and mergers. You need to almost go by carrier. Eastern was a combination of all kinds of things that I would not necessarily lay on deregulation.

Senator SMITH. But are you arguing for us to re-regulate?

Mr. BANMILLER. I would argue a revisit of the regulation process. Total re-regulation I do not endorse. I do not think that toothpaste, as they say, can be put back in the tube. I think for the State of Hawaii, it was a problem because I do not think it was geographically considered. I think there is an answer between regulation and deregulation.

When I said we deregulated revenue, the markets were open. You could go anywhere and it was crazy in 1978–1979. But nobody looked at the expense columns. What is it going to cost? What are the labor agreements? What are the agreements and responsibilities with the pensions? And as a result, we all focused on opening up markets and not the expense side, and some of the carriers that lost were foolhardy in those early days.

Senator SMITH. Well, to that point, Jim May, I am from Pendleton, Oregon. We used to have United Airlines fly in there and fly empty planes in and out of there, and we loved having United Airlines there.

Mr. MAY. They are missing one of the great rodeos in America.

Senator SMITH. And it still is. It has been filled by another carrier and occasionally a second one, and so we have air service still.

But I have wondered in my own mind. I am not a re-regulator. I will state that right up front. I have made a list of your suggestions. I think that they are excellent. But you also said no new burdens. Re-regulation would represent, I think, a significant additional burden.

Mr. MAY. Senator Smith, I would beg to differ ever so slightly with my good friend, Mr. Banmiller, in that I would argue that airlines remain one of the most highly regulated businesses in the world today. We have had prices deregulated. We have had routes deregulated, but I think it stops right about there. I can go down the list of the amount of regulation that we have with the FAA and the DOT and the TSA and the CBP and the Department of Homeland Security and the State Department, and we can go right on down the line. There are very few things that happen at an airline that do not require some governmental supervision or responsibility. So I do not think that simply re-regulating is the answer.

I would suggest that a pretty good case could be made for further deregulating this industry and get us out of the business of some of the responsibilities in the areas of security, for example, rebalance the equation on FAA funding, things of that sort, and I think that would go more to reducing the economic burden.

Senator SMITH. Well, how about as it relates to—you know, we give slots at airports. We give airspace and we do that federally. How about getting a flight to Hana that keeps Hana in business and Pendleton, Oregon in business? In exchange, should there be some sort of re-regulation in that sense for the rural folks in the Hawaiian islands to continue to have some measure of protection in terms of passenger transportation?

Mr. MAY. We have always supported the EAS program, and I think this committee needs to continue to take a hard look at it and see how it can be improved because it is always going to be a very tough economic put, if you will, for a lot of particularly small communities. I love Hana. It is one of the garden spots of this world.

Senator SMITH. I spent my honeymoon there. I think the same thing.

Mr. MAY. So we both share that affection. But it is going to be a difficult place to maintain economically viable service on a regular basis without some form of government assistance or subsidy.

Mr. BANMILLER. Senator Smith, may I just add one comment?

Senator SMITH. Yes.

Mr. BANMILLER. When I said deregulation versus regulation, I agree with Jim May. My point was how do you, in our situation, address everybody I could talk to about the predatory pricing activity and everybody said we cannot do anything about it. So somewhere between the Department of Justice, the Department of Transportation, all the regulators, there must be an answer in here somewhere other than we cannot do anything about it. And now I sit here before you.

Senator SMITH. Mr. Chairman, if I could ask one more question.

The CHAIRMAN. Please.

Senator SMITH. Let me just say up front, again so you do not take this in any way personally. I am not trying to insult Aloha Airlines. I have used it many times and have affection for it as well.

But I wonder if you could go back now, go back to 1978, are there things that Aloha should have been doing to get ready for a Mesa Airlines and Go? I mean, the mix of airplanes? Were there contracts that were agreed to that just simply were unsustainable in a deregulated environment?

Mr. BANMILLER. Senator, I will be honest and say I wish I had that answer. I am sure, between 1978 and now, the company could have done some things differently like any company.

Senator SMITH. Well, no company, in defense of Aloha, can deal with these kinds of fuel increases. As far as I am concerned, you are off the hook on that basis alone.

But as you look back at it—it just seems to me that we are in a world now where oil is just going to get shorter and shorter and shorter because we have these huge emerging middle classes of the biggest populated nations on Earth, and they are buying cars and they are buying planes and they are joining the industrialized world. And it is a resource that, at least in our country, we do not believe in tapping anymore.

Mr. BANMILLER. I think what happened in 1978 with deregulation, there was something called the Public Utilities Commission. We had it in California. I think perhaps the company, if they had, should have been more vociferous in saying we do not have roads. We do not have rail. And when you are in the continental United States, you view transportation differently.

When I went to Hawaii, I had a different view of transportation than I do now because the only way to get to each one of those islands really is to fly. The ferry does not really work comfortably and it does not promote commerce. Having the ability perhaps for Hawaii not to have jumped into deregulation in the way that it did, that probably should have been visited a bit differently.

Senator SMITH. Is Go Airlines making money?

Mr. BANMILLER. No, sir.

Senator SMITH. Have you got a case? It sounds to me like you have a case in terms of predatory pricing, I mean, if you are giving a seat away for 9 bucks and fuel costs being what they are. Are they filling their seats?

Mr. BANMILLER. On advice of counsel, I am going to give you a modified remark. A 50-seat airplane does not work in the islands because of the high cycles. We fly 20–30 minute trips. That is not the airplane that works. So in addition to that, we estimated—and they have now admitted to losses, $20 million–$25 million a year. That is on four airplanes.

Senator SMITH. Have they added seats, flights since you have left the market?

Mr. BANMILLER. They have added some flights. Yes.

Senator SMITH. Have their prices gone up?

Mr. BANMILLER. They still have $49 fares, although I believe their inventory of $49 is probably going down. And I suspect within the next 6 months, the fares in the State of Hawaii, the average fares, are going to be up substantially.

Senator SMITH. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Can I ask a few questions, Mr. Fukunaga? Listening to your comments, am I correct to assume that Governor Lingle will support and sign into law the airline loan guaranty program and the tax exemption for jet fuel?

Mr. FUKUNAGA. On the tax exemption, she would. We supported that piece of legislation. We recognize the application to our inter-island operators is certainly advantageous.

On the loan guaranty, we asked the legislature to make some adjustments so that such a bill could be made viable. In other words, there is no funding that was provided for it. Certainly it is not in our administrative budget. And so they would have to provide that for us so that we can have a mechanism that would be capable of supporting loans. Again, your comments earlier about lenders recognizing the plight of our carriers to make those loans available certainly would be the other half of the dimension there. But she certainly is supportive.

The CHAIRMAN. In your testimony, you spoke of EAS communities having reduced service and receiving a lot of complaints. Have you transmitted these complaints to DOT?

Mr. FUKUNAGA. We are not allowed to do that, but we did mention to Representative Hirono and had her put her staff in contact with the source of the complaints so that they could work that directly because it is an issue that is outside of our jurisdiction.

The CHAIRMAN. Did you say that the Governor cannot communicate with DOT?

Mr. FUKUNAGA. On the issue of asking them to get involved. That is my understanding, and that is the reason why we took this other alternative approach.

The CHAIRMAN. You mean the law prohibits our Governor from communicating with DOT?

Mr. FUKUNAGA. I believe that we cannot get involved in the EAS process. It is not one that the State is involved in. And so we have to just put the parties together to make sure they understand the impact of the situation that we are experiencing.

Essentially the request was to allow the USDOT to reopen the bidding opportunity even though there is service being provided, and I think because that service is being provided, the requirement is being met in terms of having service. The question is not so much the service but the quality of the service and the type of service. I think that is the thing that is creating some difficulty.

Hana is one example. Kalaupapa is maybe even more difficult. Obviously, the patients and the residents who are there depend on a lot greater reliability and reasonable cost in terms of being serviced. So we would certainly like to see that issue be addressed.

The CHAIRMAN. Secretary Reynolds, is the Governor of the State of Hawaii prohibited from communicating with you on matters of EAS complaints?

Mr. REYNOLDS. I am not familiar with any restriction from our end. We routinely seek the views of local officials, including State officials in many cases, whenever we are involved in a particular Essential Air Service case.

We are aware of some of the issues at Hana. Congresswoman Hirono has brought those to our attention. And we have been working a little bit with the carrier there. Of course, as Mr. Fukunaga indicated, the carrier is providing subsidy-free service at this time, but we are working with the carrier on some of the issues associated with some of the complaints that we have heard.

But to your point, I am not familiar with any restrictions on contacting us. I do not believe there are any such restrictions, at least on our end.

The CHAIRMAN. Mr. Secretary, does your Department monitor predatory practices in the aviation business?

Mr. REYNOLDS. We do not actively monitor predatory pricing in the airline industry. In the past, airlines have come to us and brought us what they feel—allegations of predatory pricing in the past. But we do not actively monitor fares at this point.

The CHAIRMAN. Now, when they do submit a complaint, what do you do about it?

Mr. REYNOLDS. It depends on the particular type of complaint. Usually an air carrier will provide its allegations and then provide evidence and other information to support it. Depending on what is happening, we will look into it and we will speak with the other carriers involved if there is an actual investigation going on.

I will note that, of course, when it comes to predatory pricing, we share jurisdiction over anticompetitive behavior with the Justice Department. And when it comes to taking formal actions, the Justice Department has tended to be the point agency in these cases.

The CHAIRMAN. Mr. Banmiller, did you share your concerns about predatory pricing with the DOT?

Mr. BANMILLER. Yes, I did, Chairman. I met with both Secretaries of Transportation on this issue over the past two and a half years, and I met with lawyers from the Department of Justice.

The CHAIRMAN. What was the reaction or response?

Mr. BANMILLER. We will look into it, and that is all I heard. We followed up on several occasions through various legislators, and the comment back continued to be, including people from the DOT, well, predatory pricing is very hard to define and our interests are for the consumer and low fares. So I did not get very far.

The CHAIRMAN. Mr. Secretary, I do not know if you can respond to this, but did you consider the report submitted by Aloha Airlines worthy of your consideration?

Mr. REYNOLDS. We were familiar with the allegations, as Mr. Banmiller indicated. He met with officials on several occasions. Further information or evidence I am not aware was ever provided to the Department. I was not in the conversations that he had, so I cannot speak to what went on exactly.

In this particular case, there is litigation going on, obviously, of the nature of the claim that Aloha is pursuing on their own. So I do not want to get into too many details.

On its face, this is an issue that is very different from any other predatory pricing claim that we have ever seen before because in other cases, wherever there were investigations, it was a new entrant coming in and then complaining about an incumbent carrier lowering prices and dumping capacity and trying to drive the new carrier out, where in this case, it is the incumbent that has the issue. And routinely when air carriers go into new markets, they offer discounted fares in order to attract business. So at least initially, it did not have a look of the traditional cases that we have seen in the past.

The CHAIRMAN. Because one of the reasons for bankruptcy, as cited by Mr. Banmiller, was predatory pricing, it is a serious matter. Mr. Secretary, can your Department provide this Committee with a report on the complaint submitted by Mr. Banmiller and your response to it?

Mr. REYNOLDS. Yes, I can, Senator.

The CHAIRMAN. I thank you very much.

In the years I have been on this Committee, I have been led to believe that most of the airlines on this globe are either fully or partially owned by the host governments. The ownership interest may be 5 percent or it may be 100 percent, as in Saudi Arabia.

What is the situation with the United States? Does the Government of the United States have any ownership interest in any airlines other than the military?

Mr. REYNOLDS. I do not believe so except perhaps for interests that the PBGC might actually have in a few carriers. I know they have had interests in the assets of various carriers. But the Federal Government, other than when there were the loan guarantees following September 11, there were some warrants and other interests held in U.S. carriers which eventually were redeemed after the loans were repaid. So I am not aware of any active investment or interest on behalf of the Federal Government unless there is residual interest in something, for example, at the PBGC.

The CHAIRMAN. If that is the situation, is there a level playing field between international airlines and U.S. airlines?

Mr. REYNOLDS. I think, for the most part, there are level playing fields in the most active markets. We always have the opportunity to go after foreign air carriers if we feel that there are unfair competitive practices, and if there is improper government involvement in a particular air carrier that is affecting service, our carriers are not shy about bringing those sorts of issues to our attention. And we will usually go to the home governments of any of these carriers and try to deal with these situations. I am not familiar with any in the recent past having a major issue there, at least dealing with areas where the U.S. carrier is competing with the foreign carrier.

A lot of the heaviest competition is over the Atlantic. Most of those carriers are privately held, for the most part, and even the EC has been taking steps against state investment and involvement in the carriers to reduce that as they compete amongst themselves.

The CHAIRMAN. Would you consider that the load placed upon the operations costs by the Government of the United States is proportionately higher than what other governments place upon their airlines?

Mr. REYNOLDS. I do not know offhand the comparative burdens of different governments. I imagine it probably varies widely. I do not know if Mr. May might even have any insight on that, but offhand I do not know. We would have to look into that.

The CHAIRMAN. Mr. May, do you think we have got a level playing field here?

Mr. MAY. No, sir, I do not.

I think we could even things out, but a lot of it is competitive in its marketplace. One of the areas where the European carriers have a distinct advantage, probably as much as 30 percent right now, is on fuel because they are paying for it in Euros. We are paying in dollars, and the dollar is significantly devalued. So they have got a real advantage there.

I think that we are happy to compete internationally and will do well internationally in most areas. I acknowledge that there are foreign government investments in some carriers around the world, some very extensive. But we are happy to compete trans-Atlantic, trans-Pacific here in the United States.

I think there is a lower burden imposed by governments in terms of taxes in many countries than there are here. I think ours are probably as great as anywhere you will find on the globe in terms of what carriers are paying.

The CHAIRMAN. I thank you very much.

What role does the Department have in enforcement when you come across predatory pricing?

Mr. REYNOLDS. As I mentioned earlier, we will take complaints frequently—or not frequently. In the past, we have had complaints from carriers, and we have looked into the matter, as I mentioned. We will take the information, evidence that is provided by the carrier that feels it has been affected by the behavior. We will then frequently talk to the carrier that is accused of predation. And frequently our involvement has had an effect in the past.

Again, we have not actually had a formal predation claim in the last decade, and even informally on predation, the allegations of Aloha are the only ones we have had in the last 10 years. So it is not really a common occurrence at this time. I cannot speak to who may have complained to Justice about behavior, but just in terms of what we do.

Again, we share enforcement responsibilities with the Department of Justice, and we will work with them as they move forward on cases. In fact, they have only brought one action, and that was about 10 years ago. Maybe it was begun a little bit more than that against an airline. The Justice Department—a lot of people thought they had a very strong case—was not able to prevail in court against the carrier in the one case in the last decade and a half on predation.

The CHAIRMAN. I realize that you have not been made fully aware of the Aloha Airlines situation, but from what you have heard at this hearing, would you consider the allegations worthy of study or investigation? Predatory pricing, that is.

Mr. REYNOLDS. Well, we can look into it further. Again, I do not have all the information, and since there is a pending lawsuit, I too do not want to speculate on evidence that is not, frankly, before me or the Department at this point. So, again, I just would resist opining on something I do not really have full information on.

Again, we will provide a response to you about the allegations that were brought to us by Aloha and can talk further on that.

The CHAIRMAN. Mr. Willis, do you agree with Mr. Banmiller that there was predatory pricing in Hawaii?

Mr. WILLIS. There is absolutely no question. I can give you or your staff numerous examples of it. I mean, we lost almost half of our traffic through what Mesa and Go had done. What they did is they diluted and diverted our traffic. In fact, their percentage of the marketplace actually came mostly from our traffic. It was a combination of our traffic and Hawaiian and Aloha's.

One thing I just wanted to mention, if I may. Senator Smith had mentioned his concern about re-regulation. One thing that might be worthy of your consideration to provide some sort of a level playing field in the stabilization in the marketplace would be something similar to what Aloha and Hawaiian did post-9/11, which was the inter-island cooperation agreement. Right now, we need stabilization in those markets. Otherwise, you are just going to see a monopoly condition present itself. That is number one.

The second thing is what you had mentioned to Mr. Fukunaga about SB–509 because I got the impression that they may not be able to support that bill. Right now, lending to airlines is closed. That is why that bill is very, very important for the existing carriers in Hawaii to have access to the capital markets.

I apologize for getting off subject, but it is kind of important to address that.

The CHAIRMAN. And 30 years ago, when this committee considered airline deregulation, after long and lengthy hearings and debates, we took a vote. It was almost unanimous. One vote against. I was the one against. When the vote was announced, you can imagine the controversy. You know, I felt like an outsider all by myself.

But my concern was that the change was too sudden in deregulation of scheduling and costs, and I suggested to some of my friends in other states that if this ever goes through, you may be losing business in your state. I recall a little city called Charlestown in

West Virginia that at one time was receiving nine flights a day, and suddenly almost overnight, they got none.

I cannot tell you whether I did right or wrong, but I think something has to be done, not to re-regulate but maybe we should revisit that.

Mr. May, you were speaking of a couple of things that we can do. Can you just reemphasize it again?

Mr. MAY. Yes, sir, Mr. Chairman. I think the idea of filling the Strategic Petroleum Reserve at today's prices borders on criminal infringement of the rules of economics.

The CHAIRMAN. Has your organization formally indicated your concern to the Government of the United States?

Mr. MAY. We have not recently done that. I did it during the last dust-up over fuel prices, and we asked for both the release and to stop filling at current prices then, which were probably about 70 bucks a barrel. And we were rejected.

Within the last 3 weeks to 4 weeks, I sent a letter to Secretary Bodman asking for a release from the Northeast Home Heating Oil Reserve, and I have not received a response from him on that.

But we got together with our energy committee within the last few days, kicked around a series of ideas, some of which are not quite ready for prime time, but I would be happy to provide them to the Committee. One of the ideas that we came up with is our concern that there is a premium involved in the price of a barrel of oil today as a result of speculation. There are a lot of exchanges operating out there, ISE down in Atlanta and elsewhere. A lot of people making a whole lot of money on the price of oil right now. If the U.S. Government would exercise a whip hand and release from the SPR, increasing supply, arguably driving prices, they would not be able to act with such impunity thinking that nobody is going to have any impact on pricing.

So we think a 10 million barrel release would have a dramatic effect and would send a signal. We would not want it announced in advance. We would like it just to happen. Every now and again, if you release some of that oil, that will keep everybody on their toes, and I think we would have a more meaningful marketplace reflection on price. So those are two ideas.

The third idea is a balanced funding formula and FAA reauthorization, not a new subject to this Committee.

And the final idea was to try and encourage that we get the next generation air traffic control systems in place as quickly as we can. 2025 is not going to do it. We have adopted the phrase suggested by others. The "now generation" as opposed to next generation is what we need because the more efficiently we can fly point-to-point, the more efficiently we can route our aircraft into crowded airports and out of crowded airspace, the less fuel we are going to be able to burn and the more efficiently we can conduct our operations.

So those were the four things that I recommended to the Committee.

The CHAIRMAN. From what I gather, you consider these matters to be urgent and should be acted upon right away.

Mr. MAY. Mr. Chairman, I think without question. We have had five carriers, including Aloha, go bankrupt since Christmas. I think there are others that are very much on the edge. There is no sign whatsoever that fuel prices are coming down anytime soon. Most of the business plans for our carriers were built on a projection of probably $85 oil, maybe $90 oil in some instances, and when you look at the impact of the crack spread on top of the price of a barrel, 135 bucks on average is what we are paying right now. And that is just unsustainable.

The CHAIRMAN. Thank you.

Mr. Snowbarger, your agency is an important one for employees. You speak of pension guarantees. In making plans for the future, do you anticipate more bankruptcies, layoffs, and pension guarantee problems? Is there going to be an increase or decrease?

Mr. SNOWBARGER. There will be an increase in bankruptcies. We have seen a number in industry, for instance, that have gone through bankruptcy once that may very well come back like Aloha for a second bankruptcy, and maybe they were able to keep their pension plans the first time through, maybe not the second time through. I think with the credit markets the way they are, with the economy the way it is at this point, I think we are going to see an increase over the next few years.

We are sort of a lagging indicator of the economy. We normally have an up-tick in the number of plans that we take on maybe 2 or 3 years after the worst of the economic cycle. So that may not hit us this year or next year, but maybe late next year, a couple years down the road.

And it also depends on sort of the cycles within each industry. Again, we probably will not take over many more steel plans because there are not many more steel plans left. We have taken over a considerable number of the pension plans in the airline industry, although there are still more out there that do cause us some concern.

I think that is the reason Congress provided for extended payment of their contributions in the Pension Protection Act that was passed in 2006. But I think anytime you see a troubled industry, it is very possible that we will be taking over plans.

The CHAIRMAN. When you speak of increases in bankruptcies, does that apply to the airline industry also?

Mr. SNOWBARGER. Well, I think it is difficult for me to predict exactly what is going to happen in the industry. I think these gentlemen have given you pretty dire forecasts about what they are facing. I am not an expert on what they are facing, but fuel costs alone—I understand that. I am paying more at the pump, and I can imagine if that is 45 percent of their costs and the prices are not going down, that it will be difficult. I cannot tell you how they might react to that. It is possible that through combinations of airlines or something of that nature, there are economies that would allow them to continue in business. Like I say, I do not know that I am expert enough to predict what might happen.

But there are airline companies out there that have sizable pension plans. The pension plans that we have taken over in the last few years, particularly from United, to a lesser extent Delta Airlines in their pilots' plan, are some of the largest claims that have ever come to the agency.

The CHAIRMAN. Thank you, sir.

Mr. Secretary, do you agree that this matter of deregulation should be revisited?

Mr. REYNOLDS. I think the Administration supports the current deregulated environment. We know that there have been communities have have fared better than others under deregulation in the airline industry, but as Mr. Banmiller said, I do not think you could put the toothpaste back in the tube even if you wanted to. And I do not know that the Administration would support any form of economic re-regulation of the industry at this point.

The CHAIRMAN. This has been a long day, gentlemen, and I thank you for your patience. But as you can imagine, this is a very important matter for the people of Hawaii. And I thank you for your presence here and your testimony. It has been very helpful.

If you do have amendments that you would like to submit, changes in your testimony, or if you have any added words you would like to place in the record, please feel free to do so. The record will be kept open for 3 weeks.

So thank you very much. The hearing is adjourned.

[Whereupon, at 5:34 p.m., the hearing was adjourned.]

A P P E N D I X

Prepared Statement of Hon. Ted Stevens, U.S. Senator from Alaska

I am pleased to join my good friend from Hawaii at this hearing today to look at the aviation challenges his state faces. Our states are very similar since they are so heavily dependent on aviation.

When Aloha went out of business, it was not like Independence Air going out of business. In our states, airlines are the backbone of our economies. The effect on Hawaii of Aloha going out of business is a lot more like the Metro system shutting down in Washington D.C., than it is of just an airline going bust.

Aloha provided 80,000 seats of service a week. That's 80,000 people who now can't go to their doctors, visit their family, get to their jobs, or conduct business. There really is no other practical or economical way of moving between the islands other than through the air.

In addition to Aloha shutting down, ATA airlines ceased operations. ATA carried 15 percent of visitors to Hawaii. Without ATA in the market, it is likely that there will be fewer visitors and prices will rise. This will no doubt have a serious impact on Hawaii's economy which is so dependent on tourism.

The Committee is very interested to hear more about this situation and what we can do to prevent it from happening in the future. As we all know, the airline industry is facing some really tough financial times because of the price of oil. We have already seen five airlines—Aloha, MAXjet, Skybus, ATA and Champion shut down.

We need to figure out how best to help Hawaii and how to ensure that we don't have even more bankruptcies. We are especially interested to hear from the U.S. Department of Transportation witness about what the Department can do in this area.

Finally, I think we need to carefully watch how high fuel costs will affect other transportation sectors such as the trucking and railroad industries—and even the fishing industry which is an intense user of fuel.

Response to Written Questions Submitted by Hon. Daniel K. Inouye to Michael W. Reynolds

Question 1. Does the DOT monitor the U.S. aviation market for potential cases of predatory pricing?

Question 2. Can you tell me how many examples of predatory pricing have been uncovered over the past decade?

Question 3. What role does the DOT have in the enforcement of such predatory pricing cases?

Question 4. Can you provide us any insight into the Administration's views on the allegations of predatory pricing in the Hawaii market?

Question 5. Do the Hawaii communities who are eligible for the EAS program, but do not receive EAS funding, have air service comparable to what they would receive under the EAS program in terms of the number of flights per day and destinations?

Question 6. If the air service now provided to Kalaupapa is not comparable to the service provided under the EAS program, is it possible for the community to return to the EAS program? If it is not, why not?

Question 7. What steps can Kalaupapa take to be placed in the EAS program?

Answer 1–4. During my recent testimony before the Senate Committee on Commerce, Science, and Transportation on the subject of Hawaiian air service, you requested that I provide a report on the Department of Transportation's handling of allegations that go!, which is operated by Mesa Airlines (Mesa), might be engaging in predatory pricing.

While the Department was aware that go! had entered the inter-island markets with very low fares, this strategy on the part of a new entrant carrier seeking to develop an initial market presence is not uncommon. Aloha's President and Chief

Executive Officer, David A. Banmiller, had also expressed concerns to Department officials that go!'s pricing policies were largely meant to drive established carriers like Aloha from the inter-island markets. However, the Department was never presented with a factual basis to support allegations that go!'s activities constituted predatory conduct. Also, neither Aloha nor any other carrier has filed a formal enforcement complaint seeking an investigation. As was discussed at the hearing, both Aloha and Hawaiian Airlines have chosen to undertake private rights of action in the courts alleging misuse by go! of proprietary information, as well as, in the case of Aloha Airlines, engaging in predatory pricing. We understand that Hawaiian recently settled its case against Mesa for $52.5 million.

Normally the Department of Justice's (DOJ's) Antitrust Division takes the lead role in prosecuting cases of alleged predation in the airline industry, and when the Department of Transportation is presented with evidence that a carrier's pricing policies might constitute predatory behavior, we share that information with the Antitrust Division. However, as I am sure you are aware, predation claims have proven particularly difficult to sustain in the courts in recent years. Moreover, virtually all predation concerns that carriers brought to the Department in the past concerned the impact of large incumbent airlines' pricing on new entrants. A successful challenge by the Federal Government against the pricing activity of a new entrant such as go!, based on its potential harm to a long-established incumbent in the Hawaiian inter-island markets, would clearly require extensive supporting documentary evidence that in large measure the carriers alleging the competitive harm would have to provide.

It is important to keep the allegations in this case in the proper context. As I testified, the Department has not received any formal complaints of predatory pricing over the past decade. We did, however, receive several informal complaints about predatory conduct in the mid-1990s. In each instance, a new entrant carrier contacted DOT and provided substantial evidence in support of its allegations.

The characteristics of the Aloha-go! situation, as far as we have been made aware, are unique. First, it was the incumbent carrier, Aloha, which operated larger aircraft and more capacity in the market, alleging that a new entrant engaged in predatory pricing. Second, Aloha has alleged that Mesa obtained confidential, competitively sensitive information as a prospective investor and subsequently used this information in launching go!.

Furthermore, DOJ has had difficulty in proving predatory pricing under the antitrust laws. Low prices, which new entrants typically offer when they enter a market, are not in and of themselves evidence of predatory behavior. Several years ago, DOJ brought suit against American Airlines for alleged predatory pricing and lost. The unique characteristics of the situation in Hawaii suggest that an important, and possibly differentiating, component is whether confidentially obtained proprietary information was used illegally or improperly to launch go!'s inter-island operations. Adjudicating such allegations is better left to private actions brought by the parties that believe they have been harmed.

DOT's statutory policies encourage us to oversee the airline industry in such a way as to encourage competition and low fares. Airline deregulation proves that new business models, especially low-cost carriers, are critical to ensuring that the benefits of deregulation are passed through to consumers in all sectors of the economy dependent on efficient air transportation. The usual challenge for government is to exercise economic oversight of the industry to promote vigorous competition. Therefore, in the past, our focus has been on structural economic issues that were largely unanticipated at the time of deregulation.

Nonetheless, based upon the testimony that was provided to the Aviation Subcommittee, we will ensure that our colleagues in the Antitrust Division are aware of the concerns that have been expressed by Mr. Banmiller and others with go!'s inter-island market pricing policies.

I can assure you that we are keenly aware of the unique role that air transportation plays in the State of Hawaii and that the status of air transportation both to and within Hawaii continues to be an important issue to the Department of Transportation, particularly in light of the recent cessation of passenger service by Aloha Airlines. The Department will continue to monitor air services in Hawaii, and will maintain its efforts to promote and sustain competition in Hawaii and throughout the United States.

If I can provide further information or assistance, please feel free to call me.