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Before the House Committee on Transportation and Infrastructure, Subcommittee on Aviation

Regarding Airline Industry Consolidation

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Mr. Chairman and Members of the Committee thank you for requesting that the Business Travel Coalition (BTC) appear before you today to represent consumer and business traveler interests on the subjects of a potential Delta Air Lines and Northwest Airlines merger and radical U.S. airline industry consolidation. My testimony today is also on behalf of the 400,000 members of the International Airline Passengers Association (IAPA).

Congress must insist that the Departments of Transportation and Justice not focus on the proposed Delta / Northwest merger as a standalone transaction, but rather, the analysis must include implications for the competitive structure of the industry resulting from a radical consolidation of the other major network carriers. Moreover, Congress needs to understand the total consumer costs resulting from massive service disruptions and the degradation of the reliability of the system. The direct, indirect and opportunity costs for mid-size communities that lose efficient connectivity to important business centers around the country and globe need to be quantified.

Importantly, given the existence of federal preemption, and the major airlines' general unresponsiveness to consumers' customer service concerns, fewer competitors will make a bad and costly situation for consumers far worse. The consequences of mergers for the national economy, airlines and consumers must be carefully and deliberately examined. BTC, therefore, applauds this Committee for taking this early and important oversight step.

I. INTRODUCTION

What is powering the urgency of this merger proposal, and the ones that are sure to follow, is the dangerous idea that they must be rushed through, without careful analysis, in the waning days of the current administration. Urging a rubber-stamping of such a profound change to the competitive structure of the U.S. aviation marketplace, with all that is at stake, is both irresponsible and insulting – to this administration, to the next one and to Congress.

BTC believes there are powerful reasons why these megamergers would be harmful to consumers, and would solve none of the industry's most serious problems. A "rush to judgment" regarding this merger proposal is a sure recipe for failed policy. BTC urges the Committee to examine the consumer and competitive issues very carefully. Over time, and with appropriate econometric and stakeholder impact analyses, concerns that DOT and DOJ might rubber-stamp this transaction would be abated. In the fullness of time, it will be important for Congress to hear from many more industry participants so that it can understand and act on the passionate concerns that so many experts have recently been expressing about airlines' misguided plans to merge.

Airline consumers have an equally vital interest in a functioning competition needed to ensure the most service at the best prices. However, as every Committee Member knows well, and your constituents who fly frequently know, the managements of the legacy airlines have done a terrible job over the last decade in almost every area, including service quality, people management, operational efficiency and returns to shareholders. The managements of Delta and Northwest drove their companies into painful bankruptcies.

When airline CEOs say, “trust us, this megamerger will be great for consumers and solve many industry problems,” this Committee needs to respond, “we would fall down in our duty to approve this merger on trust alone.” The burden of proof that this merger is good for consumers needs to be on the airlines, and DOT and DOJ should not approve this megamerger unless a very thorough, rigorous scrutiny by independent experts, who are focused on consumers and the public interest, is undertaken.

Without question, the U.S. airline industry has real problems. Some are self-caused, others relate to excessive government tax burdens and mandates, and still others, such as fuel costs and a slowing economy, are of such a nature that the ability of airlines to influence them is increasingly limited. However, these problems should not be used as a justification for rash or pretextural solutions that will not work and will harm consumers. For example, this Delta / Northwest merger will provide near-zero relief vis-à-vis the high cost of jet fuel.

Below is an examination of the key arguments consumers would make in opposition to a Delta / Northwest merger and radical industry consolidation that most experts anticipate would follow.

II. THE PROMISE OF INCREASED EFFICIENCIES

The claim that a megamerger would produce many billions of dollars in network and costs efficiencies enough to not only provide a reasonable return on a very risky investment, but enough new additional profits on top of that to counteract high fuel prices is absolutely unrealistic. How can there be billions of dollars in untapped cost savings at two airlines that just underwent years of cost cutting in bankruptcy. Likewise, how can one claim huge scale benefits from megamergers unless one believes that airlines the size of Delta and United are too small to be competitive. With respect to Delta / Northwest, how can one accept that there are billions of dollars in revenue synergy when there are no plans to restructure either network?

III. THE REALITY OF AIRLINE INDUSTRY MERGER HISTORY

Virtually, every large U.S. airline merger in the last 20 years has been a dismal financial failure. The Delta / Northwest proposal emphasizes all of the features of past mergers that have consistently failed and doesn’t exploit any of the synergies of the rare mergers that did produce positive returns, e.g., TWA / Ozark and Northwest / Republic. Delta needs to carry the burden of demonstrating how they are going to avoid the disasters of the past, and how they uncovered new sources of merger efficiencies that no other competitor has yet discovered.

IV. THE PROBABILITY OF CUSTOMER SERVICE DISASTERS

Megamergers create a risk of an operational meltdown that could cripple the nation's aviation system. Fuel prices and the lack of merger-related synergies would create huge pressures to cut corners on implementation spending, creating pressures that would exacerbate conflicts with (and among) employee groups. Difficulties with the integration of complex computer systems and maintenance programs could create problems that made the recent American Airlines' debacle seem unobtrusive. There is simply no way that these airlines can assure Congress, and the communities that rely on dependable airline service, that these problems won't happen and become a permanent and unacceptable part of U.S. aviation. Claims to the contrary represent the triumph of hope over experience. Hope is not a strategy.

V. THE HIT TO DOMESTIC U.S. COMPETITION

A. Corporate Buyers' Concerns. In anticipation of airline merger proposals, and potential resultant industry consolidation, the U.S. General Accountability Office requested of BTC that it survey corporate travel buyers from around the country during the fourth quarter of 2007. Some 60% of buyers were of the judgment that industry consolidation would lead to higher fares. Likewise, 60% felt that customer service levels would decline in such a scenario. Further BTC analysis of the proposed Delta / Northwest merger validated these buyers' concerns in important markets.

In six heavily traveled and important nonstop city pair markets where Delta and Northwest fly head-to-head, these carriers account collectively for more than 85% of all passengers who fly nonstop.

ATL-DTW - 90%
ATL-MEM - 85%
ATL-MSP - 88%
CVG-DTW - 100%
CVG-MSP - 100%
MSP-SLC - 99%

The Herfindahl-Hirschman Indexes (HHIs) in these city pairs, and the increase in them post merger, are off the charts. These services are into and out of airports that are already Fortress Hubs for Delta or Northwest, and the prospect of any entry sufficient to replace the lost head-to-head competition is very remote. As such, a large number of business and leisure travelers face the certain prospect of paying even larger hub premiums than is already the case for citizens of these communities.

B. Unilateral Effects. Merged mega airlines will leverage their route structures to dictate terms and conditions (pay more for less) to corporate buyers, even for those airline pairings without significant route overlap. For example, in a combined Delta / Northwest, the new airline would be in a position to insist, that if a corporation wanted any discount on the highly regulated fares and capacity-controlled routes to Asia, it would need to provide significant domestic and international market shares at Atlanta, Salt Lake City, Cincinnati, etc. (The problem is lack of route rights for most carriers and limited capacity, which creates a real lever over corporate customers.) In this example, discounts on the previous domestic Delta routings would be reduced and high-yield business traffic that before would have been available for low-cost carriers, and other competitors on domestic and international routes, would be locked up by the newly created largest carrier in the world.

C. Coordinated Effects. Going from 6 to 5 airlines would make fare increases easier to stick, especially if Northwest were absorbed into another large carrier because this carrier has often played the role of the "spoiler." And of course, the problem with fare increases is even more enormous if the industry goes from 6 to 3 super major carriers. United Airlines recently brought back the infamous *Saturday Night Stay* requirement that will virtually fence-off lower-priced fares for business travelers increasing ticket prices by hundreds of dollars. Other major carriers are currently evaluating United's move, and any one of them, unwilling to go along, could scotch the price increase. However, if the industry were to collapse to 3 super carriers, such price moves would be easier to coordinate by an order of magnitude. The pernicious effects of conscious parallelism would become a permanent feature in this new industry competitive structure.

D. Strategies of Predation. The resulting mega carriers would fortify their hubs with near-exclusive contracts with corporations and travel management companies, and other well-tested practices such as gate hoarding, schedule bracketing, triple frequent flyer points and travel agency override programs, making the barriers-to-entry for low-cost carriers of the 1990s seem very low. Congress should be concerned with the market power of super-mega airlines and their incentive and means to frustrate new airline entry at hub airports.

E. Adjacent Market Power. Congress should be concerned with an industry that could collapse to 3 mega airlines from 6 major airlines with respect to the ability of these mega carriers' ability to drive supplier prices to below competitive rates for travel agencies, travel management companies, airports, global distribution systems, parts suppliers, caterers and all manner of supply chain participants. Likewise, these carriers would have the power to accelerate the transfer of costs onto the backs of consumers. Congress should also view with great concern the increased joint purchasing power of the global alliances (buying groups) with respect to their ability to exercise monopsony power and drive supplier prices below competitive levels.

VI. COMPETIVE END-GAME

The primarily objective and dirty little secret of these megamergers is the permanent end to meaningful competition between the U.S. and Continental Europe—two airline competitor groupings would control 80% to 90% of a profitable, growing market of over 30 million annual passengers, where there would be virtually no possibility of new competition. Airlines could raise prices at will without any risk that "market forces" could constrain competitive abuses.

The only rational justification of these expensive, risky mergers is the profits from anti-competitive behavior internationally. All of the public arguments for radical industry consolidation have come from the airlines that would benefit from the permanent strangulation of international competition. All of the potential external funding for Northwest / Delta and United / US Airways would come from the European airlines that would be the leaders of this two-airline duopoly, Air France and Lufthansa. Given today's economy and exchange rates, anything that damages healthy competition and healthy growth of international air travel would be horrible for the U.S. economy.

VII. THE OPTIONS

A. Status Quo. In this scenario, airlines accelerate their own unilateral reductions of uneconomic capacity and continue to address cost issues and efficiency issues with respect to optimizing fleet, network structure, information technology, employee relations, operational efficiency, customer service, brand marketing, supplier relationships and capital structure. Indeed, with respect to fleet rationalization, the proposed Delta / Northwest merger would result in complex and costly assemblage of aircraft types, the exact opposite direction the industry needs to go in.

B. Robust Recovery. If oil prices should fall back to below $80.00, as many energy experts predict, because of the cost-cutting initiatives of the past few years, the major network carriers could come out on the other side of the current U.S. economic slowdown and experience a robust airline sector recovery.

C. Mergers. Mergers of the type and scale being proposed would burn up cash and drive high-yield business travelers away at the worst possible time for airlines.

D. Break Ups. One of the major network carriers could be broken up at the direction of shareholders with the assets going to the most efficient competitors.

E. Liquidations. If the proponents of "let the market work its will" truly believe what they say, then let a major carrier fail instead of propping them up with government-sanctioned anticompetitive combinations. Antitrust law is not meant to be sympathetic to industries that cannot solve its own problems.

VIII. THE REMEDIES

The Committee was interested in potential conditions and remedies for DOJ to consider in its decision-making process, in the event that it decides to approve this and other megamergers over a broad range of stakeholders' objections. Here are some of our initial ideas of ways to somewhat lesson what would otherwise be the anticompetitive effects of radical airline industry consolidation:

A. As a remedy for passengers who were involuntarily bumped or whose flights were canceled or connections missed due to labor work stoppage or slowdown, airlines would be required to amend their Contracts of Carriage for a 5-year period to increase the level of compensation for denied boarding and afford that same increased level of denied boarding compensation to travelers who missed their flights or had them cancelled in those circumstances.

B. As a remedy for passenger disruption and increased risk to passenger safety during an anticipated prolonged period of labor strife, operations integration issues, management team changes and general distraction for senior executives at the mega carriers, for a period of 5 years there would be a moratorium on the further outsourcing of aircraft maintenance.

C. As a remedy for the anticompetitive effects of code sharing and alliance antitrust immunity, and in consideration of the global scope and scale of these powerful new mega carriers, code sharing and antitrust immunities would be done away with and replaced with a functioning interlining system.

D. As a remedy for the anticipated loss of hub services, or degradation of service to mid-size communities, for a period of 5 years the new mega carrier would not be allowed to reduce the number of seats at its major hub airports.

E. As a remedy for the adjacent market power of these new mega carriers, specifically the dramatically increased incentive and means to transfer costs to travel agencies and reduce their compensation--a move that would directly raise the cost of travel for business travelers--the National Labor Relations Act would be amended to expressly permit travel agents to engage in collective bargaining with airlines and with antitrust immunity.

VIII. CONCLUSION

If these airlines cannot convince Congress that these megamergers will generate many billions more in synergies than any past merger, and if Congress does not believe that they will be flawlessly implemented with the enthusiastic support of all employees, then the only rational explanation for these mergers is the expectation of long-term profits from anti-competitive behavior internationally. This proposed merger, and the highly anticipated United / US Airways combination would have been rejected out-of-hand in the 1980s or 1990s. However, the airlines are hoping that the current administration will quickly rule that a permanent 80% to 90% U.S.-to-Continental Europe duopoly poses no threat to consumers or the public interest.

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