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UNITED AIRLINES/US AIRWAYS MERGER

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

JUNE 21 AND 22, 2000

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

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UNITED AIRLINES/US AIRWAYS MERGER

WEDNESDAY, JUNE 21, 2000

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

The Committee met, pursuant to notice, at 9:35 a.m. in room SR–253, Russell Senate Office Building, Hon. John McCain, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN McCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. We will begin the hearing. First I want to thank our witnesses for testifying today on the proposed merger of United Airlines and US Airways. It is no secret that I am extremely skeptical of the proposal the carriers have laid before us. I look forward to a thorough discussion of the consumer benefits as well as detriments that could result from the deal. A combined United Airlines and US Airways would be twice as big as the next largest competitor, American Airlines. Its market power would be unprecedented.

On the one hand, I would like to think that the merger would shake things up in the industry enough to see American and Delta, for instance, cut fares as they compete for their lives. On the other hand, I am realistic, or perhaps cynical enough to conclude that if the Nation's biggest airline is allowed to acquire another major carrier the rest of the airlines are sure to fall in line with their own merger transactions.

Consolidation in the industry does not bode well for new entry, which is key to a competitive airline environment. Already, most successful, recent new entrant carriers acknowledge that they will not enter the majors' hub markets because they cannot survive in a head-to-head battle. This perception is our reality. Additional consolidation would only make it worse.

Prospects for this merger, as well as further consolidation, are worrisome enough that even an established carrier like Southwest Airlines is concerned that a megacarrier or carriers would have deep enough pockets to drive them into the ground. Southwest, of course, is one of the clear success stories of airline deregulation. The Department of Transportation has documented that Southwest Airlines alone is responsible for many billions of dollars of consumer savings. The question we must ask is whether we can continue to depend on Southwest's ability to discipline prices if the deck is shuffled in their competitors' favor.

I want the record to reflect that I have made no final decision on whether this merger should proceed and in fact have serious concerns as to whether it is indeed in the public's best interest.

Statistics demonstrate the merger would likely result in at least seven hubs where a combined United-US Airways airline would have a dominant position in terms of passenger share. United would be a virtual behemoth in the East. Government restrictions such as slot controls and perimeter rules would only enhance and protect United's superior position on the East Coast.

Airport restrictions, particularly on the East Coast, represents an area where the Congress and the Department of Transportation must take an active pro-competitive stance. We've made strides at New York's La Guardia and Kennedy Airports, for instance, but what good is it to loosen slot restrictions if new competitors do not have access to publicly funded gates.

I turn now to the slot restrictions and perimeter rule at Reagan National. They must go away if we really expect to see competition at Reagan National. At the very least the parties here today who are asking us not to stand in the way of the marketplace cannot continue to stand in the way of our efforts to let market forces rule elsewhere.

The father of deregulation, Professor Alfred Kahn, recently sent me a letter outlining his preliminary concerns with the proposed United-US Airways merger, which I would submit for the record.

[The information referred to follows:]

Ithaca, New York, June 9, 2000

Hon. JOHN MCCAIN,
Chairman,
Committee on Commerce, Science, and Transportation,
United States Senate,
Washington, DC.

Dear Senator McCain:

I'm very sorry that I can't accept your invitation to testify before your Committee on June 20th, and hope that you will regard the arrival that day of my son and his family from Australia, for a brief visit, as a sufficient reason. I particularly regret my inability to take advantage of that opportunity to renew our acquaintance.

Your Ann Choiniere has asked me to offer, as a substitute, a statement of my—as yet only provisional—opinions about the proposed merger of United Airlines and US Airways. I am happy to do so, even though, to repeat, I have by no means a settled final opinion about whether or not it should be approved.

I do urge you to give careful consideration to its possible anticompetitive effects, however. The central premise of deregulation was that competition would best serve and protect consumers; that meant vigorous enforcement of the antitrust laws rather than direct regulation would become critical in the new regime.

Primary responsibility for making this investigation rests, of course, with the antitrust agencies. It is my understanding, however, that the Antitrust Division's resources are severely strained by their other obligations, including other proceedings specifically involving the airlines; if they lack the resources to look at this latest proposed merger with great care, it seems to me that would be a case of the government being penny-wise and pound-foolish. Partly because of the possible direct effects of this merger and, perhaps even more, because of its threatening to set off a series of imitative mergers that would substantially increase the concentration of the domestic industry, there is a possible jeopardy here to the many billions of dollars that consumers have been saving each year because of the competition set off by deregulation.

It seems to me there are several levels at which to assess these possible anticompetitive effects.

1. The first goes to the question of whether there are any substantial number of particular routes on which United and US Airways are already direct competitors. In the case of the proposed merger of Continental/Northwest, the Antitrust Division identified several very important routes between their respective hubs (for example, Houston/Minneapolis-St. Paul, Houston/Detroit, Cleveland/Minneapolis-St. Paul, Cleveland/Memphis, Newark/Twin Cities) on which it appeared those airlines were the two main if not only competitors, and their merger would simply eliminate that competition. I do not know to what extent there are similar overlaps between US Airways and United.

2. In deregulating the airlines we relied very heavily on the threat of potential as well as actual competition to prevent exploitation of consumers: an important part of the rationale of deregulation was the contestability of airline markets. It seems to me highly likely that there are many routes in which United or US Airways is a potential competitor of the other. And it is my recollection that while studies of the behavior of airline fares after deregulation (notably one by Winston and Morrison and another by Gloria Hurdle, Andrew Joskow and others) demonstrated that one actual competitor in a market is worth two or three potential contesters in the bush, they nevertheless also found that the presence of a potential contester—identified as a carrier already present at one or the other end of a route—did constrain the fares incumbents could charge.

3. The likelihood that a United/US Airways merger would indeed result in suppression of this potential competition would seem to be enhanced by what I take it would be United's explanation and justification—namely, its need for a strong hub in the Northeast (commented on widely in the literature, along with attributions of a similar need to American Airlines). But if United really does feel the need for a big hub in the Northeast, this suggests that it is indeed an important *potential* competitor of US Airways, and that, denied the ability to acquire the hub in the easiest, noncompetitive fashion, by acquisition, it might instead feel impelled to construct a hub of its own in direct competition with US Airways: if some place within a couple of hundred miles of Pittsburgh is the needed location—observe the hubs of Continental at Cleveland and Delta at Cincinnati—then why not, say, Buffalo for United? And while I have the impression that the suppression of potential competition has not played a major role in most merger litigation, it might properly be definitive in this case, if only because, either explicitly or implicitly, United is in effect conceding the potentiality of that competition in its rationalizations of the merger itself. The stronger its argument that it does indeed require a big hub in the Northeast, the more that signifies that the alternative, if it were denied the opportunity to acquire US Airways, would be to construct a major competitive hub of its own.

4. In addition, if indeed United's acquisition of a competitive advantage by this acquisition—giving it the first claim on traffic feed from US Airways' extensive network—does increase the pressure on other carriers, particularly American to merge similarly, then it seems to me that is a possible competitive consequence of this particular merger that should additionally be taken into account in deciding whether it should be permitted.

I do hope you will undertake this important inquiry: we may be confronting a very radical consolidation of the industry, which cannot be a matter of indifference to people like you and me, who have regarded deregulation as a striking success thus far.

With warm personal regards.

Sincerely.

ALFRED E. KAHN,
Robert Julius Thorne Professor of Political Economy, Emeritus, Cornell University: Chairman, Civil Aeronautics Board 1977–78.

The CHAIRMAN. He urges the Government to focus on a few areas, overlapping routes between United and US Airways, the continued ability of the potential for competition to discipline prices, and the likelihood and effects of additional consolidation downstream.

I want to highlight another point that Professor Kahn makes. He states that United's main justification for the merger is the need for a hub in the Northeast. Why, then, doesn't United create one, rather than following the path of least competitive resistance by trying to acquire one of its competitor's hubs? I know that is the vision of airline deregulation we all shared.

Again, I want to point out Mr. Kahn's letter, where he points out the likelihood that a United-US Airways merger would result in suppression of this potential competition, would seem to be enhanced by what I take it would be United's explanation and justification, namely its need for a strong hub in the Northeast, commented on widely in the literature, along with attributions of a similar need to American Airlines, but if United really does feel a need for a big hub in the Northeast, this suggests that it is, indeed, an important potential competitor of US Airways, and that denied the ability to acquire the hub in the easiest noncompetitive fashion by acquisition, it might instead feel impelled to construct a hub of its own in direct competition with US Airways.

I hope that all of the witnesses today will take a careful look at Professor Kahn's letter, because I think he outlines very accurately the questions that arise concerning this proposed merger. Also, we will get into exactly what the new airline out of Reagan National Airport will entail.

I think a very legitimate concern is that if an airline uses the assets, the employees, and all of the other facilities of another airline, there is a legitimate question as to whether that airline is indeed a new airline or simply an ancillary of the existing airline. That is a legitimate question and I think one that needs to be addressed, and also the knowledge and expertise of those who are running that airline, and their qualifications need to undergo examination as well.

Senator Hollings.

STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

Senator HOLLINGS. Thank you very much, Mr. Chairman. I am skeptical also, and I agree the question is legitimate. I begin as a born-again regulator. We made a mistake in deregulation, and it took some time to prove that. Otherwise, I am always worried about hub concentration levels. The best I could get with the recently enacted FAA authorization was that a passenger facility charge would not be permitted until the various airports submitted their plans to promote competition. That's the best I could do, for now.

That is rather spurious, but in any event it is my record, and it is not because of this particular merger. I have been a student of US Airways because I regularly pay the Government rate, which is high. Senator Collins, I also pay for my wife, which is absolutely exorbitant, $700. If I called this afternoon and said I want to fly Friday morning, if I hear from Senator Lott that we are not going to have any votes on Friday, I would want to get on that 9:30 direct flight. That is a little puddle-jumper. It has got a little motor to it. It is not a jet, and it is $700, and there is no first class. Everybody's on coach, and they give you a pretzel, I think it is, but I am glad to get it because that is better than going through Charlotte first.

So in trying to study US Airways I have come upon the conclusion from experts that I have talked to in the airline business that they had, and have had historically, an unusually rich—and I want Mr. Johnson to listen to this, because I want to know how he is going to work his way out of it—an unusually rich pilot's pay schedule, and unusually rich flight attendant pay scale, higher than everybody else. In fact, US Airways cannot make money, and in fact that is why they lose money even charging the $700, even with their control of a number of hubs.

Mr. Wolf really sold them on a real good sale, and he did an outstanding job. We cannot understand why United would want to buy US Airways, other than to get control of the East Coast.

But they would still have that rich series of contracts. US Airways had all the business on the East Coast. Today, we have connecting carriers taking away passengers from US Airways and providing competition. It makes it harder to make it, and with those kind of expensive contracts, so one of the questions is, how can you work out of that predicament?

And of course you have got the obvious skepticism, selling US Air to Bob Johnson to form a DC Air. Now, I happen to know him from years back. He is the most deserving fellow in the world, and we in Washington always say when you do not like somebody, you respect him. I not only respect him, I like him, but why didn't you all give that to Senator McCain and me? We could help you.

[Laughter.]

Senator HOLLINGS. Why give it to Bob Johnson? I know about control, because I am very sensitive to the issues, and I sometimes am like my friend Congressman Oberstar in using the wrong language in this politically correct world in which we live, but I know—let's don't say captive or control of United, but I know Mr. Johnson is not an ingrate.

And so when you get the equipment and you get the slots and you get the frequent flyer plan and you get everything else like that from United, although he wants to tell the Committee that oh, yeah, he is going to be competitive and reduce those rates, after all, I think he would go along with the merger, because it was the merger, somewhat like Vice President Gore going along with the President. After all, why should he raise sand about the President's conduct when the President made him the Vice President? Why should Mr. Johnson try to start competing when, after all, he would not even have the airline to begin with but for this deal?

So it is going to be a real question in my mind how he can get out from under US Air's high cost structure, includes expensive overcostly arrangements with their pilots and attendants, so that they can get down to a competitive carrier and give us some service, because we do not have it.

Thank you, Mr. Chairman.

[The prepared statement of Senator Hollings follows:]

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

Good morning. I wish to thank the Chairman for holding this hearing. Many other groups and individuals, including Members, the press and "so-called" experts, have commented on the proposed United-USAirways deal, and now it is our turn.

Let's start with one fact—deregulation has not given us what we wanted, and it is about to get worse. When we passed the Airline Deregulation Act in 1978, we were promised many things—low fares, better service, and the absence of predatory conduct, given that planes can easily be moved from one market to another. The government applied those theories to every transaction proposed, and with one exception, approved them all. The result is what we have today—a balkanization of our aviation system—major hubs dominated by single carriers. Such concentration will only get worse if we end up with 3 mega-carriers.

My concerns with the proposed merger have less to do with the transaction before us, though it raises serious issues, than the path that we have allowed ourselves to be led down. If we are reduced to three mega-carriers, we will have to consider some form of consumer fare protection. Action may include zones of reasonableness for short-haul, non-stop flights out of the hubs or conditioning all of the deals on divestiture of a substantial percentage of gates at the dominated hubs.

The proposal before us today is controversial because of its scope and because of the industry-wide implications. The folks that will testify, Mr. Goodwin, Mr. Wolf and Mr. Johnson, are all businessmen who will try to convince us on the reasons why the deal—despite its antitrust issues—should be approved. Mr. Johnson clearly wants his turn to lose a fortune in the airline industry, and Mr. Goodwin and Mr. Wolf are more than willing to take his $144 million. Of course, they want to see Mr. Johnson succeed, or be in a position to succeed, and I know that Mr. Johnson is an independent, driven, and creative executive who wants to succeed. Some, however, have posed the essential question of whether the spinoff really creates an independent company.

DC Air will have planes provided for by United—at market rates; slots and gates provided by USAirways—and paid for by Mr. Johnson; DC Air will offer its passengers United's frequent flyer program and provide other backup services. Yet, some will argue that all of this "assistance" from United prevents it from being independent. Mr. Johnson knows that for the spinoff to be successful, DOJ must determine that DC Air is independent. To achieve this status, DC Air must be able to set its own fares—and hopefully lower than they are today. This is a critical factor.

One thing that we must bear in mind—DC Air has given us assurances, and we will hear them again today—that it will continue to serve the 43 communities from Washington that are today served by US AIRWAYS. Service criteria may not be one of the matters DOJ will consider if it finds DC Air too dependent upon the consolidated carrier. Furthermore, DOJ or DOT can impose additional conditions on DC Air, if either determines from an antitrust or other perspective that such measures are necessary, i.e. prohibiting DC Air from code-sharing with United or requiring DC Air to contract with another carrier for frequent flyer miles. One other thing DOJ may want to consider—giving DC Air the shuttle flights, rather than allowing the United to keep these valuable routes. Giving DC Air these valuable routes may lead to lower fares between Washington and the Northeast.

Let's look at the hub concentration levels. Right now there are 16 hubs where one carrier accounts for more than 50% of the traffic. After the deal is approved, the number will stay the same. This is where the market power resides. For years, we have heard that the potential competition would keep fares low. We were told that carriers would not raise fares in markets such as that between Charleston and Charlotte, because if they did then someone else would bring their planes into the market. However, with the way the industry functions today, that never happens. The home team can raise or lower fares, with little likelihood of competitive entry. US Airways today has almost 90% of the traffic at Charlotte, and the combined carrier would have 91%. While this is not a significant increase, and the transaction transfers power from one entity to another, it still leaves the folks at Charlotte with only one choice in the short-haul, non-stop markets.

According to DOT, the theory was that there was lots of competition in the longer haul markets where hubs compete with another. Flights from non hubs such Columbia, SC to destinations in the Midwest may have 3 or 4 carrier options, each with one stop through a hub. DOT has told us in report after report that deregulation was working—more people were traveling, and at lower prices. Yet, how does this square with 16 major metropolitan areas being dominated by one service provider. We now have local markets where 40% of the passengers have no choices in price or service.

DOJ and DOT also must focus on the number of one-stop markets where competition may be lessened. We know that the consolidated United/US Airways hub flights will have no competition, but will there also be an erosion of competition in other markets? Finally, putting Reagan National Airport aside, at Dulles the combined carrier will have more than 50% of the market, giving United monopolies on several routes. DOJ must look at Dulles. Who else will go in there? In the recently enacted FAA bill, FAIR 21, we have directed DOT to stop funding these mega-fortresses, unless we have some assurance that the airports will make every effort to provide facilities for other carriers, and thus help address the market power concerns.

With respect to airports, and barriers to entry, we asked GAO to give us information on the ability to get gates at some of the hubs. Gates are there for the taking at some hubs (Pittsburg and Charlotte), but no one wants to challenge the home team. We have heard that it is harder to get gates since the major incumbent may have a say in the use of gates at their respective airports. We have given the DOT the ability to stop that. As I mentioned, they now must exercise the authority to ensure competition.

What else has the government done? Last year, DOJ filed suit against American for its use of hub market power to drive out 3 new entrants at Dallas-Fort Worth. DOT has proposed predatory guidelines, but has yet to issue a final set of guidelines. I know that the proposal was controversial, but it is time to address those concerns and issue the final rules.

In 1998, the Department of Justice challenged the Northwest-Continental deal based on an overlap of mere 7 markets affecting 4 million passengers. DOJ is finally waking up to the fact that we have untoward levels of market power—which were granted or obtained in the name of efficiency—which must be checked. This deal before us involves at least 4.9 million passengers in just the hub-to-hub routes of the two carriers, where there will be a reduction from 2 carriers to 1, or from 3 to 2, depending upon the market. In many of those routes, there is no likely carrier able or willing to enter the market. Few times do we see a carrier, be it a low cost carrier or a network carrier, challenge routes connecting two hubs. With the feed traffic at each hub, the combined carrier effectively controls price, service and scheduling. In addition, several cities like Boston and New York will see significant increases in concentration, as will Dulles.

Proponents of the merger contend the merger will benefit the traveling public. The advantages include—64 new non-stops, 560 new on-line connections, and 29 new international routes. Yet, both of these carriers rank near the bottom of the DOT on-time list, 7th and 10th. The new carrier will have to coordinate over 1,000 aircraft, and 146,000 employees. If United or US Airways can not provide satisfactory customer service with their current size, how will they coordinate even more passengers and aircraft?

We will be back here next year looking at how best to address competition policy matters. We took the authority away from DOT in 1988, leaving it to our antitrust regulators. Next year, we will need to rethink that position if we continue to be beset by the types of problems we know exist, and will continue to exist, absent concrete action.

The CHAIRMAN. Thank you, Senator Hollings.

Senator Frist.

STATEMENT OF HON. BILL FRIST, U.S. SENATOR FROM TENNESSEE

Senator FRIST. No statement, Mr. Chairman. I am just glad to be here.

The CHAIRMAN. God bless you. Senator Rockefeller.

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

Senator ROCKEFELLER. Mr. Chairman, I would be glad to yield to Senator Collins. I do not see any reason to keep her here. I do want to make a statement.

The CHAIRMAN. Senator Rockefeller, we will proceed with the way that the Senate Commerce Committee proceeds, and that is that sitting members will make their statements. If you do not wish to make a statement, we will move on to Senator Kerry.

Senator ROCKEFELLER. I plan to make a statement. I will make a statement.

The CHAIRMAN. You are recognized. You are recognized for 5 minutes.

Senator ROCKEFELLER. I am going to make my statement. Thank you, Mr. Chairman, very much for recognizing me for the period required in which to make my statement.

When United first announced this kind of intention to purchase US Airways nearly a month ago, I was like the chairman and the Ranking Member, and I had some sense of initial nervousness and skepticism. If you come from West Virginia and you do not have skepticism, you are not West Virginian—particularly when it comes to mergers and deregulations, as Senator Hollings has said.

As I listen more closely to the details of the deal, however, and as I talk with the principals, I have come to have a little bit more of an open mind, and am a little bit more hopeful, though still cautious.

Then I began digging into the details of it, because airline service is everything to us, as it would be to Senator Collins in Maine, and several of the other panelists. I actually became much more optimistic and, in fact, rather enthusiastic about the prospects of this merger and, to be quite honest, somewhat relieved.

I, of course, reserve my right to raise concerns, as any responsible Committee member would. I know there are many questions to be asked. I know we have to hear from DOT and DOJ and all the rest, but from where I stand today the United-US Airways-DC Air deal looks like one that will be good for West Virginia and, quite frankly, since West Virginia shares rural backgrounds with many other States, I think it is going to be good for other small communities and other States now served by US Airways.

Let me make clear that I do not make such a positive statement lightly. I have given it a good deal of thought, and I will continue to give it a good deal of thought. I know this is a major merger, and any time that happens there are questions that are raised.

The railroad problem is something that I have been fighting about for 16 years, without any success in this Committee whatsoever. I am still right, and those who voted against me are still wrong, and it has hurt West Virginia's economy tremendously, so I am very sensitive to what it is, and very delicate and precise about what helps and what hurts West Virginia's economy, and I care about that a lot.

Certainly, for West Virginia, competition and service in the premerger environment is the starting point for any meaningful discussion of this subject. Quite honestly, today the picture is not very pretty. US Airways is our biggest carrier. In fact, it is virtually our only carrier to most of our markets.

I have great respect for Steve Wolf, but too much of our service from US Airways in West Virginia is provided by their weaker regional affiliates. It is not of the best quality. It has high fares, cramped aircraft, what I would call lousy schedules, frequent cancellations, and virtually no marketing, so in fact we have virtually no competition today in West Virginia as it is.

On the other hand, I have been working with Mr. Wolf and others at US Airways to improve this situation for some time, and I will continue to do this while the merger is pending and beyond, if the merger is not ultimately approved, and I know that Mr. Wolf's people have worked hard on this, have had meetings with us, Pittsburgh and other places, when other airlines have turned up their noses at serving West Virginia.

I do not like that. That makes me angry. I represent that State, and I do not like it when people do that. I do not have the luxury of having Phoenix and other places, or Boston for that matter. We have small places, but our people are just as good as anybody in Arizona or anybody in Massachusetts.

But I hope my colleagues and our witnesses can understand that as we begin this consideration, what I do not like is the status quo, and things cannot get a whole lot worse, and so what I see in talking with Mr. Johnson on behalf of the new DC Air is mostly this.

First of all, the concept raised by the Chairman that Mr. Johnson, who runs about a $3 or $4 billion company, may not be particularly skillful in airlines, is something that I necessarily reject.

People come into the U.S. Senate from a variety of professions, and if they get elected, people treat them as Senators, and there is another school of thought which says that really good managers pick good people, and those good people help them run airlines.

And I have full confidence, after a long talk with Mr. Johnson, that he is that kind of person, with a very, very strong commitment to doing this and, frankly, with a commitment to Washington, D.C., which is where a lot of our people want to go, and with a unique commitment to Washington, D.C. that virtually no one else has shown.

So I see, one, a strong commitment to serving every one of our communities in West Virginia if this merger were to succeed, as I see it so far, a commitment to keep fares stable, or lower, for the next 2 years at least, a second and competing carrier into Washington, D.C., which would be very good for us, from several of our markets, a dramatic increase in the number of cities we can travel through to nearby hubs, which is vital for our people, the attention to quality that seems to come from a mainline service carrier, rather than an affiliate service, and meaningful opportunity to do something which people often overlook, which is market, marketing your airports, your facilities.

So I want to say that basically, Mr. Chairman, I go at this with a fairly positive point of view, and I am looking forward to the hearing, and I thank you for your consideration.

[The prepared statement of Senator Rockefeller follows:]

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

Mr. Chairman, I want to thank you for holding this very timely and important hearing. I hope we can spend most of our time here today hearing from and posing questions to our witnesses, so I will be fairly brief in my opening remarks.

When United first announced its intention to purchase US Airways nearly a month ago I had some of the same initial nervousness and discomfort—perhaps even skepticism—that some of my colleagues have expressed today and in other House and Senate hearing rooms over the last few weeks. As I listened more closely to the details of the deal, however, I was almost immediately more hopeful, though still cautious.

And as I began digging into the details of the deal in the last few weeks—meeting with several of the panelists here this morning and talking with the West Virginia aviation community about what it will mean at home—I have found myself both relieved and optimistic.

While I, of course, reserve my right to raise concerns in the future, my basic view going in to this hearing and this process is that:

I know there are many questions still to be asked and still to be answered. And I know we need and will look to the expert opinions of the DOT and the DOJ on the anti-trust issues and possible conditions for this merger.

But, from where I stand today, the United-US Airways-DC Air deal looks like one that will be good for West Virginia and, I believe, good for other small communities and states now served by US Airways.

Let me be clear that I do not make such a positive statement lightly or without a good deal of thought and careful consideration of the facts. I know that when there is a merger of two major players in *any* industry (rail, telecom, oil and gas, chemicals, etc.), there are also serious and legitimate concerns about the potential for anti-competitive consequences.

Those of us in government have a clear responsibility to ask the tough questions. In this case we need answers, and advice, about issues like—

- possible fare increases and service losses,
- the true financial and competitive viability of the new DC Air,
- the competitive effects on hub-to-hub routes, and
- the potential for this merger to set off a series of major consolidations in the industry.

And implicit in all of these forward-looking questions about the impact of the proposed merger, there is also the need for taking a good hard look at the state of the airline industry as it is today. Certainly for West Virginia, competition and service in the pre-merger environment is the starting point for any meaningful discussion about competition and service in the post-merger environment.

Frankly, the picture today is not pretty.

US Airways is our biggest carrier. In fact, it is the *only* carrier in most of our markets. With all due respect to Mr. Wolf, too much of their service into West Virginia is provided by weaker regional affiliates and is of poor quality—with high fares, cramped aircraft, lousy schedules, frequent cancellations, and virtually no marketing. We have almost no competition today.

I have been working with Mr. Wolf and others at US Airways to improve this situation for some time, and I will continue to do that while this merger is pending (and beyond, if the merger is not ultimately approved). I know that Mr. Wolf and his people have been committed to West Virginia for many years, when others turned their noses up at us. I appreciate their willingness to try to make things better even now, and I know they have understood the urgency with which I have tried to recruit other airlines into the State to compete with them.

But I hope my colleagues and our witnesses can understand that we begin in West Virginia, and perhaps in rural communities across this country, with the conviction that the status quo is unacceptable—*i.e.*, that it can't get much worse.

The question for us from that point is whether this proposed change presents an opportunity for making things better. We look carefully at what's being presented to us by Mr. Goodwin on behalf of United and by Mr. Johnson on behalf of the new DC Air, and what we mostly see is this:

- a continued strong commitment to serve every one of our communities,
- a commitment to keep fares stable or lower for the next two years,
- a second and competing carrier into Washington, DC, from several of our markets,
- a dramatic increase in the number of cities we can travel to through nearby hubs,
- the attention and quality that seems to come from main-line carrier service (rather than affiliate service), and
- a meaningful opportunity to reinvigorate our marketing.

Obviously the analysis doesn't and can't end here—and I don't mean to suggest that it's this simple or perfectly clear-cut. Regardless of my current optimism about this merger, I will watch carefully as it proceeds, and I'll be willing to act quickly if it becomes clear at any point that the merger will have a negative impact on my state or on the country as a whole.

I look forward to hearing today from the General Counsel of the Department of Transportation and an esteemed anti-trust expert, Mr. Foer. I hope in the near future we might also hear directly from the Department of Justice. And I am interested to hear the perspective of AirTran, as a new entrant and low fare carrier that knows airline competition like few others.

I also want to thank Mr. Goodwin, Mr. Wolf, and Mr. Johnson, for coming here to the firing line and for putting forth a carefully constructed merger proposal that gives all of us in the Congress and the country an opportunity to think hard and creatively about the state of the airline industry *and* the future of our air service.

The CHAIRMAN. Senator Brownback.

STATEMENT OF HON. SAM BROWNBACK, U.S. SENATOR FROM KANSAS

Senator BROWNBACK. Thank you, Mr. Chairman, and thank you very much for holding this timely hearing. I think this is a very important subject, and I am delighted the Committee is holding a hearing on such an important subject and in such a timely fashion.

I want to raise a couple of concerns that I hope the witnesses will address during the hearing as they come forward, particularly from the industry. I, as other people on the dais, am going to be looking at it for its impact on Kansas and the people in my State using US Air and United. I would hope that they would be able to assure us that the level of service we have had to date will be a floor above which hopefully this will go. I must admit some skepticism about whether that is going to take place or not, but I want to hear from the witnesses how they view that, and how they intend to provide those services into my State.

A second concern is the survivability of DC Air. I wonder, if United and US Air, or US Air is being merged into United because they do not view themselves as big enough to compete or strong enough to continue, is DC Air going to be able to do that over a period of time? Certainly over a 2 to 4-year period of time, probably, but over a longer period of time, is that going to take place and, if it does not, what is it going to merge into, or what would we see taking place down the road, because I really wonder about that issue, given the premise of why this merger is taking place as well.

I know there are other factors as well, not just being able to be competitive, is why the merger is taking place, but I know that is also a major factor as well, and DC Air will not be the size of US Air.

And finally, our comments on another round of mergers, will this cause that to take place throughout the airline industry? That has been a concern that was raised in railroads earlier, that if you start this one, will it be another set, and what will that do to competition and availability of air flights across the country, and I hope that that question gets addressed squarely during the hearing as well, because I think these are all substantive issues.

One is a parochial one for me that I think each of us carry, but the other one is industry-wide, their impact, that I hope to get to directly address, as I certainly have some questions about each of those areas.

Thanks, Mr. Chairman.

The CHAIRMAN. Senator Kerry.

STATEMENT OF HON. JOHN F. KERRY, U.S. SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you. This is obviously a very important topic, an important hearing, and I appreciate that you are proceeding forward with it.

I listened carefully to my friend from West Virginia, whose opinion I value greatly on these issues, because he is the Ranking Member on the Subcommittee and puts a lot of attention into it, and he always speaks very forcefully for West Virginia.

I think, though, some of the questions we need to look at are beyond our States. I mean, I have concerns, obviously, about Boston and getting from Massachusetts to anywhere, let alone here, but I am also concerned about the national network, and what the outcome of this may be, and I am particularly appreciative to both Steve Wolf and Jim Goodwin for taking the time to come and meet and frankly answer a lot of questions and provide some insight, certainly, to calm some initial concerns, but it does not erase all the concerns about this. I think every colleague on the panel is voicing some of these concerns.

Not so many years ago, when I first came to the Senate, you know, we had 14 airlines to choose from flying from Boston to anywhere, and now we are down to about four, and it is a lot harder to get certain places than it used to be, and very few of us would be comfortable saying that we think the quality of air traffic today is better.

Sometimes it is. Sometimes it works out pretty well. Obviously, a lot more people can be moved a lot more rapidly. There are a lot more aircraft in the air. The entire system has expanded dramatically, and more Americans have access to travel than ever before, and that is a great benefit in many ways. It is a democratization of access, if you will, but it ain't better in many, many, many regards.

In terms of the facilities, they are crowded. The aircraft, to the great benefit of the airlines, seem to be full, but obviously are more crowded, the quality of service is more difficult, and so forth, and these are all issues that I think need to be worked out.

In the context of this merger we need to think about the overall impact on ticketing, on access, on routing, and particularly on competition. This merger will have an impact on service, prices, and competition, and none of us are precisely sure or capable of saying that that is going to be pure upside, or even be able to define exactly where the upsides are.

What we do know is that the combination of United Airlines, the Nation's largest carrier, and US Airways, the sixth largest carrier, is going to create a giant airline with nearly twice as many flights as the nearest competitor, and that is of concern, so we have to ask questions about what that will do precisely to competition.

Now, I understand, and both Mr. Goodwin and Mr. Wolf made a good case about the East-West versus North-South current structure, so they do not compete directly today, but that does not mean that when they come together their market force and what has been created is not going to have a significant impact on other airlines, even pressure other mergers to take place, and that is one of the most important considerations. If this merger is approved, what happens to the rest of the fabric of the American airline industry?

There is currently a relative equilibrium in the airline industry as far as the number of flights per day. Of the top three carriers, United has approximately 3,200 flights, American approximately 3,000, Delta approximately 2,700. After the merger, United would have somewhere in the vicinity of 6,400 plus or minus, depending on what happens, with what restrictions are placed on it, and with those kinds of figures it is very, very hard not to imagine other airlines coming up with their own merger proposals.

We already hear of various discussions, but that means we could be reduced to the big three if the number of speculated mergers follow, so I think we have to ask what happens to prices and what happens to service, both of which are already very complicated.

The fare structures are such that they can drive you nuts trying to transition from one ticket into another, as people in the business world often have to do because of last-minute arrangements, and as we have to do. It is both expensive and complicated, and I think we have to find out whether there will be any incentive for the new United to keep the fares low, notwithstanding a promise for a 2-year nonstructured fare change, and that raises its own questions.

When you are only promising to deal with nonstructured fares, I think we have to look at the routes, and really try to figure out what assurances consumers are going to have. Consumers want to have competition in the airline industry so they can have a choice in the price of their tickets.

It would be a very sad result, in my judgment, if this triggered a major consolidation in an industry that has already seen so much consolidation that you are beginning to see, I think, some restraints on the level of choice that consumers have, and the competition. The market forces that we want so badly to encourage seem to be diminished.

Another concern I have, and I think many of my colleagues share this and Senator McCain mentioned it and others have mentioned it, is what happens in Washington, and here it is absolutely no commentary at all on Mr. Johnson, but it is just a simple question of how viable that entity will be.

Mr. Goodwin and Mr. Wolf made some very, I thought, important observations to me about the time schedule on which complete independence would exist, and complete recapitalization of their own equipment and own facilities, and I think that is encouraging, and I think that is obviously something to look at.

There are many reasons for the current problems that airlines face. They are not the sole fault of the airlines themselves. The FAA has been very slow. We have been slow. Congress has only just resolved this issue of the trust fund. It has taken far too long to get the capital improvements out there that are needed, and that has had a profound negative impact on the industry, too. We have to be honest about it and take blame for some of that.

But nevertheless, the size issue remains a very important one. We have two very able CEO's who I think can help answer a lot of these questions and my mind, Mr. Chairman, will remain open subject to the kinds of issues that I have raised, which I think it is very important to resolve for the American people, and I thank the chair.

The CHAIRMAN. Senator Wyden.

STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, Mr. Chairman. I believe strongly that Congress should not voice support for this merger until the implications for the entire airline marketplace are reviewed.

I think it is worth noting that Bob Pitofsky, the head of the Federal Trade Commission, sat where Senator Collins is just a few months ago and he said one of his great concerns about the American economy is the threat of copycat mergers, and what we have seen in industry after industry is that you allow one of these gigantic deals to go forward, and as sure as the night follows the day, everybody else says, I have got to be just as big or else I will not be able to compete.

I think what Senator Kerry touched on is the reality of what will happen, that if this deal goes forward, based on what we know now, we will see Delta ask for the opportunity to have another big merger, we will see American ask for it, we will then have three behemoths that will dominate the American airline marketplace, and the history of those kinds of mergers is for the public, the consumer gets less service, they get higher prices, there are more hubs, and there are fewer spokes.

So I know we want to get on with the hearing, and I would only note that and I was very pleased and grateful to you, Mr. Chairman, and to Senator Hollings and to Senator Rockefeller that you all joined me as part of the debate on the transportation appropriations bill in indicating that we are going to review whether there ought to be a new yardstick for determining these airline mergers, and that yardstick would specifically focus on customer service.

In the past, as we all know, it has been based on competition. Certainly we want to produce more competition. We have not seen that in all the marketplaces, but what we have seen is a deterioration in customer service, and when the Inspector General comes in with his report in a few weeks with respect to customer service, we are going to see that despite all those voluntary pledges that we got from the airline industry with respect to finding out about the lowest fare, with respect to getting the facts about overbooking, things are getting worse rather than better, and I look forward, as this Committee has done so often, to working in a bipartisan fashion.

The CHAIRMAN. Senator Breaux.

STATEMENT OF HON. JOHN B. BREAUX, U.S. SENATOR FROM LOUISIANA

Senator BREAUX. Very briefly, Mr. Chairman, thank you and the Ranking Member, Senator Hollings, for setting this hearing up.

It seems like more and more in this country we have less and less. More and more we have fewer railroads, more and more we have fewer communication companies, more and more we have fewer oil companies, and now today more and more we have fewer airlines.

I am not suggesting that just because there is consolidation it cannot possibly increase efficiency and actually provide more competition in some areas. The railroad situation has gotten so bad the Committee has actually put a moratorium on any more consolidation of railroads for 15 months and said let's stop and take a look at where this country is going in the areas of transportation, communications, and so many other areas.

So I am not against this. I am not supportive of it. I want to hear what I think all of our Members want to hear about it, but I have a great deal of concern that more and more we are having less and less.

Thank you very much.

The CHAIRMAN. Senator Snowe.

STATEMENT OF HON. OLYMPIA J. SNOWE, U.S. SENATOR FROM MAINE

Senator SNOWE. Thank you, Mr. Chairman, and obviously this is a very significant issue. The quality, the reliability, and the adequacy of air service in this country is no longer just a luxury or convenience. In fact, it is a major necessity, and it is an imperative.

It is obviously crucial to economic development, to the quality of life, to any given region of the country, and that is why I think it is in our national interest to evaluate and to ensure that every region of the country has the ability to compete in this very competitive environment, and that means having quality, reliability, and service.

I believe, Mr. Chairman, that it is important that we exercise our critical oversight responsibility to evaluate this merger between United Airlines and US Airways not only in terms of whether or not it is going to have a significant impact Nation-wide on prices, but also in terms of the impact it is going to have on small and medium-sized communities throughout the country.

There is no question this merger would be a pivotal chapter in the aftermath of deregulation. We know that small and medium-sized communities have not fared well under deregulation, and the question is whether or not, and how could they fare well in the era of consolidation? The General Accounting Office did a report evaluating the effects of deregulation on small and medium-sized communities, and the benefits of deregulation were uneven.

In fact, the GAO went on to say that many small and medium-sized communities like communities in the State of Maine have witnessed a decline in the number of available nonstop service options, and the amount of jet service versus turboprop service, have experienced higher fares and poorer services since deregulation, and went on to say some analysts have observed that competition in certain markets has diminished due to the Federal Government's acceptance of most airline mergers.

So clearly, we have experienced personally, as one who has been traveling and commuting for more than 20 years from the State of Maine, since the beginning of deregulation to now, that we have seen the quality of service decline. We have also seen prices rise significantly. In fact, in Northern Maine up until recently it almost did not have any airlines serving those communities, when in fact

20 years ago it had a 727 as well as other airlines, and fortunately US Airways was willing to come in and provide that service.

Bangor, Maine, another major community in the State of Maine, up until recently did not have any jet service to any major community on the eastern seaboard. It did manage to attract a regional jet just in recent months.

So clearly, deregulation has had a significant effect on the quality of air service to a State like Maine, so we might ask the question, why would this megamerger not further undermine service to areas such as small and medium sized communities in a State like Maine? Our best efforts to attract United to Bangor have not resulted in service to this key Maine city, so why would an airline maintain service to such markets in the long run?

United and US Airways already serves Portland, the largest community in Maine, as they do many other cities, so is it not logical that consolidating these two competitors would reduce competition in places like Portland, where both carriers already serve a given city, and couldn't this reduced competition ultimately lead to higher prices?

My concerns run the gamut, because of the experience that we have already seen in smaller and rural States throughout the country. I mean, Maine is one such example. That is why Senator Dorgan and I a couple of years ago asked the Department of Transportation to examine the impact of deregulation on small and medium-sized communities throughout rural America, and we have seen the answers to that question. It obviously has had an impact, and so this consolidation certainly further raises those questions.

Both United and US Airways have four hubs in the East. Again, would it be likely that Portland, for example, that has been able to have access to four of those hubs, because they have both United and US Airways serving Portland, Maine, as a community, would they continue, or would that consolidation reduce the access to those four major hubs on the eastern seaboard?

So those are some of the questions that I have a concern about. Further, obviously, the creation of DC Air here in Washington to serve the Northeast Region of the country also raises questions about whether or not an operation just working out of one major airport can maintain long-term viability for air service to the Northeast quadrant of the country.

So Mr. Chairman, I think it is important that these questions are evaluated. This merger does require the strongest scrutiny by the Justice Department, particularly because we have to be exploring whether or not there is already too much consolidation in the airline industry, and whether or not, as a result of this potential consolidation, it would invite further mergers in the future, so that we have three major air carriers Nation-wide, and whether or not this would accelerate and advance an erosion of service that already has impacted many communities, as I have cited, in a State like Maine.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Dorgan.

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

Senator DORGAN. Mr. Chairman, I know that you have witnesses, and I will be brief.

We all know there has been an orgy of mergers in this country in recent months and years, and it is true in every industry, and I think it is unhealthy for our economy. We do not need more concentration, especially in the airline industry. We need more competition.

Post deregulation, the Federal Government in virtually every area that had some relationship to jurisdiction here had one huge rubber stamp, and it said approved. Want to get married? We approve it. Want to merge? We approve. I mean, you are hard-pressed to find anybody that says no with respect to this growing concentration.

I happen to think that both of these companies are good companies, but again I say that the proposal that this will create seamless transportation capabilities is in my judgment something that ignores the consumer. The ultimate seamlessness for the airline, I suppose, would be to have one airline all across America. There would be no seams then, but of course there would be no competition, and that would not be in the interest of the consumers.

We have created a system of regional hubs that are now largely dominated, and so we have regional monopolies that are unregulated in the airline industry. The consumer in most cases has fewer choices and higher prices, and Mr. Chairman, because you are an old pilot, you understand that in most cases when you pick up the microphone and call approach control in rural areas, they are not working with a whole lot of traffic. They say, just come right on in, you are cleared to land, 100 miles out of the airport, because frankly, we have less service and fewer choices in rural areas.

Now, with respect to this proposed merger, I would say that I again think both of these are good companies. I like the companies, but we must, it seems to me, worry a lot about the consumer and whether we have robust, aggressive competition providing expanded choices and competitive prices in this industry to the American consumer. That is what needs to be our significant concern here today.

The CHAIRMAN. Thank you, Senator Dorgan. Senator Collins, thank you for your patience. Welcome to the Committee.

STATEMENT OF HON. SUSAN M. COLLINS, U.S. SENATOR FROM MAINE

Senator COLLINS. Thank you very much, Mr. Chairman. Mr. Chairman, members of the Committee, I very much appreciate the opportunity to testify this morning about an issue of considerable importance to the people of Maine, and to share some of my concerns about the proposed merger of United and US Airways.

In contemplating what this merger may mean for the American people, one critical question that I would urge the Committee to focus on is whether rural areas will lose access to quality, affordable air service or be left with fewer choices in the number of air carriers that serve their State.

The importance of air service to small and medium-sized communities simply cannot be overstated. Our region's ability to attract and retain jobs in the global marketplace is inexorably linked to its transportation system. Unfortunately, many rural areas, including northern and eastern Maine, have not fared well under airline deregulation.

I share many of the concerns expressed by Senator Hollings in this regard. Just last Friday, when I was flying back to Maine from Washington via Boston, I sat near a business executive who was flying to his summer home in Maine. He told me that his large company considered buying a business in Eastern Maine, and that the sole reason they ultimately decided not to make the investment was the fact that the area in Eastern Maine was so poorly served by convenient air transportation. Ultimately, that factor alone made them decide to not go forward with the purchase.

I might add that this business executive and I had a long time to discuss this issue, as we sat on the runway at Logan for over an hour in a US Air Express plane in an unairconditioned plane before returning to the gate due to a mechanical failure.

I got to hear a lot of opinions on that plane about the adequacy of air service to the State of Maine. Indeed, the number of cities served by more than two airlines has fallen by 41 percent since 1989, and for many residents of smaller communities the result of deregulation has been poorer service, fewer choices, and higher costs. Add to that the ongoing consolidation within the airline industry, and it is very easy to see why this huge merger raises a number of red flags.

In Maine, we are heavily dependent upon US Airways for our transportation needs. It provides service to Portland, Augusta, Rockland, Bangor, Bar Harbor, and Presque Isle, and we are grateful to the airline for providing this service.

In each case, the service is critical to these communities and the surrounding area. For some of these communities US Airways is the only air service carrier. This service is essential not only for the residents but also for the businesses that provide the economic foundation of the region.

So the question to me is, if this merger goes forward, will the result for Maine be less frequent and more expensive air service with fewer choices of air carriers? I recognize that the airline industry is seeking to meet the demands of a global economy, but that should not be used as an excuse to abandon or slash service to our smaller communities. The airlines are supported by billions of taxpayer dollars that the Federal Government has invested in our air transportation infrastructure.

With this investment comes a certain amount of public responsibility that I believe the airlines need to assume. Clearly, each proposed merger should be reviewed on its own merits. Those that will enhance quality air service for all Americans, including those in rural areas should be allowed to move forward, but those mergers that fail to meet this threshold should surely be subjected to a heightened standard of review.

Mr. Chairman, I very much appreciate your exploring this issue. I think it is tremendously important, and I hope that if this merger is approved, that it will only be approved if we are sure that it will not result in less service, diminished competition, and fewer choices to the people living in rural America.

Thank you very much, Mr. Chairman. I would be happy to answer any questions that you or the members of the Committee might have.

[The prepared statement of Senator Collins follows:]

PREPARED STATEMENT OF HON. SUSAN M. COLLINS, U.S. SENATOR FROM MAINE

Mr. Chairman, first, let me thank you for giving me a chance to testify this morning before the Commerce Committee about an issue of considerable importance to the people of Maine. I appreciate having an opportunity to share with the Committee some of my concerns about the proposed merger between United Air Lines and the U.S. Airways Group.

In contemplating what this merger means for the American people, one critical question is whether rural areas will lose access to quality, affordable air service?

The importance of air service to rural areas simply cannot be overstated. A region's ability to attract and retain jobs in the global marketplace is inextricably linked to its transportation system. Unfortunately, many rural areas, including eastern and northern Maine, have not fared well under airline deregulation. Indeed, the number of cities served by more than two airlines has fallen 41 percent since 1989, and for many residents of smaller communities, the result of deregulation has been poorer service, fewer choices, and higher costs.

Add to that the ongoing consolidation within the airline industry, and it is easy to see why this huge merger raises a number of red flags.

Mr. Chairman, we must ensure that this proposed merger does not result in rural communities facing the prospect of losing the only air service they have.

In Maine, we are heavily dependent upon U.S. Airways for our transportation needs. It provides service to Portland, Augusta, Rockland, Bangor, Bar Harbor, and Presque Isle. In every case, this service is critically important to these municipalities and the surrounding communities. And in some of these less populous areas, U.S. Airways is the only air service carrier. For those communities, this service is essential, not only for the residents, but also for the businesses that provide the economic foundation of the region. If this merger goes forward, will the result for Maine be less frequent and more expensive air service with fewer choices of air carriers?

While I recognize that the airline industry is seeking to meet the demands of a global economy, that should not be used as an excuse to abandon service to rural areas. The airlines are supported by billions of taxpayer dollars that the federal government has invested in our air transportation infrastructure. With this investment comes a certain amount of responsibility that the airlines need to assume.

Each proposed merger should be reviewed on its own merits. Those mergers that will enhance air service for all Americans, including those in rural areas, should move forward. Those mergers that fail to meet this threshold should be subjected to a heightened standard of review.

The CHAIRMAN. Thank you very much, Senator Collins. We know you have a busy schedule, and we thank you for your patience, and you are always welcome before this Committee. You and your compatriot are a sizable force here, as well as other parts of the U.S. Senate. Thank you for being here this morning.

Senator COLLINS. Thank you very much.

The CHAIRMAN. May I ask the members of the first panel, Mr. James E. Goodwin, chairman and CEO of United Airlines, Mr. Stephen Wolf, chairman of US Airways, Mr. Robert L. Johnson, chairman and CEO of DC Air, and Mr. Joe Leonard, chairman and CEO of AirTran, to please come forward.

Welcome gentlemen. We will begin with you, Mr. Goodwin. Welcome. Thank you all for your patience this morning. It is obvious that many members of the Committee have great interest in this issue, and I appreciate your patience.

Mr. Goodwin.

STATEMENT OF JAMES E. GOODWIN, CHAIRMAN AND CEO, UNITED AIRLINES

Mr. GOODWIN. Good morning, Chairman McCain, Ranking Member Hollings, and other members of this distinguished Committee. On behalf of United Airlines, more than 100,000 employees worldwide, thank you for the opportunity to testify today. United Airlines appreciates the chance to discuss our merger with US Airways and explain how it will significantly benefit consumers and the communities served by both airlines.

In short, my name is Jim Goodwin. I am chairman and CEO of United Airlines. Before assuming my current position I was president and chief operating officer. At various times I have managed North American operations, international operations, maintenance and marketing. I began my career at United 33 years ago this month. In short, I am an airline guy. I have spent my entire career learning how airlines work, and I have also learned how important it is to listen and listen carefully to what others have to say.

Well, I have been listening over the last few weeks to what Members of Congress are saying about our merger, and today I want to address clearly what I have heard. The concern I hear most frequently is whether this merger will spark a future round of consolidation, and related to that is a concern about competition in the airline industry. A second deals with customer service and whether it will improve as a result of this transaction.

Let me first talk about possible consolidation. It is a serious question, and one that deserves your serious attention, but I cannot predict what may happen. I can only tell you that consolidation in the airline industry remains an open issue, not an absolute certainty.

I do know, and this I can predict with certainty, that this merger will create immediate and sure competition. Why? Because if fear of consolidation stops this merger, it will prevent Charlotte from growing as a hub and becoming a more vigorous competitor to Atlanta in the Southeast. If fear of consolidation stops this merger, it would prevent consumers from realizing the competitive benefits of the country's first truly national airline, an airline that will increase single carrier service to communities large and small across America, and deliver more convenience and more travel options to consumers.

In short, this merger will expand customer access and choice. It will do so by introducing 93 new nonstop flights that United plans to immediately offer to U.S. and international destinations, half on routes where no airline offers nonstop service today. It will do so by offering single carrier service on 560 planned new city-to-city routes, routes not available today to customers of either airline. I believe that adds up to more competition.

This is an industry open to new competition. Today there is a long list of airlines that did not exist 20 years ago, Frontier, National, Legend, JetBlue, Midway, AirTran, Vanguard, Spirit, and America West among them. They are just not competing. They are each competing against a major carrier in various regions of the country. Today, for a variety of reasons, the average domestic airline ticket costs 40 percent less in real dollars than it did 20 years ago.

Now, I do not expect that others will defer to my sense of where the industry is heading. That is why this Committee will conduct its own review and why Congress has established a regulatory process to study mergers like this one.

We welcome this scrutiny. We welcome it because we are confident that those who will be reviewing this transaction will conclude, just as we have, that this merger will benefit consumers. In my years in the airline industry I have looked at every single possible combination for United, and I am here today because this merger is the only one that will deliver what our customers tell us they want.

United takes customer service seriously. As good as our record is, we know we can do better. Last year, 99.3 percent of our customers arrived at their destination without any baggage problems. I can tell you that I will not be happy until it is 100 percent. Today, we are demonstrating our resolve to improve customer service through our United commitment. To cite just one example, United was the first airline to put leg room back on the airplane, 5 inches of extra space in economy plus on our domestic fleet of 450 aircraft.

Should we do more? Of course we should. United must deliver the superior service that our customers deserve, and I pledge that we will do everything we can to fulfill that promise now and after the merger is complete. It is good business, and it is the right thing to do.

There is a lot more I could say, Senator, about the benefits of this transaction. In the meantime, I look forward to talking with each of you during the course of this hearing.

Thank you.

[The prepared statement of Mr. Goodwin follows:]

PREPARED STATEMENT OF JAMES E. GOODWIN, CHAIRMAN AND CEO, UNITED AIRLINES

Chairman McCain, Ranking Member Hollings, and other Members of this distinguished Committee, on behalf of United Airlines' more than 100,000 employees worldwide, thank you for the opportunity to testify today. United appreciates the chance to explain why our customer-driven merger with US Airways should be approved and how this transaction will significantly benefit consumers and the communities served by both carriers.

As I will explain in more detail in a moment, the merger is a "win win" for valued customers of both carriers as well as all air travelers. The transaction will create a 21st Century airline that offers consumers significantly improved choices for more convenient, single-carrier service on thousands of routes around the world. At the same time, it will usher in new, competitive air service at capacity-controlled Ronald Reagan Washington National Airport.

Moreover, communities, especially US Airways hub cities, will receive considerable travel and economic benefits as a result of the transaction. The combined reach and efficiency of the new network will also enable United to offer improved service to smaller cities throughout the system.

Mr. Chairman, last year this Committee reminded us that as an industry we need to do a better job listening and responding to our customers. Frankly, you should not have had to remind us of this fact since customers are the lifeblood of our business. At United, we certainly took that advice to heart. We implemented a comprehensive customer service enhancement program—"our United Commitment"—to improve the traveling experience of our valued customers. I am proud of the improvements, which that program continues to produce. However, we are not resting on our laurels. Each day, the entire United family is striving to provide the best customer service possible.

At the same time, we intensified our efforts to identify what type of service our customers valued most and expected us to provide. As a result of the evaluation, this is what we learned. Our customers told us they want hassle free, single-carrier service in as many city-pair markets throughout the U.S. as possible. Similarly, international passengers told us that they want seamless, global network service such as that offered by the Star Alliance, the premier alliance with which United is proud to be affiliated. Listening to the marketplace, the message was unmistakable—our customers expect us to offer them the benefits of the most comprehensive air service network possible and they want such service benefits as soon as possible.

Put in that context, let me explain our decision to acquire US Airways. Like a chain, an airline's network is only as strong as its weakest link. As United examined its ability to respond fully to our valued customers, we considered whether we could improve our efficiency and the sustained level of service we provide. What we discovered was that United's weakest link was US Airways' strongest link and vice-a-versa. Accordingly, United concluded that by combining the two carriers, we would draw upon the strengths of both airlines and simultaneously fill service voids in each other's existing networks. The result, we believe, will be the first truly efficient nationwide network that will provide consumers with unparalleled travel convenience and service.

United has an extensive east-west system in the U.S. with hubs in the Midwest and the West. In contrast, US Airways has a comprehensive north-south route system along the East Coast anchored by hubs in Pittsburgh, Philadelphia and Charlotte. Together, the two networks are highly complementary.

Let me emphasize the complementary nature of our respective networks and tell you the other reasons why the transaction will produce unprecedented consumer benefits. Unlike previous airline mergers dating back to the 1980s, United and US Airways do not share a common hub. Moreover, the United-US Airways combination will increase consumer choice and competitive service as we expand our network to improve single-carrier service throughout our system. For example, we plan to offer new single-carrier service on 560 city-to-city routes—routes on which neither United or US Airways even competes today. Examples of new one-stop routes include Charleston, W.V., to Portland, Oregon and San Jose, Calif.; Charleston, S.C., to Austin and San Antonio, Texas; Bangor, Maine to San Diego, Calif.; Reno, Nev., to Tallahassee, Fla.; and Fargo, N.D., to Panama City, Fla. The 560 new routes also include a number of international flights as well, including new one-stop flights from Phoenix to Copenhagen; San Jose, Calif., to Madrid; Birmingham; Ala. to Brussels; and Tulsa, Okla., to London.

Mr. Chairman, let me share several statistics that illustrate the complementary nature of our networks and how it will expand single-carrier service options for consumers. Along the East Coast, US Airways carries about 38 percent of passengers compared to just 1.7 percent for United. On the West Coast, in contrast, US Airways flew under 1 percent of passengers while our share of that market is about 25 percent. By combining our complementary domestic systems, passengers on both coasts—especially US Airways passengers on the East Coast—will be better linked with United's network of global service.

Not only are consumers and competition protected by the complementary nature of our respective networks, we have taken great care to proactively identify and remedy what we thought might be an issue for regulators. I am referring to the combining of our operations in Washington. To address any possible issue about the overlap on routes we would have as a result of the transaction, we are voluntarily divesting the bulk of US Airways' significant and valuable resources at Reagan National. As a result, DC Air, an independent new-entrant carrier, will be able to bring significant new competitive service to the nation's capital.

Before I discuss the significant consumer benefits this transaction will produce by adding DC Air as a new entrant competitor at Reagan National, let me take a moment to respond to questions some have raised about DC Air's independence. Simply put, DC Air will be a wholly independent carrier owned by Mr. Johnson and United intends to compete vigorously against it just like any other carrier. Mr. Chairman, I cannot speak for Mr. Johnson but I firmly believe that DC Air intends to compete vigorously against us as well. To dispel any misperception, let me share some facts with the Committee. Like any other independently operated carrier, DC Air will (1) determine its own scheduling, (2) determine its own pricing, (3) collect its own revenue and (4) hire its own employees.

Mr. Chairman, it is true that we have an arms-length agreement to assist DC Air in the initial phase of its start-up operations. That commercial arrangement is intended to help DC Air successfully get off the ground, not to somehow keep it under United's thumb. Let me be clear, United is merely offering DC Air the opportunity to acquire services. However, we are not obligating it in any way to do so on a continuing basis. In addition, the services are being offered to DC Air at market price, just as our subsidiary UAL Services offers services to a multitude of competitor carriers around the world. For instance, United is offering to wet-lease 10 Boeing 737–200 aircraft to DC Air during its initial two-year transition period but DC Air can discontinue this arrangement with four-months notice.

As is commercially customary, the agreement also gives DC Air the option of extending the wet-lease arrangement under certain circumstances. By no means will this wet-lease arrangement account for DC Air's entire fleet. In fact, DC Air intends to lease 19 regional jet aircraft that currently are operated by US Airways commuter affiliates.

In addition to aircraft, United also is offering DC Air the chance to purchase an array of other services at market price including station handling, maintenance, training, and access to club facilities. Consistent with industry practice, such agreements can be terminated by DC Air if it finds a better deal elsewhere.

Now, let me turn to the significant benefits this transaction will create for passengers using Reagan National. The transaction will not simply maintain status quo competitive levels and consumer choice at Reagan National, it will expand both in a meaningful way. For instance, DC Air has said it plans to offer service from Reagan National to 43 cities. That total includes all 31 cities in which US Airways' service from Reagan National competes today with United service from Reagan National or Dulles.

In the case of routes between Reagan National and three cities—Pittsburgh, Philadelphia and Charlotte—that currently are served by US Airways alone, United will enter those routes and offer consumers at Reagan National a new competitive choice. As part of the transaction, United will also operate the shuttle between Washington, New York and Boston. I can assure you that we will compete vigorously with Delta on those popular routes.

Mr. Chairman, let me make one additional point about DC Air which I believe is very important. An important feature of the DC Air plan is to preserve non-stop air service between Reagan National and many small and medium-sized communities throughout the eastern U.S. Under the plan, DC Air will provide non-stop service from Reagan National to cities such as Charleston, S.C., Charleston W.V., Columbia, S.C., Knoxville, Tenn., Morgantown, W.V. and Portland, Maine.

As I mentioned, combining our airlines will create the first truly efficient nationwide air service network. Now, let me explain how this translates into benefits for consumers, communities and the U.S. economy.

For consumers, the combination of United and US Airways will create a new millennium airline that will deliver significant benefits to millions of passengers. This transaction brings together two complementary route systems that will result in a new network connecting US Airways' eastern U.S. routes with United's western U.S. routes and our international network. The result for consumers: more convenience and more travel options to more places in the United States and around the world. Added to that is the reach of our Star Alliance partners, which will link passengers to a comprehensive network that will directly carry them to destinations around the globe in a way not currently possible.

The transaction will enable consumers to enjoy the considerable benefits that travel on United will offer—benefits that will help simplify travel and make it as hassle-free as possible. Those benefits range from the convenience of single-carrier service and one baggage check-in to United's #1-rated Internet site, the best airport lounges in the industry, and a frequent flyer program—Mileage Plus—that delivers more opportunities to earn miles and many more destinations for award travel throughout the world.

For our cargo customers, the transaction means new, single-carrier service to more efficiently move freight around the world.

United will continue to serve all cities now served by US Airways. However, by no means will United simply offer status quo service. Enhanced service is the hallmark of this customer-driven merger. Passengers will benefit from 93 planned new non-stop flights. Of these, 64 are domestic flights and 29 will be international flights. It is important to note that half of these 93 flights will be on routes where no airline provides non-stop service today. On domestic routes, for example, consumers will benefit from planned new non-stop flights between Pittsburgh and San Jose, Calif.; Washington Dulles and Orange County, Calif.; Raleigh-Durham, N.C. and San Francisco, Calif.; Austin, Texas and Charlotte, N.C.; Denver, Colorado and Ft. Lauderdale, Fla.; and between San Francisco, Calif. and Tampa, Fla. Portland, Oregon will receive new non-stop service to Philadelphia, Pittsburgh and Charlotte.

For United passengers, the merger will create new, single-carrier service to 93 destinations and add about 5,000 routes to the network. For U.S. Airways passengers, the benefit is even greater—new, single-carrier service to 145 destinations and an additional 7,000 routes.

United also plans to introduce daily non-stop service to other international destinations as well. For example, from Dulles, our plan is to offer the only daily non-stop flight from Washington to Copenhagen and, subject to government approval, the only daylight service to London Heathrow. In Boston, United plans an additional daily flight to Frankfurt and the only daily non-stop service to Tokyo. And from Denver, we plan to offer new service to London Gatwick.

I would like to share another example of how our merger will improve the competitive landscape for consumers. The transaction will strengthen Charlotte's competitive position as a hub in the southeastern United States. Charlotte will become an important, competitive alternative to Atlanta and give the city and its businesses greater access to key domestic and global trade centers. It will also make it easier for Charlotte passengers to travel to Latin America, Asia, Europe and other destinations around the world on United and its Star Alliance partners.

The strength of the Charlotte hub as a competitive counterbalance will be enhanced by new non-stop service we plan to offer. That new service includes new non-stop service to three cities—Portland, Oregon, Austin and San Antonio—as well as additional non-stop flights to Denver, Seattle and San Francisco. In all, United plans to provide non-stop or one-stop service from Charlotte to 215 cities in the United States, Canada and Mexico as well as to 34 other international destinations.

In addition to injecting new competition into the domestic market, the merger will also benefit consumers by enhancing competition in international markets. US Airways' system will enable United to serve transatlantic, Latin and Caribbean routes more effectively. The transaction will significantly enhance the ability of US Airways' hubs in Pittsburgh, Philadelphia and Charlotte to grow and compete.

Like consumers, communities served by United and US Airways similarly will benefit from this merger. As the Committee knows, air service is an engine for commercial activity. This is especially true in the increasingly global economy that is creating commercial opportunities literally worldwide. Planned new service and improved access through United's global network will benefit communities by stimulating economic activity, spurring tourism and facilitating new commercial opportunities.

For instance, Pittsburgh will gain significant new single-carrier, one-stop service to the Asia/Pacific region as a result of this transaction. That service will act as an air service trade bridge creating new commercial opportunities for western Pennsylvania. The same is true for Philadelphia and eastern Pennsylvania, which will benefit from five new daily non-stop flights to international destinations that include Brussels, Frankfurt and Amsterdam.

Examples of direct and indirect economic benefits for communities resulting from improved and expanded air service access range from new export opportunities to increased foreign investment to tourism. Sometimes such beneficiaries can be far removed from the airline industry. For instance, I understand the Maine and Massachusetts seafood industries may benefit as a result of gaining quicker and more efficient access to the Japanese market through our planned new, non-stop access to Tokyo via Boston. Such community and regional economic benefits are inextricably linked with improvements in air service.

This discussion of the benefits of the transaction for communities must address an issue of great importance to this Committee—its impact on small community air service. At the root of the merger is our goal to build a truly national airline network that will carry passengers as conveniently and efficiently as possible. Small communities are an important part of both United's and US Airways' networks. The same will be true for our combined network.

Let me assure the Committee that United will maintain its firm commitment to provide the best small community air service possible. We understand how critical access to the national air transportation system is for smaller cities. We also recognize that small community air service is an important economic development issue for many small cities and some states.

As the largest provider of Essential Air Service in the U.S., United has firsthand experience knowing how vital a link to the national air transportation system is for smaller cities. However, we are not limiting ourselves to that distinction. United is already delivering on its promise to expand our service to communities. Thanks to this Committee and this Congress, the easing of High Density Rule at Chicago O'Hare has allowed us to add flights from O'Hare to a number of small and medium-sized communities. United Express recently introduced service to Springfield, Ill. And by October, we will be offering 22 new daily United Express flights—mostly on regional jets—to destinations that will also include Tulsa, Okla., Columbia, S.C., and Little Rock, Ark.

Passenger feed into our system from small city markets is critical to the efficient operation of our network. To put it succinctly, our network relies on passengers from small city markets and therefore we have an important stake in ensuring that our small community air service remains as vibrant and efficient as possible. The network efficiencies resulting from the merger will better position United to fully capitalize on opportunities in small city markets. For instance, we plan to give consumers in Charleston, S.C., new travel options by introducing one-stop service to three cities—Portland, Oregon, Austin and San Antonio—and additional one-stop service to three other cities—Denver, Seattle and San Francisco. Other small cities like Bangor, Maine, will gain new one-stop, single-carrier service to important international destinations such as Tokyo. Simply put, as our network expands and strengthens, our ability to serve small city markets improves.

Finally, the merger is in the best interest of the U.S. economy. There is no doubt that the airline industry is a major contributor to our nation's economy and its prosperity. Besides its own direct spending and employment, our industry also contributes significantly to the creation of earnings and jobs in every major sector of the economy. A study by the Air Transport Association found that the U.S. airline industry generated $273 billion in economic activity in 1998 through direct, indirect and induced expenditures. Each dollar spent directly by the airlines produced another 2½ dollars in economic activity.

Recently, there have been a number of press reports indicating possible consolidation in the airline industry in Europe and elsewhere. Airlines are not seeking to get bigger solely for the sake of size alone. That is not the case at all. As with this transaction, airlines are being forced by the marketplace to build the strongest and most comprehensive route structure possible to compete effectively in the global economy. As Clyde Prestowitz, the President of the Economic Strategy Institute, explained in Congressional testimony just last week, our transaction "reflects the reality that the airline industry is not immune to the impact of globalization." To respond to consumers, airlines are seeking to build the strongest and most efficient networks possible.

Since the airline industry is global in scope, it is in the national interest to ensure that our carriers are not placed at a competitive disadvantage vis-à-vis foreign carriers that are permitted to optimize network-operating efficiencies. Mergers such as ours should be considered with an open mind on a case-by-case, fact specific basis.

Mr. Chairman, let me conclude by again thanking you for the opportunity to testify today. As I have said, we strongly believe this transaction should be approved. It is in the best interest of consumers, communities served by both carriers and the U.S. economy. I would be pleased to respond to any questions.

The CHAIRMAN. Thank you, Mr. Goodwin.

Mr. Wolf, welcome.

STATEMENT OF STEPHEN M. WOLF, CHAIRMAN, US AIRWAYS

Mr. WOLF. Mr. Chairman, Mr. Hollings, on behalf of the entire US Airways family I appreciate the opportunity to be here this morning.

I had prepared comprehensive remarks.

The CHAIRMAN. I would ask that you pull the microphone a little closer, please.

Mr. WOLF. Although when I submitted my testimony, I had prepared comprehensive remarks, I thought insightful remarks for today's hearing, but as I read them earlier this morning, I concluded I had missed the mark. They did not respond to the many comments I heard from Members of Congress over the past week to 10 days.

Those comments fell into very broad categories, but in all cases they were tinged with angst, real angst, sincere angst: What is the business, how does it work, why is this happening and, importantly, what does it mean for my constituents, and in 4 minutes I am going to try to answer.

The CHAIRMAN. Mr. Wolf, please take as much time as you wish to consume. That is true for the other witnesses as well.

Mr. WOLF. Thank you, Senator.

What is the business? Above our obvious understanding, it has the four characteristics that you never want in your business. It is capital-intensive, labor-intensive, exceedingly complex, and phenomenally competitive.

Capital intensity, $175 million to buy one airplane, to fly maybe 12 hours a day. Labor intensive, hundreds and hundreds of job categories merely to get one aircraft out on time and the bags on board and to its destination safely. Exceedingly complex, computer systems for inventory parts through tracking, aircraft availability, et cetera, beyond man's ability to almost deal with, and indeed, phenomenally competitive. I do not think I need to speak about that.

Why is this happening, this merger between US Airways and United Airlines? From US Airways' perspective it is happening for two reasons. One is a push reason, and one is a pull reason.

First, the push reason. My concern when I joined the company 4 years ago was not about its then-precarious financial condition, its absence of strategic direction, its fleet plan that was somewhat unexplainable. My concern 4 years ago when joining the company was, was there room long-term for a mid-sized mature cost carrier in the country, recognizing there were six when deregulation came into being, and there was only one remaining.

Braniff, Eastern, Pan American had gone away, and Continental and TWA had each gone through bankruptcy twice and in the process dramatically altered their cost structure. There was one remaining mid-sized mature cost carrier left, and the question remains, the pull reason, the communities we serve and the consumers who live there wanted access to a large online network with all of its associated benefits.

Two anecdotal comments. I was in my job for 4 or 5 weeks when Governor Ridge from Pennsylvania was in Washington and came to see me, and the upshot of that conversation was, he wanted me to provide long-term online nonstop service, or at least one-stop service throughout the Pacific.

The second anecdotal comment was, some 10 weeks ago when we initiated nonstop service from Charlotte to Paris, Governor Hunt came over on the trip, along with a group of economic delegates from the State, and at a reception we hosted that night, Governor Hunt said to me, Steve, if there is anything you can do for us, at the top of my list is online non-stop or one-stop service to Latin America.

Now, I did not really tell them at the time that I doubted within their natural life we would be able to provide it. I did tell them we would do everything in my power to do so, and this transaction gives Governor Ridge one-stop service from Pittsburgh and Philadelphia to Hong Kong, Tokyo, Seoul, throughout the Pacific, and it gives Governor Hunt of North Carolina one-stop service throughout Latin America, Buenos Aires, Sao Paulo, Rio de Janeiro, et cetera.

Importantly, in this transaction, our unit cost, US Airways, the highest in the industry, becomes dramatically lower, and indeed enables us to compete and become a viable carrier long-term, all under the banner of United Airlines.

How does the business work? Hubs compete with hubs and in the process bring enormous consumer benefit, although this is clearly not understood. One example, we fly from Buffalo to Pittsburgh four times a day.

In Pittsburgh we run off US Airways' hub complexes, where we have 508 flights per day. There are 24 passengers per day who fly from Buffalo to Pittsburgh. On average, we have six per flight, but as a result of our hub complex in Pittsburgh, where we have a product offering in Pittsburgh than is far greater than you could economically justify in the city of Pittsburgh, Pennsylvania, we are able to offer those flights because on those flights we not only sell Pittsburgh we sell a host of connecting cities.

We compete vigorously in Buffalo for not only the Pittsburgh passenger, but even more so for the connecting passenger, and we compete against every network carrier in the country in Buffalo for those on-board passengers.

Why do we fly Charleston, South Carolina to Charlotte eight times a day? There are only 34 people who want to go there. We have about four passengers, on average. We do it because we run a big hub in Charlotte, just short of 500 departures a day, on which they can connect and go onward.

For the first time, passengers traveling between 515 city pairs will have a choice of online carriage all the way through. 4,943 city pairs will have online service for the first time, 103 new flights will be added almost immediately, mostly transcontinental and international. Indeed, providing our Charlotte hub, as an example, with new service to Austin, San Antonio, and Portland, Oregon, along with Aruba and Barbados will, indeed, enable Charlotte to compete in a more aggressive fashion with Atlanta.

Fares. Boy, do they get their attention, and they should. At the time when deregulation came into being there was first, economy, night coach, and family fares. That was effectively it. Today, fares are far more complex and far more prolific than one can even imagine, all designed to attract the last remaining passenger.

The industry had 68,000 fare changes yesterday. US Airways had 8,000 fare changes yesterday, each one of those designed to attract the last possible passenger onto their system.

Service. It is the best commercial aviation service in the world, and does it have its warts? Of course it does. Do we misconnect a bag? Are the lines too long? Did we get the special meal on board? Not in all cases, but for the 600-plus million Americans who flew last year—excuse me, passengers, it worked for the vast, vast majority of them. It is the best system in the entire world, and when we spend some money on infrastructure, it is going to get even better.

What does it mean? None of us could have predicted 20 years ago that Southwest would be carrying more passengers than all but four airlines in the world today. The aviation marketplace today is global in scope. It demands ease of access to Beijing and Budapest as well as urgency of access to Sacramento and Knoxville, and hence United Airlines will lead the way in that new future with opportunities for communities across the country unlike anything we could provide or they could provide independently.

Mr. Chairman, we have a unique opportunity, and we look forward to putting in place the first network of the 21st Century.

Thank you.

[The prepared statement of Mr. Wolf follows:]

PREPARED STATEMENT OF STEPHEN M. WOLF, CHAIRMAN, US AIRWAYS

Chairman McCain, Senator Hollings and Members of the Committee, on behalf of the entire US Airways family, I appreciate the opportunity to be here this morning to discuss the proposed merger between United Airlines and US Airways.

I have been reflecting on the many comments that have been made about this transaction by Members of Congress and others over the past week. I have heard how this endeavor somehow will reduce competition and therefore lead to less service and higher fares. I have heard how it will trigger a wave of other mergers and how it will cost employees their jobs. I have heard how DC Air is not a real carrier and that slots at Reagan National Airport should go not to a new entrant but should be redistributed to existing carriers.

Mr. Chairman, you have a reputation for plain speaking and for going to the heart of a matter regardless of the consequences. If you will allow me, I would like to be similarly direct on the issue before us today.

The hue and cry we have heard—which I am sure has been well-meaning—has been largely anecdotal and when held to the light of day, will be shown to reflect sincere if misplaced frustration over fares that people perceive to be too high and service that people perceive to be too low. These issues clearly are important, but the central issue before us today is: Will the merger of US Airways and United Airlines benefit consumers?

Mr. Chairman, the fact of the matter is that this merger will bring overwhelming new opportunity and competition to scores of communities across this country by creating significantly expanded service options and greater consumer choice. It will bring new job opportunities and economic growth to these communities and a new competitive vigor to U.S. air carriers as they enter an era of heightened competition in domestic and international air travel.

Mr. Chairman, as a result of this merger:

- 37 communities will gain direct access to the vast United national and international system that they do not have today. Communities like Bangor, Maine; Erie, Pennsylvania; and Asheville, N.C. will instantly experience a major increase in their service options.
- For the first time, passengers traveling between 515 city pairs will have a choice of on-line carriers. For example, today, a passenger traveling between Albuquerque and Augusta, Georgia, has a choice only of Delta; between Flint, Michigan and Sacramento, only Northwest; and between Myrtle Beach, South Carolina, and Portland, Oregon, only Delta. After this transaction, there will be two choices.
- 4,943 new city pairs will have on-line service for the first time. While many of these involve small communities with limited traffic today, the added opportunity of new service can only mean an increase in the number of passengers choosing to fly. Examples include Bangor, Maine to Anchorage, Alaska; Myrtle Beach, South Carolina to Palm Springs, California; and Fargo, North Dakota to Sarasota, Florida.
- 103 new flights will be added, almost all of them transcontinental and international, providing our Charlotte hub, for example, with new direct service to Austin, San Antonio and Portland, Oregon as well as new service to Aruba and Barbados, giving it a stronger platform to grow and compete with Atlanta. Philadelphia's already extensive international service will grow with flights to Brussels and Amsterdam.
- In the face of the overwhelming presence of foreign carriers serving our markets, this transaction enhances United's competitive position. For example, our hub cities of Charlotte, Philadelphia and Pittsburgh will now be only *one stop* away from Tokyo, Hong-Kong and Seoul to the west as well as Buenos Aires, Santiago and Sao Paulo to the south. This is an enormous advancement in their patterns of service.

And, Mr. Chairman, all of this will be done with a job guarantee and all will be done with a two-year fare freeze.

If one steps back and looks at the fare issue, in 1977, just prior to deregulation, more than 240 million people flew on U.S. air carriers. Last year, U.S. carriers carried more than 635 million people. Those numbers alone attest to the widespread availability of *affordable* air travel.

I well understand that there is no issue as sensitive as air fares and I have seen the charts and graphs Members have displayed over the past week of hearings. Yes, airfares ARE complex today, but this reflects the competitive nature of this industry. Under regulation, we had a simplified fare structure characterized by uniformly high fares. Congress' decision to deregulate led to intense price competition, resulting in an array of fares and greater consumer choice. The reality is that there has been a 44 percent decrease in average fares since 1977, the last year prior to deregulation.

Lower fares are the direct result of the efficiencies and the intense competition built into the far-reaching networks that have been created over the past two decades—efficiencies and competition that would be enhanced by this transaction. And this doesn't even begin to take into account the enormous impact of the Internet in giving consumers instant access to appealingly low fares for an extraordinarily wide array of travel.

There have been suggestions that this industry will move to three or four or five network carriers—a future I for one do not have the wisdom to predict. But under any of these scenarios, this industry will continue to be characterized by intense competition. In fact, it would be enhanced in other ways beyond network competition. Just as DC Air is a new entrant by-product of the US Airways-United merger, it is inevitable that there would be other opportunities for new entrants and low-fare carriers as gates and other facilities are divested.

These would add to the pool of aggressive carriers that have learned from past failures and today provide an added level of competition—carriers such as America West and Frontier, JetBlue and AirTran, Spirit and Legend and, of course, Southwest, which now is the fifth largest airline in the *world* in terms of passengers carried and growing rapidly into a national carrier of immense scope with the highest market capitalization of any U.S. carrier.

For US Airways and the customers and communities it serves, this transaction offers an instant solution to the question of long-term competitiveness. US Airways is the smallest of the six major network carriers. Yet we have the highest costs in the industry.

We already have seen what has happened to other mid-sized, mature-cost carriers operating at the beginning of deregulation. Braniff, Eastern, and Pan Am no longer exist and two others, Continental and TWA, exist only after having gone through bankruptcy twice.

In this environment, to provide our consumers with the truly national and global service they demand, we have to join with a partner that has a more extensive scope, breadth and reach. With a route network that primarily complements ours, a merger with United Airlines is the right thing to do. The result will be more jobs, more growth, and greater economic development for the communities we serve.

And we have taken steps to ensure that US Airways' service to numerous medium and smaller sized cities from our nation's capital would continue through a new entrant carrier, DC Air.

Some have argued that the slots at Reagan National should be put up for auction. This was considered but I firmly believe it would be the wrong solution. Make no mistake about it, history clearly shows that as airlines acquire slots at Reagan National, they use those slots in a way that is most profitable to them. That means serving National from their hub or hometown airports with additional frequencies. If US Airways' slots at Reagan National are redistributed piecemeal to incumbent carriers who will use that access to add more frequencies to Washington from their principal network cities, there will be an abrupt and painful loss of service to smaller communities such as Portland, Maine; Charleston, West Virginia; Columbia, South Carolina, and Burlington, Vermont.

Instead, Bob Johnson, a person of impeccable business credentials, has pledged to continue service to all 43 cities now served from National and to improve it through the addition of more jet aircraft.

In closing, allow me to step back for a moment and reflect upon this business of which I have been privileged to have been a part for more than three decades.

Other than the world of the computer, I can't think of another industry that has been more dynamic and more vibrant than the world of aviation. It is a dynamic business driven by competition and change.

Just as none of us could have predicted 20 years ago that Southwest would be carrying more passengers than all but four other airlines in the world, neither can we judge this latest evolution of the system within the framework of 1980. The aviation marketplace today is global in scope. It demands ease of access to Beijing and Budapest with the same urgency as to Sacramento and Knoxville. The world has never been more interconnected than it is today. Goods and services flow across borders and oceans with speeds and ease unimagined only 20 years ago. If our aviation system is to remain the envy of the world, we must look ahead, further into the 21st Century, not backward.

The enhanced United Airlines will lead the way into that future, bringing with it opportunity for communities all across this nation. At the same time, the nature of its evolution will enhance not only competition among the major networks but also the entry of new carriers that has been one of the key transforming features of the era of deregulation.

Mr. Chairman, we have a unique opportunity, if only we have the courage and wisdom to seize it.

Thank you for allowing me to share my thoughts with you today.

The CHAIRMAN. Mr. Johnson, welcome. Take the microphone, please.

STATEMENT OF ROBERT L. JOHNSON, CHAIRMAN AND CEO, DC AIR

Mr. JOHNSON. Chairman McCain, Senator Hollings, and members of the Committee. I thank you for the opportunity to be here this morning. I am the founder and chief executive officer of BET Holdings, a multimedia company whose principal business is the operation of the BET cable network, a 24-hour basic cable programming service that reaches 60 million cable households across the country. From an initial investment of $½ million by TCI in 1980, BET celebrates its 20th anniversary with a market cap of approximately $2½ billion, and is a preeminent business serving the entertainment and information needs of African Americans.

I own 65 percent of the equity of BET Holdings. In addition to being a member of the board of directors of US Air, I also serve on the board of directors of Hilton Hotels and General Mills, and of course the United Negro College Fund.

Mr. Chairman, last week I testified at two hearings before the House and Senate. The issues raised in both hearings concern my plan for building a competitive new airline based here in Washington, D.C. called DC Air. They were limited to a few key concerns, and let me take this opportunity to address them now for this Committee.

First of all, I was asked if DC Air, a regional carrier which will serve 43 cities from Washington Reagan National Airport, can be competitive. It absolutely will be competitive.

I am purchasing from United the slots to allow me to serve routes that US Airways has served profitably for in some cases as many as 50 years, and my costs will be lower than US Airways' or United's, because I am starting an all-jet carrier focused on D.C. that would not have the burdens or complexity or mature cost structure that US Airways has. DC Air will be competitive on both price and service with anyone who flies to Washington, D.C., Dulles Airport or BWI.

I was also asked if DC Air would be truly independent. Would it be a truly independent carrier that would provide competition, with some concerns being raised by the memorandum of understanding with United Airlines because it provides transition service.

Let me make the point here, 3 million people depend on the US Air routes to get back and forth to D.C. On the day that this transaction closes, if it is consummated, those same 3 million people annually will look for this service to be there. In order for any new entrant, myself or anyone, to provide that service, we have to have a transition operation that can fly on day 1, and this arrangement I have with United will provide for that.

It is an arrangement that I have the right to escape from on 4 months' notice, 4 months' notice to United Airlines, and it is an incentive for me to escape that arrangement, because I am paying higher costs for those services, so I have negotiated these transition services because I plan to run a full-fledged operation with 37 aircraft serving 43 cities on day 1.

We are ready to begin discussions with other major airlines such as American, Delta, Continental, and Northwest to seek out partnering opportunities such as code-sharing and frequent flyer arrangements. We see these as beneficial to our passengers, who would be able to earn frequent flyer miles in the major airlines program while flying DC Air. We believe our services at National Airport will be perceived by these carriers as desirable features of their extended networks.

I was also asked if this is a sweetheart deal, and I responded, if it is, it is a very expensive sweetheart. I am paying fair market value for the assets I purchased. Not only am I paying fair market value, I plan to invest hundreds of millions of dollars in jet aircraft, and I am paying market rate for every service I am buying. I am putting $200 million of my own money into this venture, and I am not doing it to help Steve Wolf or Jim Goodwin out of the goodness of my heart.

And Senator Hollings, I think you are right, I think Vice President Gore desperately wants to be President, but I think his desperation pales in comparison to my desire to get a return on my $200 million. I am not doing this to curry favor with anybody. I am doing this because I have a history of creating value, and I have created value to the tune where today I have a personal net worth of $1.65 billion. I am not mad at my money. I am putting money into this venture because I believe it will be a competitive and profitable opportunity for me.

I was asked why I felt that I should be the recipient of 222 valuable slots at Washington Reagan National Airport. Well, my answer to that is, why not me? I am certainly capable in putting together the finances to acquire and operate this airline. I am certainly capable of hiring the best and brightest talent to run this airline, and I can be as competitive in operating this airline as anyone in this room, including the gentleman on my right and the gentleman on my left, and so I say why not a new entrant, and if that new entrant is DC Air, I want to be the one to operate it.

One thing I will add, though, if these slots are sold off in an auction process I believe these slots will be sold to the highest bidders that will certainly not use these slots to fly to the small and midsize cities that DC Air will serve, communities such as Portland, Maine, Knoxville and Nashville, Tennessee, Charleston, Columbia, and Greenville, South Carolina, and Charleston, West Virginia, and Providence, Rhode Island, just to name a few. Instead, they will be used to increase existing service to other airline hubs.

And on the contrary, I am a resident of Washington, D.C. I have lived here for almost 30 years. I pay a huge amount of taxes here. BET is located in Washington, D.C. in one of the most depressed neighborhoods of this community. I am committed to this community, and I am committed to the economic development of this community, and DC Air will be Washington's home town carrier.

The communities we serve from Washington, D.C. will not just be another spoke in a carrier's vast hub and spoke network. They will be our entire business.

I was asked what impact the transition from US Airways to DC Air would have on the service to the communities we serve. The answer is simple. It will improve.

Today, one third of the service provided to these communities are turboprops, while two-thirds are jets. On the day of DC Air's operations we will increase to 75 percent jet service, and we will move as rapidly as possible, subject to aircraft deliveries, to 100 percent jet service for all of these communities.

I was asked what sort of employer would I be. I fully expect DC Air to be a union carrier. I intend to foster strong employee relations with all employees, because that translates into great service for our customers, and great service is what DC Air will be about.

So in summation, my vision for DC Air is straightforward: to build on the well-established East Coast service that Washington Area passengers have come to rely on from Washington National Airport, to provide safe, reliable high quality service at competitive prices to customers in the 43 communities we serve, to compete vigorously on price and service in the markets we serve, to facilitate the growth and economic development at our company's air service, and to develop and maintain an airline that the Washington community will be proud to call its home town carrier.

Thank you very much.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF ROBERT L. JOHNSON, CHAIRMAN AND CEO, DC AIR

Mr. Chairman, Senator Hollings, and Members of the Committee, my name is Robert Johnson. I am founder and Chief Executive Officer of BET Holdings, Inc., a multi-media company whose principal business is the operations of the BET Cable Network, a 24-hour basic cable programming service that reaches 60 million cable households.

From an initial investment of $500,000 by Tele-Communications, Inc. in 1980, BET Holdings celebrates its 20th Anniversary with a market capitalization of approximately $2.5 billion dollars and is the preeminent business serving the entertainment and information needs of African Americans.

The recently announced acquisition of US Airways by United Airlines has created for me another historic and exciting opportunity. I have agreed to purchase certain assets currently operated by US Airways out of Reagan National Airport and will be launching DC Air. I do so not to create an African American owned airline, though it will be that. I do so not just to make sure that air transportation remains competitive, though I will do that. Rather, I do so to build a great and successful company that I believe with all my heart will benefit the Washington area, offer high quality service and value to passengers traveling to and from DC, and make us all proud that "our airline" is the best to fly.

My vision for DC Air is straightforward:

- to build on the well-established East Coast service from Washington's National Airport that Washington-area passengers have come to rely on;
- to provide safe, reliable, high-quality service, at competitive prices to customers and communities in this area;
- to compete vigorously on price and service in the markets we serve;
- to facilitate the growth and economic development that accompanies air service; and

- to develop and maintain an airline that the Washington community will be proud to call its hometown carrier.

In terms of its development and its creation, DC Air is a product of the United/US Airways merger, and that is great news for consumers. Why?

The creation of a new airline is no small task in this intensely competitive industry. New entrant carriers face numerous obstacles such as high, fixed start-up costs, the lack of a strong identity, and an unproven route structure and business plan. DC Air, however, is not a typical airline startup company. Benefiting from the experience and expertise of United and US Airways personnel, we intend to build upon a proven network anchored at Washington's National Airport. DC Air will be a viable and totally independent competitor from Day One. At the same time, it will avoid the mistakes and pitfalls that often confront and, in many cases, overwhelm new entrant carriers in this industry. DC Air will be the largest carrier (measured by number of departures) at Washington's premier, close-in airport, offering 111 daily departures, flown by 37 aircraft, serving 43 airports, extending as far as Maine, Florida, and Kansas City. And as DC Air develops, we will assess opportunities to expand service to additional communities.

For over several decades in some cases, great American cities like Albany, Allentown, Birmingham, Buffalo, Burlington, Charleston, Columbia, Greensboro, Greenville, Huntsville, Knoxville, Lewisburg, Manchester, Morgantown, Norfolk, Roanoke, Rochester and Syracuse, among others, have enjoyed nonstop air service to the heart of the nation's capital. These communities have relied upon this extensive service network, which has provided significant commercial, trade, economic development, and governmental relations benefits for these important cities.

The network has been maintained during periods of economic growth and recession, during harsh winters and humid Washington summers. Sustained service to many of these cities is made possible by the efficiency of a network that is centered at the beautifully renovated, convenient Ronald Reagan Washington National Airport.

DC Air is fully committed to sustaining and enhancing this network of service that links these critical American cities to our nation's capital. As a new entrant, DC Air will provide frequent, competitively priced air service, ultimately with an all-jet fleet. Retaining the synergies of the current route system is absolutely vital to ensure the important access for these communities to Washington, D.C.

History clearly shows that as air carriers acquire the coveted, valued slots at Washington National, they use those slots in the most profitable way—in service to their hometown hub cities. In fact, excluding US Airways, the principal U.S. carriers serving National Airport only do so from their hubs or focus cities: America West from its hub in Columbus, Ohio; American from its hubs and international gateways in Chicago-O'Hare, Dallas, New York-JFK, and Miami; Continental from its hubs in Cleveland, Newark, and Houston; Delta from its hubs in Atlanta, Cincinnati, and Dallas, its New York-JFK international gateway, and its Delta Shuttle cities, New York-LaGuardia and Boston; Northwest from its hubs in Detroit, Memphis and Minneapolis; TWA from its hub in St. Louis and its New York-JFK international gateway; and United from its hub in Chicago O'Hare and its Miami international gateway.

Only US Airways, the current hometown, Washington-based carrier, offers breadth of service to the Washington passenger, serving not just its hubs in Charlotte, Philadelphia and Pittsburgh, but also 46 additional communities each day. That is why the creation of the hometown D.C. carrier is so critical to the preservation of a route system that has served medium and small cities throughout the eastern United States for so many decades. That is why the merger proposal reflects the strong conviction of each of the three principal players that not only must competition be preserved in the D.C. metropolitan area, but that new competition must come in the form of a carrier able, willing, and completely dedicated to preserving and enhancing the existing network of service upon which the citizens of so many of these cities have come to rely.

The prospects for vigorous new competition and improved quality of service to these communities are boundless. DC Air is up to the challenge and is eager to assume the historic commitment to these great American communities by providing safe, reliable, high-quality service with outstanding employees.

I appreciate that the airline industry is unique in many ways, and I further appreciate that the industry is highly unionized. I welcome *all* employees—whether union or non-union—to the DC Air family. My plan is to provide fully competitive compensation and benefits packages, while fostering an environment of participation and common goals for all our employees. This plan, I believe, will result in high job satisfaction among DC Air employees, which, in turn, will translate into the top-quality service our passengers should expect and demand.

Startup of Operations

To assist in shaping and realizing the vision of DC Air, Bruce Ashby has been named acting President of DC Air. Bruce has 14 years of airline experience, most recently with US Airways, where he held the position of senior vice president—corporate development. Prior to that, he held the positions of senior vice president—planning and vice president—financial planning and analysis. Before joining US Airways in April 1996, he held corporate officer positions at Delta Air Lines, where he was vice president of marketing development, and at United Airlines, where he was vice president of financial planning and analysis and vice president & treasurer. Bruce played a key role in the formation of three "airline-within-an-airline" units: MetroJet by US Airways, Delta Express, and Shuttle by United, all of which were successfully launched and grown by these respective carriers, and continue to operate today. Bruce's broad background at a senior management level in the areas of airline finance, planning, marketing, operations, and labor negotiations will prove invaluable to DC Air.

As I mentioned earlier, unlike a typical airline startup, which might begin with one or two airplanes flying one or two routes, DC Air will be a fully operational airline serving 43 communities from National Airport with 111 daily departures. This plan brings important consumer benefits, by providing nonstop service and a new, competitive force to the 43 communities that we plan to serve, 36 of which are served from Washington's Dulles airport as well.

To enable this level of startup, DC Air has entered into a memorandum of understanding with United Airlines, as part of the proposed United-US Airways merger, that will provide DC Air, from Day One, with the hard assets it requires to mount its operations. These include 222 departure and arrival slots at Washington National Airport; necessary gates and related airport facilities, for which DC Air will assume the leases; and the operations of one of its commuter airline subsidiaries, including the management staff, turboprop aircraft, and related assets. In addition, during a brief transition period in which DC Air will build its own fleet, United will ensure near-term aircraft availability through customary contractual "wet-lease" relationships for up to ten B–737–200 aircraft and up to 19 regional jet aircraft. In short, DC Air will have the necessary people, aircraft, and airport rights and facilities from Day One.

In addition to the Day One hard assets, United has agreed in the memorandum of understanding to provide DC Air, if DC Air so requests, with certain supporting services at market rates. These services are typically purchased by airlines, and include items such as fuel, occasional use gate agreements, station-handling contracts, and standard industry interline ticketing and baggage agreements. DC Air is free to purchase any and all of these services on the open market from the numerous other providers of such services.

It is critical to appreciate that none of these understandings compromises DC Air's independence.

We are rapidly moving through the process of turning the vision of DC Air into an operating reality. We have begun discussions with aircraft manufacturers in order to build our long-term all-jet fleet of aircraft. We are drafting the definitive documentation with United Airlines to implement our memorandum of understanding. We will soon be entering into detailed discussions with the DOT and FAA to obtain the required permits and certificates. And, we are engaged in working with the federal, state and local governments and community leaders to ensure that their needs are met.

In addition, we are ready to begin discussions with other major airlines, such as American, Delta, Continental and Northwest, to seek out partnering opportunities such as code-sharing and frequent flyer arrangements. We see these as beneficial to our passengers, who would thus be able to earn frequent flyer miles in these other major airline programs while flying DC Air. We believe our service at National Airport will be perceived by these carriers as a desirable feature of their extended networks.

Service

DC Air's initial aircraft fleet will be composed of turboprop aircraft operated by DC Air employees, plus 19 regional jets obtained through an industry contractual relationship with current US Airways affiliates and 10 Boeing 737–200s obtained through a wet-lease arrangement with United Airlines.

Currently, the markets that DC Air will serve are flown by US Airways with 34% turboprop departures and 66% jet departures. Of the 111 daily departures to be flown by DC Air, 25% will be turboprops and 75% jet departures. We will move to an all-jet fleet of aircraft over the first few years of operation; ultimately 100% of DC Air's service will be flown by jets.

DC Air intends to retain service to the communities it serves. One of the key benefits that comes to the communities we serve is that we are purchasing from United all of the slots required to serve these communities. Were the slots to be divided up among several larger carriers, none of these carriers would have sufficient slots to serve all the communities and each would naturally tend to add service to high-volume markets, such as hubs and focus cities where they already have a significant presence. Conversely, DC Air is committed to continuing service to all of our mid-size and smaller communities, and its sole focus is on serving these communities with the highest quality operation. Access by these 43 cities to the heart of the nation's capital will be assured.

Competition

DC Air will provide Day One competition to the Washington, DC area, with competitive pricing and high-quality service.

DC Air will offer nonstop competition to larger incumbent carriers from National Airport in eight of its 43 markets: Atlanta, Georgia; Charlotte and Raleigh-Durham, North Carolina; Columbus, Ohio; Detroit, Michigan; Ft. Lauderdale, Florida; and Philadelphia and Pittsburgh, Pennsylvania. These constitute 22 of its 111 daily departures, or 19%. All eight of these markets are also served from Washington's Dulles airport.

In addition, DC Air will compete in 28 markets with service currently offered from Dulles Airport: Albany, Buffalo, Rochester, Syracuse and White Plains, New York; Allentown, Pennsylvania; Hartford, Connecticut; Burlington, Vermont; Charleston, Columbia and Greenville, South Carolina; Greensboro, North Carolina; Charleston, West Virginia; Dayton, Ohio; Indianapolis, Indiana; Kansas City, Missouri; Nashville and Knoxville, Tennessee; Louisville, Kentucky; New Orleans, Louisiana; Norfolk, Richmond and Roanoke, Virginia; Portland, Maine; Providence, Rhode Island; and Jacksonville, Orlando, and Tampa, Florida. These constitute 70 of its 111 daily departures, or 63%.

In seven of its markets, DC Air will face no direct competition at National or Dulles airports. These include two designated Essential Air Service markets (Lewisburg and Morgantown, West Virginia), as well as Birmingham and Huntsville, Alabama; Little Rock, Arkansas; Manchester, New Hampshire; and West Palm Beach, Florida. Washington's National Airport represents the only nonstop link for these communities to the nation's capital.

Summary

DC Air is an airline that works. It works for our customers, who will receive top-quality service at competitive prices between Washington's premier airport and the forty-three other cities we plan to serve. It works for our many mid-size and small communities, because it will retain nonstop service to National from those communities that otherwise would likely be converted to connecting service over another carrier's hub. It works for our employees, who will enjoy the benefits of working for a competition-focused, all-jet carrier with a clearly defined mission. And it ensures that airline competition will grow and thrive here in Washington.

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

Mr. Leonard, welcome.

STATEMENT OF JOSEPH LEONARD, CHAIRMAN AND CEO, AIRTRAN AIRWAYS, INC.

Mr. LEONARD. Mr. Chairman, Senator Hollings, and members of the Committee, thank you very much for letting me be here this morning. Similar to Mr. Wolf and Mr. Goodwin, I have spent more than 30 years in aviation. In fact, I have spent all of my adult life in this industry. My experiences include running operations for Northwest and American Airlines. I was chief operating officer and president of Eastern Airlines, president and CEO of Allied Signal Aerospace Services Division, and for the past year-and-a-half I have been chairman and CEO of AirTran Airways.

In that time, I have experienced some highs and some lows in the industry, and have learned a thing or two about competition. I am proud to say that I presided over the turn-around and return to profitability of AirTran Airways. We have established a profitable low fare network by focusing on low cost and providing a safe, quality product.

We currently operate 52 jets. We have taken delivery of 11 brand-new 717's, which we were the launch customer for, and we have orders for an additional 39, which will be delivered at one a month over the next 3 years. This puts us in an enviable position to regulate our growth based on the economic conditions and market opportunities.

To accomplish this, however, has not been very easy. It is a result of overcoming daunting bouts of anticompetitive behavior by major carriers and an array of barriers to entry that are so commonly employed to discourage genuine low fare competition. That is the key point, Mr. Chairman. The state of competition in the airline industry today is at best poor in terms of the type of competition that consumers benefit from the most, that being price competition. It is limited to those relatively few routes where carriers like AirTran Airways and Southwest Airlines compete.

The big six do not compete on price today, and in fact the United and US Air combination will not change that fact materially. The big six already operate like the big three with code-sharing agreements and marketing alliances. The proposed merger will only formalize those relationships.

From the perspective of someone that has been struggling against anticompetitive practices of the majors for sometime, I can tell you that it really does not matter if you are squished by the 800-pound gorilla or you are squished by the 1,100-pound gorilla. You are still squished and it still hurts.

I believe that most of the critics of the merger will agree that the key provision is not whether it will help United and US Airways. It definitely will. It is also clear that the merger acknowledges the requirement to divest of the assets at Reagan National Airport. They have made that part of their proposal.

The question is whether the proposed DC Air is a true divestiture. Will it result in meaningful competition and provide a remedy for competition resulting from the merger? I submit, based on the facts presented here, that the answer is a resounding no. Even a cursory review of the business plan clearly indicates that DC Air will not be independent, contrary to statements made.

DC Air will lease aircraft from United, flight crews from United, maintenance facilities from United, maintenance crews from United, ground facilities from United, and participate in United's frequent flyer program, all under the direction of a current US Airways vice president. To affirm this control, United has placed very strict limitations on the sale or lease of slots at DCA, the primary asset of the new carrier. It is a very, very clever way to make sure that no real competition will enter the Washington metropolitan marketplace.

Given the structure of the proposed new airline, DCA would have the highest cost in the industry. Perhaps in time DC Air will be able to achieve a more competitive cost structure and even reduce fares, but it certainly will not happen for years, if at all, and I doubt that it will be.

Furthermore, in regard to FAA activity in this area, most new carriers these days are requiring a year-and-a-half or 2 years to get certification, and the FAA has had a very dim view on virtual airlines, which this looks very much like, and both the FAA and the Department of Transportation in the past years have rejected similar proposals.

So I do not know if there is a plan to give DC Air a special handling, but if it does not get special handling it will take a very long time to get this situation put together based on recent history of Legend Airways, Access Air, and others who have recently started.

High cost and extensive use of smaller airplanes is not a realistic formula for low fare service. Clearly, no real competition and no consumer benefits will result from this new carrier. In fact, most markets will lose seat capacity as a result, so where is the public benefit?

The new carrier will reduce capacity in key East Coast cities in accordance with their own schedule, but not add significant capacity in United's megahubs, such as Charlotte, Pittsburgh, or Chicago. The new carrier will not provide effective remedy to the lack of competition in the Northeast.

Real competition comes from low cost carriers with quality service. AirTran Airways has been competing in Atlanta, and last year saved the consumers in that marketplace $700 million. Unlike most low fare carriers, we choose to compete in what would otherwise be a dominant hub, Atlanta, and while Delta still maintains a 72-percent market share versus our 8.5, the resulting price competition has made Atlanta the busiest airport in the world.

Air fares in the market that we serve are 40 to 60 percent lower than other monopoly hub markets. In 1997, the DOT wisely granted AirTran exemptions to fly into La Guardia Airport, New York, and last year alone we saved New Yorkers $175 million as a result.

One of the most significant markets not benefiting from low cost competition is Reagan National Airport. While nearly every airport in the country is seeing record boardings, Reagan National is actually shrinking. That is the result of lack of competition.

Clearly there is no lack of demand for travel to Washington, but the outrageously high fares are suppressing that demand. Given the opportunity to compete at Reagan National with a network similar to that proposed by DC Air, we estimate the consumer benefit of a low fare network would easily exceed $600 million in the first year.

The conditions of approval of this acquisition I believe must have provisions for real competition by independent new entry carriers. It will not surprise you that AirTran has some ideas about how to do that. We have included in our material a detailed plan to operate a network in Washington and up and down the East Coast. These are not back-of-the-envelope computations, but are reflective and well-documented, and show the impact of AirTran Airways competition has had on prices and passenger demand in similar routes.

Typically when we enter a new route, fares drop 40 to 60 percent, and passenger demand increases by 50 percent. We stimulate market. AirTran has successfully demonstrated its ability to operate the type of low fare hub network envisioned by the DC Air proposal. We have competed profitably with Delta and other major carriers in Atlanta and other large and small cities in the eastern half of the United States. We are prepared to expand our low fare quality brand of service from Washington National to all the markets outlined.

I applaud Congress for the attention it has given to airline competition issues. It is clear to me without your vigilance the gains the new entrants have made, the consumer benefits resulting from those would be impossible. The provision in AIR 21, which requires large airports to file competition plans, clearly and wisely recognizes the need for low fare new entrant carriers to create beneficial competition. However, in terms of the overall trend in low fare competition, Government policy is very much like the weather. Everyone talks about it, but no one does much about it.

AirTran is uniquely positioned to provide the type of competition that is called for in the US Air-United merger. We are prepared to offer significant low fare service at Reagan National and all along the eastern seaboard. This is an opportunity to act to restore real competition in the airline industry, the type of competition that will mitigate the hub concentration of the majors, the type of competition that is viable in the long term and has a lasting public benefit.

Mr. Chairman, thank you for the opportunity to be here this morning.

[The prepared statement of Mr. Leonard follows:]

PREPARED STATEMENT OF JOSEPH LEONARD, CHAIRMAN AND CEO, AIRTRAN AIRWAYS, INC.

Mr. Chairman and Members of the Committee:

As you go about the difficult work of considering the implications of the proposed United and US Airways merger, here are the key points that I think you should consider:

1) The merger of United and US Airways would NOT alter the already desperate condition of competition in the airline industry, and it WOULD strengthen both airlines.
2) The key element in the merger proposal is the structure of the divestiture of US Airways slots at Washington's Reagan National Airport. Does the divestiture create an effective remedy for the competitive problem it was designed to address?
3) The disposition of those slots through the proposed creation of DC Air would NOT provide meaningful competition, and it WOULD sharply curtail service in many communities currently served by US Airways. It also will almost certainly lead to fare increases in those markets.
4) Finally, and most important, this merger has opened the door to what I believe is a historic opportunity to expand service and lower fares in the most heavily protected bastion of the major airlines—Reagan National. The Executive Branch and the Congress are now facing the best and perhaps the last meaningful chance to stimulate service and lower fares at Reagan National for years to come.

Mr. Chairman, members of the Committee, I appreciate the opportunity to address you today on competition in the airline industry. Similar to Mr. Wolf and Mr. Goodwin, I have more than 30 years experience in aviation, having spent all of my adult life in this industry. My experience includes running maintenance operations for Northwest and American Airlines, COO and President of Eastern Airlines, President and CEO of Allied Signal's aerospace division, and for the past year-and-a-half, Chairman and CEO of AirTran Airways.

In that time I have experienced the highs and lows of the industry and have learned a thing or two about competition.

The state of competition in the airline industry is at best poor. In terms of the type of competition that is most beneficial to consumers—price competition—it is limited to those relatively few markets where a low fare carrier, like AirTran Airways and Southwest, provide competition. The fact of the matter is the big six carriers do not compete on price. And the combination of United and US Airways will not change that fact or significantly worsen an already struggling situation. The big six carriers are already combined as a result of marketing and code share alliances into three distinct camps; this proposed merger will only formalize the relationships and change some of the dance partners—but the dance will go on. I say this from the perspective of someone who has been struggling against the anti-competitive practices of the major airlines for some time, and with some success.

Over the past week, several members of congress have expressed concern about the concentration of the airline industry, particularly hub concentration. Unlike most low fare carriers, AirTran Airways chooses to compete in what would otherwise be a dominate hub—Atlanta—and while Delta still maintains 72% of the market to our 8.5%, the resulting price competition has made Atlanta the busiest airport in the world. Airfares in the markets we serve are 40 to 60% lower than other monopoly hub markets. The impact, however, goes beyond Atlanta. AirTran Airways' low fares create competition in connecting markets as well, as evidenced by lower average fares in markets like Buffalo to Dallas-Ft. Worth or Biloxi to Boston. Our low fare network provides the type of price competition that creates discipline among the major carriers and maintains the consumer benefits envisioned by deregulation.

I applaud Congress for the attention it has given to airline competition issues. It is clear to me without your vigilance, the few gains that new entrant carriers have made, and the consumer benefits resulting from those gains, would not have been possible. The provision within "Air 21" which requires large airports to file competition plans clearly and wisely recognizes the need for low fare, new entrant carriers to create beneficial competition. However, in terms of the overall trend in low fare competition, government policy on this is very much like the weather, everyone talks about it, but no one is doing anything about it.

I am proud to say that I have presided over the turnaround and return to profits of AirTran Airways. We have established a profitable low fare network by focusing on maintaining low costs and providing a safe, quality product with affordable fares. We have taken delivery of 11 brand new Boeing 717's and have orders for another 39 aircraft that will be delivered one per month over the next three years. This puts us in the enviable position to regulate our growth based on economic conditions and market opportunities. We can expand at a high rate by deferring aircraft retirements or increase retirements and maintain a steady state.

AirTran Airways is uniquely positioned to provide the type of competition that is called for in the merger of United and US Airways.

As you know, both United and US Airways acknowledge the need to divest of assets at Reagan National Airport as a condition of approval. Without this divestiture, the combined United would control two-thirds of all flights from the Washington metropolitan area.

The question then, is whether the proposed creation of DC Air is a divestiture that will result in meaningful competition or in any way be in the public interest? The answer, quite simply, is "no".

Even a cursory review of the business plan clearly indicates that DC Air will not be an independent carrier. DC Air will lease United aircraft and flight crews, adopt the United pilot contract terms, use United maintenance and ground facilities, participate in the United frequent traveler program, all under the direction of a current US Airways Vice President. To affirm this control, United placed strict limitations on the sale and control of the DCA slots—the primary asset of the new carrier—which is a clever means to keep any real competition from entering the Washington metropolitan marketplace.

Given the structure of the proposed new airline, DC Air would have some of the highest costs in the industry. (See appendix pages 4–5) High costs and the extensive use of smaller aircraft are not a realistic formula for low cost service. Clearly no real competition and no consumer benefits will result from the new carrier. In fact, several markets would lose service as a result. (See appendix page 6) For example, upstate New York communities will have 48% to 56% fewer seats post-merger; Louisville will have 69% fewer seats while Greensboro and Raleigh-Durham will each lose more than 50% of current capacity. Where is the public benefit? The new carrier will reduce capacity in key East Coast cities, but not add significant capacity in any of United's mega-hubs—such as Charlotte or Pittsburgh, and no service to Chicago O'Hare.

Real competition comes from carriers with quality low fare service. AirTran Airways competition in Atlanta resulted in consumer savings of $700 million last year. In 1997 the DOT wisely granted AirTran Airways exemption slots to serve New York LaGuardia, the resulting competition saved New York consumers more than $175 million last year. One of the most significant markets not benefiting from low fare competition is Reagan National Airport—and while nearly every major airport in the United States is reporting record boardings, Reagan National is actually shrinking. This is a direct result of a lack of competition—clearly there is not a lack of demand for travel to Washington, but rather outrageously high fares suppressing demand. Given the opportunity to compete at Reagan National with a network similar to that proposed for DC Air, we estimate the consumer benefit of a low fare network would easily exceed $690 million in the first year. (See appendix pages 12–14)

The conditions for approval of this acquisition—and we believe it should be approved—must include provisions for real competition by independent, new entrant carriers.

This is the key part of the merger equation—if the DC Air proposition is brushed aside, how will slots be reallocated? How that question is answered will have far more impact on passengers and fares than the merger itself.

If those slots become available, the Congress and the Executive branch can follow the traditional ineffective path of distributing them one by one to selected communities. I would call that the "let's feed all our children" scenario. Or you can do what the merger partners declined to do for obvious and self-serving reasons—reallocate the slots to one or two low fare carriers who would be required to network them to many cities, and in doing so break open the Reagan National monopoly. Reallocation of slots to AirTran Airways, either by voluntary divestiture or withdrawal, will clearly result in a level of competition never experienced at Washington's primary airport. Similar measures must be taken at other airports to ensure facilities are available for new entrant competition and to prevent the public harm that will result from increased monopolies.

If I was planning the legislative and regulatory tactics of the merger airlines, this would be my strategy: put DC Air on the table, knowing that it would be the best possible outcome for the merger airlines. If it runs into heavy flak, I'd fight the fight as long as I could, and then unveil a plan to disburse those Reagan National slots piecemeal, and to as many airlines as possible. That would be the way to guarantee that the slots could not hurt me—if they were fragmented, there would be no consolidated market power leveraged against me.

It will not surprise you that AirTran Airways has ideas about how to carry out what I describe, and in the back of the handout that accompanies my statement you will see exactly what I describe along with the fare impact. These are not back-of-the-envelope computations—they are reflective of the well-documented impact AirTran Airways competition has had on prices and passenger demand in similar routes.

AirTran Airways has successfully demonstrated its ability to operate the type of low fare hub network envisioned by the DC Air proposal. We have competed profitably with Delta and other major carriers in Atlanta and other large and small markets throughout the Eastern United States. We are prepared to expand our low fare, quality brand of service from Washington National to markets such as Akron-Canton, Bloomington, Buffalo and other upstate New York markets, Greensboro, Charleston and Savannah as well the major markets we serve today, including Chicago and Minneapolis. AirTran Airways has repeatedly demonstrated in small and large markets that low fares and quality service significantly increase demand and consumer benefits. Ronald Reagan Washington National is one of the few markets on the East Coast not to experience this benefit. We are seeking the opportunity to provide significant low fare service in this market—this is a unique opportunity to act to create real competition.

But the point, of course, is not whether AirTran Airways receives these slots—the point is what real, low-fare competition could do in this market place—be it AirTran Airways or another new entrant, low fare carrier.

Mr. Chairman, this concludes my prepared statement. I would be glad to respond to any question that you or any Members of the Committee may have.

Appendix

Slide 1

A Key Element Of United-US Airways Merger Is A Lack Of Competition In Eastern U.S.

- United recognizes the need to divest of its dominant position at Reagan National
- However, the proposed creation of DC Air falls far short of a true divestiture
- As structured, DC Air will not provide real price competition, nor remedy competitive issues

Slide 2

DC Air Will Be A High Cost Carrier

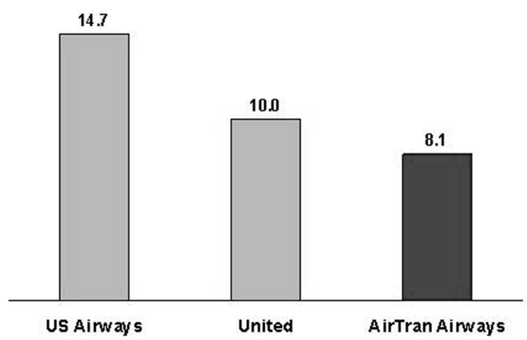
- DC Air Will Be Indirectly Controlled by United
  - United aircraft, crews and facilities
  - Restrictions on sale or disposition of slots
- DC Air's cost will resemble US Airways / United
- US Airways has the highest costs in the Industry
- ***High Costs Equal High Fares***

Slide 3

Cost Comparisons

US Airways' costs are 80% higher than AirTran Airways

Unit Cost As Reported (Cents)



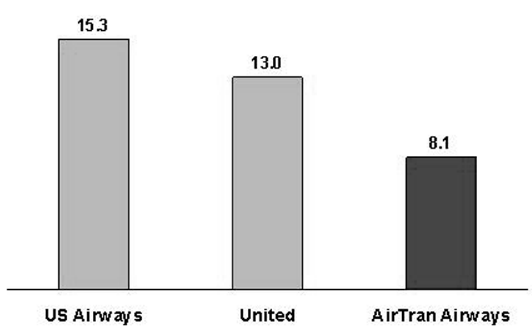
Source: Form 41 - Y/E4Q99 for US / UA
Domestic only

Slide 4

Unit Cost at 525 Miles

On a stage length adjusted basis, AirTran Airways has much lower costs

Stage Length Adjusted Unit Cost (Cents)
(AirTran Airways Stage - 525 Miles)



Notes:
Sources: Form 41 - Y/E4Q99 for US / UA
Carriers not adjusted for average seats

Slide 5

DC Air Will Reduce Capacity In Many Markets

Albany	-61%	Knoxville	-26%
Atlanta	-43%	Louisville	-69%
Buffalo	-59%	Manchester	-48%
Charleston, SC	-14%	Nashville	-47%
Columbus	-60%	Norfolk	-32%
Dayton	-49%	Providence	-60%
Greensboro	-63%	Raleigh-Durham	-60%
Greenville, SC	-26%	Roanoke	-57%
Huntsville	-45%	Rochester	-55%
Indianapolis	-45%	Syracuse	-57%
Kansas City	-13%	White Plains	-42%

- Based on DC Air's announced route and schedule plans, daily seats to Reagan National will drop by more than 40%

Slide 6

Capacity Reductions Will Increase Fares

- Number of seats to Reagan National airport will actually go down with DC air proposal
- United will reportedly reduce low fare MetroJet service in Washington area
- Fares to Reagan National are already significantly higher than other competitive airports
- Reduced seats at Reagan National will result in even higher average fares

Slide 7

AirTran Airways Is Prepared To Offer Low Fare Service At DCA

- Proven track record of providing low cost, low fare competition
- Would actually provide more seat capacity than current US Airways service
- Current aircraft orders are sufficient to provide necessary service levels
- Not affiliated or reliant on any Major carrier

Slide 8

AirTran Airways Fares Are Significantly Below Major Carriers

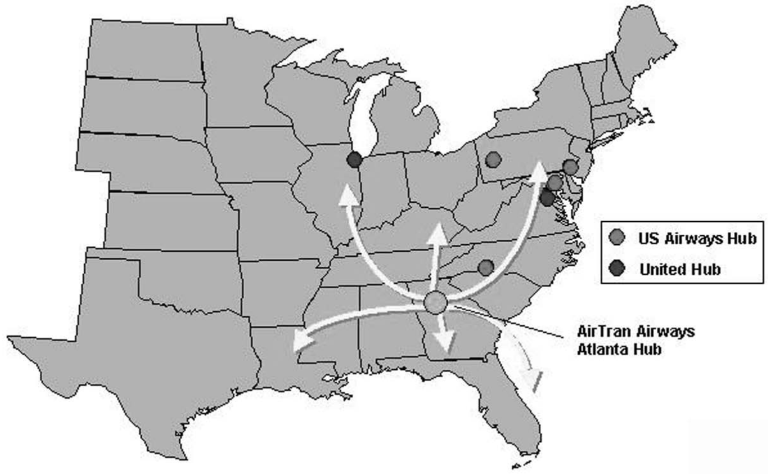
Walk-up Business Fare Comparison

US Airways From DCA	Distance	Walk-up Fare	$ / Mile	AirTran Airways From Atlanta	Distance	Walk-up Fare	$ / Mile
Pittsburgh	205	$323	$1.58	Savannah	215	$107	$0.50
Charelston WV	249	$382	$1.53	Ft. Walton	264	$133	$0.50
Buffalo	296	$364	$1.23	Memphis	332	$162	$0.49
Charelston SC	444	$434	$0.98	Dayton	421	$147	$0.35
Atlanta	547	$539	$0.99	Wash - Dulles	533	$182	$0.34
Little Rock	888	$578	$0.65	Dallas-Ft Worth	732	$212	$0.29
Kansas City	950	$552	$0.58	Boston	946	$202	$0.21

- On a per mile basis, AirTran Airways fares are a fraction of US Airways
- AirTran Airways fares are generally 50% to 70% lower than “structure fares”

Slide 9

AirTran Airways Low Fare Network In Atlanta Provides Price Discipline Against Major Carrier Hub Domination



Slide 10

An AirTran Airways Low Fare Network At Reagan National Will Counteract UA/US Hub Concentration in Northeast

11

Slide 11

AirTran Airways is Committed to Quality Low Fare Service

- Consumers flying to and from Atlanta saved $700 million in 1999 based on DOT data.
- Separately, New York City consumers saved more than $175 million last year.
- AirTran Airways is prepared to create more than $400 million in savings for passengers traveling to and from Washington.
- An AirTran Airways low fare network at Reagan National would provide an additional $294 million in annual savings to consumers along the Eastern United States

Slide 12

Estimated Savings From an AirTran Airways Low Fare Network at Reagan National

Passenger traveling in:	Savings w/ Current Passengers (in millions)	Savings w/ Stimulated Passengers (in millions)		Sample Market	Estimated Savings (in millions)
Nonstop DCA Markets	$182.3	$273.5	$405.1	DCA - Buffalo	$6.3
Connections via Atlanta	$87.7	$131.6		DCA - Gulfport/Biloxi	$1.3
Connections via DCA	$52.0	$293.9		Rochester - Raleigh/Durham	$2.9
Total Estimated Annual Savings	**$322.0**	**$699.0**			

Note: Savings estimates based on DOT Industry O&D passenger and average fare information for 12 months ended December 31, 1999; savings are calculated on historical discounts resulting from AirTran Airways market entry and range from 10% to 40% with stimulation between 10% and 50%. Actual discounts and market stimulation may be higher. Revenue impact includes jet cities only, non-jet service would increase benefits. Savings incorporates savings through fare matching by major carriers.

Slide 13

AirTran Airways Would Save Consumers More Than $690 Million per Year

The CHAIRMAN. Thank you, Mr. Leonard.

Mr. Goodwin, you and Mr. Wolf and I had a helpful meeting and following that meeting you sent a letter with regard to the fare premiums at hubs, disputing the General Accounting Office and the Department of Transportation findings that higher fares exist where one airline dominates a hub, particularly in reference to O'Hare, and you said, quote, "we think it is significant that the GAO identified the presence of Government-imposed take-off and landing slots as a principal cause of higher fares there."

As you may or may not recall, I tried to address the slots contribution to high fares by recommending new entrants at O'Hare have access to more slots, including here at Reagan National, so let me just refer to the fact that the highest fares in the country exist at Reagan National because of slot restrictions.

And yet it was United that opposed the increase in slots at O'Hare. It was United that vociferously opposed the elimination of slot restrictions at Reagan Airport, and you were largely successful at Reagan National Airport because we won frankly what is a pyrrhic victory. In 1997, former United chairman Jerry Greenwald stated, United does not advocate removal of the high density rule.

So let me get this straight. Your position is to disclaim that there are relatively high fares at your hub, then claim that the Government is responsible for high fares because of slots at O'Hare, and then finally to oppose Government efforts to mitigate high fares that may be caused by Government-sponsored slots.

Mr. GOODWIN. Mr. Chairman, maybe we can clarify those all at one time. As far as O'Hare is concerned, United Airlines as part of the AIR 21 project was an active supporter of the removal of high density rule slot constraints at O'Hare. We worked actively with members of this Committee and members of the House Transportation Committee to see that slots were removed. In fact, we would like to have seen them removed much quicker than the bill called for.

The CHAIRMAN. In other words, it was a change in policy from when Mr. Greenwald testified in 1997 and later on, or was Mr. Greenwald wrong in his testimony?

Mr. GOODWIN. I cannot speculate on what Mr. Greenwald testified.

The CHAIRMAN. He reflected the position of United Airlines. Quote, United does not advocate removal of the high density rule.

Mr. GOODWIN. Under my leadership, I did advocate the removal of the high density rule at O'Hare, and we were successful at getting the 2-year removal on the O'Hare high density rule. The first new carrier slots were put out for bid. As a result of that removal six airlines filed for new service to O'Hare, not one to a small city or medium-sized city, I might add, basically to Los Angeles and Minneapolis and other major travel centers.

As a result of that, I did see rule removal at O'Hare. There were also numerous slots created for small cities, and there were a lot of comments made here this morning by members of this Committee relative to service to small cities, and I am happy to say that as part of our commitment of what we as a company would do at O'Hare should the high density rule be relaxed was to add service to small cities, and that is exactly what we have done, Senator.

With respect to your question about Reagan National, I agree with your point of view that we did have a different point of view on the lifting of the perimeter rule and the addition of slots at Reagan National.

The CHAIRMAN. In fact, there was an intense lobbying effort on your part, which again was largely successful.

Mr. Wolf, I would like to read a few excerpts from a January 6, 1999 letter that you wrote to Secretary Slater regarding United Airlines announced increase in service at Dulles Airport, and I quote from your letter.

"In the domestic arena, the threat to unobstructed competition continues to grow. The most recent visible sign of dominant carrier predatory action is United Airlines' newly announced 60 percent service increase at Dulles Airport. This action follows US Airways announcement of its expanded operations at Dulles, as reported in today's edition of USA Today. US Airways is the target."

In today's Wall Street Journal, and you were talking about a January 6, 1999 Wall Street Journal article, Sam Buttrick of Paine Weber was quick to point out that United's expansion, quote, "is about beating US Airways out of Dulles, not about maximizing profits." He said that because United intends to put too much capacity too quickly into these markets its new flying is unlikely to be profitable, and you go on to say, as you well know, predatory actions often sacrifice short-term profits to protect dominance.

Anticipating the unmasking of United's intent, its senior vice president Rono Dutta attempted to deflect attention from the obvious by stating that United's actions may appear to respond to Washington area expansion plans by Southwest and US Airways, but growing Dulles has been part of our long-term plan. No one, however, can be found who believes in the tooth fairy.

And you go on to say, the unrelenting attempts of the major trunk carriers to undermine the operations and expansion of smaller carriers both domestically and internationally is a clear and present danger to free market competition. If successful, this will ultimately deny price and service options that have grown passenger traffic enormously, and have been made available to a broad spectrum of consumers, and you go on to ask the Department of Transportation, to say, quote, "your vigilant intervention into this type of destructive activities is required in order to provide the public benefits of two decades of deregulation."

Is it your position, Mr. Wolf, that United Airlines carried out predatory activities against US Airways at Dulles?

Mr. WOLF. It was my view then, and it is my view today that with US Airways having the highest unit cost in the industry, something I am not particularly proud of, but is a fact, we are not interested in seeing any incremental competition at all, because all of our competitors have lower costs than we have, the mature big carriers and the low cost carriers like AirTran, and the only way in which we can address that is to get substantially larger, and that is what we are trying to do here.

The CHAIRMAN. Mr. Leonard, Mr. Johnson said in his testimony that he is paying fair market value for the assets that will go to compose his airline. This purchase price, I figure of $141 million for DC Air, that puts a per-slot value at about $636,000 each. Does that price surprise you?

Mr. LEONARD. No, sir, it does not. I think it is pretty low, and I think if those slots were bid out they would go at a much higher rate than that.

The CHAIRMAN. At a 1997 hearing before the Commerce Committee, former United Airlines President John Edwardson stated that 100 slots at O'Hare would have a market value of up to $200 million. By the same calculations, 222 slots at Reagan National would have a market value of about $444 million. Mr. Johnson, is that fair market value that you are paying for these slots?

Mr. JOHNSON. Yes, Senator, it is fair market value, because I am acquiring these slots with the full intent of continuing to serve the 43 cities that I believe if they were to go out at, quote, fair market value, would not be served, places in West Virginia, places in South Carolina and North Carolina.

These communities have been having service for over 50 years, and I am sure that these communities want to continue to have service, and by selling these slots intact to a hometown carrier whose sole focus is to serve Reagan National Airport from these 43 communities, in my opinion is absolute highest and best use of these slots.

The CHAIRMAN. I appreciate your opinion. Do you have any analysis or anyone's calculations that this is fair market value, no matter where the destination of these routes are?

Mr. JOHNSON. Based on the market analysis that has been reported to me, the slots that have been sold prior at Reagan National have gone for these kind of market rates.

The CHAIRMAN. Who reported that to you, Mr. Johnson?

Mr. JOHNSON. That was reported to me by the analysis that was done by US Air and United when they priced the slots.

The CHAIRMAN. So would you be willing, then, to allow these slots to be put up for open bidding?

Mr. JOHNSON. No, Senator. I would only invest in this if I am able to acquire all of the slots, because all of the slots are necessary. Keep in mind we have got slots with great times for arrival time and not so great times for arrival. The value of these slots is getting all 222 to continue to serve the 43 communities that DC Air is committed to serve.

The CHAIRMAN. Suppose someone else wanted to bid on all of the slots. Would you agree to openly competing for all of the slots?

Mr. JOHNSON. Senator, to me, this is an opportunity that was presented to me by the sellers, and as a buyer I am going to take advantage of this opportunity because my goal is to run a focused airline from Reagan National to these 43 communities.

It is not to bid with the idea that I can increase the profitability on some slots by flying to Los Angeles, or flying to another big city, or trying to create additional hub sites. It is to try to keep focused on serving these 43 communities. That is the value of this business to me, and that is where I think we can get the maximum return, and that is why I would only acquire these slots as a full, intact, 222 slots to serve these 43 communities.

The CHAIRMAN. I think your point is well-made, Mr. Johnson. I have some difference of view, particularly since these slots are owned by the American taxpayer. These airlines acquired them for free, without paying for them, at least the vast majority of them, and I believe that the taxpayers, like spectrum and other public property, the American taxpayer should accrue maximum value from them.

Obviously, you wanted to say something, Mr. Wolf, about that.

Mr. WOLF. Yes, Senator. I just wanted to clarify the price. We indeed did a detailed analysis of the value of these slots. Individually, these slots come in two buckets. They are express carrier slots, prop airplane slots, and main line slots.

Express carrier slots go for dramatically less, $200,000, $300,000, at prime time maybe more. Main line jet slots go for substantially more, maybe $2 million for a 5:00 p.m. slot, maybe $1.2 million, $900,000 for a 2:30 in the afternoon slot. They were all priced individually. These were fair market values based upon what they had been selling for over the past couple of years.

The CHAIRMAN. Again, Mr. Johnson, I have no problem with you getting the best deal you possibly can as a buyer. My obligation is to the American taxpayer as well, to see that they receive maximum value for an asset which they own, and I dispute the value placed on those assets, which therefore makes me skeptical about your statement about, quote, fair market value.

Mr. Leonard, did you have any comment on this?

Mr. LEONARD. No. Obviously, I agree with Mr. Johnson about the network value. I think if these slots were parceled out a few here and a few there, the outcome would be a loss of service to the smaller communities.

I think the network nature of these slots is important, and I think that is why we would argue that they should be disposed of in a network fashion to assure that that service continues, but to do it in a more realistic forum to somebody like AirTran. Obviously we would like it to be AirTran, but if not us, somebody else.

But the transition period that we are looking at here is going to be years. Using smaller airplanes is going to increase cost. As proposed, it is virtually impossible to fly regional jets at the types of cost you fly mainline jet aircraft, and they will either have to raise prices, or they will withdraw from markets because they will not be able to make money.

The CHAIRMAN. I thank the witnesses. We would like to submit, and I think all of the Committee members would probably like to submit, questions in writing, and if I could indulge my colleagues, it looks like all witnesses wanted to make a final comment on my comment, and so I would like to allow that to happen. Could we just begin with Mr. Goodwin and go across? Did you have any additional comment?

Mr. GOODWIN. Senator, the only thing I would like to state from United's perspective is the point that Mr. Leonard just emphasized. When we looked at the concentration issue in Washington and recognized that we were going to have to divest a portion of the US Airways activities in the Washington Metropolitan area in order to satisfy that concentration issue with the Justice Department we were very concerned about service to small communities, and we were very concerned about being able to protect the service and benefits that those communities have had for a long time. That is why we looked at packaging the transactions there.

The CHAIRMAN. Mr. Wolf.

Mr. WOLF. Yes, two comments, Senator, and thank you.

One, very briefly, is the perspective of this transaction from our board of directors, a group of individuals who are selling the company, who have spent a lot of time on this, they felt that it met the needs of our three constituents in a very significant fashion. One, of value to our shareholders, that it was a fair price and the shareholders would vote overwhelmingly for it. Two, it protected the jobs of all of our employees, which is a rather unprecedented 2-year job guarantee, which Mr. Goodwin has now extended. No one gets laid off.

And three, it preserves and enhances dramatically the service in communities we serve. You think of Charlotte, or Charleston, South Carolina, if you just take the US Airways name off it and put United on, you are part of a much bigger system, a much more attractive network, and it brings all sorts of economic advantage.

Two, I feel somewhat guilty in letting this DC Air thing go. We spent long and hard talking about the fact that we were going to divest 222 slots to somebody. Some of these communities we have served for over 50 years.

Could we have done something more economically attractive with the slots in serving those communities? The answer is yes, and we felt very strongly about continuance of those patterns of service, and we found somebody who would assure us that they would continue to fly the routes, and what he is going to do is take all the regional prop aircraft off and put on regional jets as well as full-size jets in many of these communities.

Mr. Leonard, you could not fly a 717 and make it work, because there just is not the population to do that, although indeed, Mr. Johnson is going to have active discussions with Boeing about flying the 717 to serve some of the larger ones. It is a case of matching the equipment type with the size of the market.

Most importantly, Mr. Johnson is committing to continue to serve the market, big aircraft or small aircraft, as a new startup carrier with dramatically lower costs than we have, and that should benefit the consumer with lower fares.

Thank you, Mr. Chairman.

Mr. JOHNSON. Mr. Chairman, I think to respond to the points Mr. Leonard raised, first of all I think there is a decline in passenger traffic at Reagan National Airport, but it is primarily due to the competition that Southwest Airlines has brought to the region both at BWI and at Dulles, and we will be flying against Southwest in those regions, and that will impact on our cost, which will make us that much more competitive.

Let me go to the issue of, as Mr. Leonard said, someone should get them, but not DC Air. At one point AirTran was a new entrant, or ValuJet, the predecessor airline, was a new entrant, and the argument is that this should go to some other, quote, new entrant. I am here today telling you that DC Air is a new entrant. The fact that we are leasing 10 planes from United and some facilities is to provide for a seamless transition to these 3 million passengers.

We are also leasing 19 aircraft, regional jets, from Mesa. Mesa provides this service, which is customary and standard throughout the industry, to other airlines and they will provide that service to us.

We will also have our own eight aircraft, and we will quickly, as anyone in this business knows we will quickly bring on your own pilots wearing your own uniforms, your own flight attendants wearing your own uniforms, working for you at your cost structure, and that is exactly what we intend to do, and I expect that if I have to I could find the kind of talent that Mr. Leonard has in his operation to give us that low cost structure, because we are a focused airline.

We are not a publicly traded company. We do not expect to be worried about quarter-to-quarter earnings. All I expect to be focused on is serving the 43 communities we serve.

And so in my opinion we are absolutely a new entrant, absolutely deserving, absolutely capable, and will be independent and competitive in providing a lower cost structure and a competitive price.

The CHAIRMAN. Thank you. I thank the witnesses.

Senator Hollings.

Senator HOLLINGS. Well, there are so many questions. Mr. Johnson, you just stated that the reason for the diminuation in traffic at Reagan National Airport was the infusion of competition by Southwest at Dulles and BWI.

Now, you are going to solve that problem by owning US Airways, or now to be named DC Air, but you have been a member of the board for 2 years over there, during these past 2 years that Southwest has been in there. Why have you not all met the competition as US Airways, and why wait until DC Air comes in to do it? I mean, that is a logical question to me. It seems like you are reflecting on Mr. Wolf.

Mr. JOHNSON. No. I am reflecting on the operation that Mr. Wolf had to run. Mr. Wolf had to run a vastly different airline than I am going to be running. He had a mature operation with a mature cost structure and expenses that would not flow through to DC Air. DC Air is not going to be flying to London and to Europe as part of US Air's current operations.

Senator HOLLINGS. Some of those expenses are flowing through to DC Air. What you are saying is that I have been subsidizing all those other long distance flights on my flight to Charleston, is that right?

Mr. JOHNSON. I am going to let Mr. Wolf, who is the CEO of US Air, answer that question, but I will say though, Senator——

Senator HOLLINGS. Well, you are on the board at US Air. Come on. This is sort of an inside deal, so don't act like you are all just getting together for the first time.

[Laughter.]

Senator HOLLINGS. Well, let me let you think that question over.

Now, Mr. Wolf, let me qualify, all of you witnesses talk about 30 years in the airline business. I have been in the airline passenger business for 50 years.

[Laughter.]

Senator HOLLINGS. And I worked as an attorney. I served 47 years ago with Captain Eddie Rickenbacker and helped him before the old Civil Aeronautics Board to get the carrying rights from Charleston to Bermuda, and so I have had oversight of those airlines here for the last 33, almost 34 years, and I know of the public convenience and necessity that we used to have where the community provided the facilities.

The community went out and built an airport, put up the towers, the runways, everything else, and then they got a Steve Wolf or a Mr. Goodwin and said, now we need service into Washington, D.C., and you all would come before the Civil Aeronautics Board on the basis of public convenience and necessity to that particular community.

One of the barest things, in addition to the hubs, is you all have thrown public convenience and necessity out the window, and now, for example, the airlines act like they own the slots, and they bargain around and sell them for hundreds of millions of dollars. They really were promoted and paid for by the communities.

That is another problem for me to solve, but when you come and say for nominally competitive, Mr. Wolf, that does not reconcile with the statement that the distinguished Chairman gave, reading your letter to the Secretary of Transportation here earlier this year about predatory pricing.

You said, well, yes, United is still competitive as a high cost carrier, or Mr. Leonard would be competitive as a low cost carrier, because US Air has the highest per-unit cost, and so all of it is competition to you, is that correct?

Mr. WOLF. That is effectively correct.

Senator HOLLINGS. And so the way to solve that is to become—you said bigger.

Mr. WOLF. I said what?

Senator HOLLINGS. Bigger. In other words, more monopolistic. Good Lord, can you imagine that, to come here before the Committee and say, now, the only way I can get competitive is to get monopolistic. Did I hear you correctly? That is what I understand you to say.

Mr. WOLF. I am not quite sure that I wove that word in, Senator.

Senator HOLLINGS. Well, now you have got 85 percent of the traffic at Charlotte, North Carolina. You see, I started in there when we had Delta, Eastern, National, and Piedmont. In fact, what you say for Governor Hunt, I got that 15 years ahead of time, ahead of when you got it, because I helped you get it. I brought as much pressure as I possibly could, threatening all these secretaries on their confirmation and everything else like that, because I studied my humility under Mendel Rivers.

[Laughter.]

Senator HOLLINGS. So I happened to go before the CAB and help them get, Piedmont get years ahead of any kind of acquisition by US Air. Piedmont had that carrying right, and then you all lost it.

So you now are going to become competitive by becoming monopolistic.

Mr. WOLF. I do not think I would characterize it that way, but you are absolutely correct in saying there has been a massive economic paradigm shift from being a social state——

Senator HOLLINGS. Oh, my Lord, we do not understand large words like paradigm.

[Laughter.]

Senator HOLLINGS. Let me just ask outright, if you have got a high price problem, would you consider selling Mr. Johnson, DC Air, all of those small carrying rights and not have the merger? Is there some way we could get that approved, because I am like Senator Rockefeller, anything would improve the service of US Air that we are receiving now.

I want Mr. Johnson to get it, because I know him, and I do not know what the competitor would get. Would you just sell it to him? Would US Air just go ahead and just sell him those rights, those slots, the maintenance, the planes, the equipment, everything?

Mr. WOLF. Senator, the overriding problem US Airways has is that it is not a low cost carrier and never will be.

Senator HOLLINGS. Never will be?

Mr. WOLF. Never will be, unless we file for bankruptcy. Never will be.

Senator HOLLINGS. That is astounding.

Mr. WOLF. And thus we have to become larger in order to average our costs down to compete with the larger competitors in the country. We are the only pony left. All the rest of them died or have gone through bankruptcy, and I do not find either of those two attractive. By becoming larger, we can spread our cost over a larger base and average down our unit cost rather dramatically.

Senator HOLLINGS. So your reason, then, that you are selling this to Mr. Johnson is that you are recognizing the original instance that the requested merger is anticompetitive without it? In other words, you could foresee that both the DOT and, of course, the Justice Department would not approve it unless you did divest DC Air?

Mr. WOLF. The answer to that is effectively yes, although United and US Airways has very, very little route overlap. We do have large concentration in the Washington Metropolitan Area.

United is the largest at Dulles, we are the largest at National, and we thought the intelligent way to address that would be to carve out a substantial portion of the US Airways existing pattern of service at National and sell it to another operator, as long as that operator would assure us that it would continue to serve small communities. That is what we are doing.

Senator HOLLINGS. Well, you are known as a very successful operator, and I have to take the statement for what it says. You are either going bankrupt or you are going to get monopolistic, one of the two, so you have chosen the monopoly route, and let me, by the way, tell your staff to get on the ball.

I mean, when you say that you have got eight flights from Charleston, South Carolina to Charlotte, North Carolina a day, and 34 people wanting that flight, or an average of four per flight, that is outrageously, really ridiculously inaccurate. I mean, they are standing in line to get on that thing, and they are full flights. I can guarantee you that. You do not have a plane that is flying with four going to Charlotte. That thing is crowded every time.

And just to the point, Mr. Chairman, the airlines' computers sort of have a lock-in. Like, I had last Friday, a 3:00 flight, Washington to Charleston, seat 10A, and so when I got to seat 10A this charming lady was already seated in 10A, and I said, here is my ticket. I have got 10A, and she said, well, I have got 10A.

Can't we get some kind of computer that once a seat is assigned, it cannot be reassigned or duplicated like that? I mean, that is the kind of thing that we passengers who have been in it for 50 years are worried about.

Mr. WOLF. On the former point, in fact there are 34 human beings on the face of the earth who want to fly between Charleston, South Carolina and Charlotte daily. There are a large number of others who fly from Charleston——

Senator HOLLINGS. Not human beings?

[Laughter.]

Mr. WOLF. There are a substantial number——

Senator HOLLINGS. You have got 34 human beings, and then you have got what? Look, I fly down there every week.

Mr. WOLF.—who want to fly between those two cities. We have a substantially larger number of folks in that glorious city and State of Charleston, South Carolina who go to Charlotte who connect and go beyond.

The point is——

Senator HOLLINGS. Sure. The only way to get anywhere is to go to Charlotte, which is a hub. You are now testifying to the monopolistic control of 85 percent of the flights through Charlotte.

Mr. WOLF. Well, I guess I could cut the flights in half and only have a 50-percent monopoly, but I do not think that is what the people of Charleston, South Carolina want us to do.

Senator HOLLINGS. Now, I want to help. Mr. Johnson, how do you get those costs down? You had the gentleman himself say it is the highest cost, per-unit cost, and you are taking the planes and you are taking the pilots. What are you going to do that Mr. Wolf has failed to do to bring those costs down?

Mr. JOHNSON. I am only taking the planes and the pilots under lease for a transition period.

Senator HOLLINGS. And then you take those pilots with the same agreement that they have?

Mr. JOHNSON. No. I have completely negotiated a different agreement with the pilots, because they are flying different equipment. We will negotiate completely.

Senator HOLLINGS. Wait a minute, different equipment? I thought you were taking the same equipment and leasing it.

Mr. JOHNSON. I am leasing 10 737 200's from United, I am leasing 19 regional jets from Mesa, and I am getting eight turbo props as part of the acquisition, so the goal is to move out of the 737 200's into another jet type configuration, lower cost, and at the same time to take the 19 leases from Mesa, turn those into DC-owned aircraft that we will acquire as we go out and talk to the airplane manufacturers.

We have already started talking to Boeing. Boeing makes a 717 that seats approximately 100 passengers, and we are looking at the configuration. We have not made any decisions, but our goal, Senator Hollings, is to get out of those mature costs of US Air-United into lower cost DC Air operations, focused airline, focused only on serving the 43 communities, and employing a staff that is DC Air staff with terms and contractual agreements with the unions based on DC Air's operational cost and not on US Air or United.

Senator HOLLINGS. But you are saying as soon as you take that over you have got the equipment. You are going to give at least the same service. That is your testimony, and with that same service you are going to immediately lower costs.

Mr. JOHNSON. What I am saying, Senator, is that with the same service we are going to have the cost associated with the leases, but we will have a lower cost——

Senator HOLLINGS. I want to talk about the costs associated with the passenger. Am I going to get the same service at a lower cost immediately?

Mr. JOHNSON. In some cities, we believe, and I am not an expert in cost analysis.

Senator HOLLINGS. Wait a minute now, come on. You told us you are worth $1.6 billion and you knew how to get costs down. I mean, you know all about money. I am not worried about that.

Mr. JOHNSON. I am not an expert in airline cost tweaking, but I can assure you that our goal is, our goal is to get the cost of the flying public, who flies from South Carolina to D.C. Reagan National Airport—that is the only place we fly. We are not going to try to fly to other places.

Senator HOLLINGS. You said you are going to fly the same routes, but I am concerned about the cost.

Mr. JOHNSON. I believe that in a short time from transition we will get those costs down, absolutely.

Senator HOLLINGS. Finally, one question Mr. Chairman. In a short time, what do you mean, in a year?

Mr. JOHNSON. I think within a year some of those prices will definitely come down, Senator, yes, because what we are going from, we needed to go from 66 percent jet aircraft to 75 percent jet aircraft. Our load factors will go up. Our costs will go down.

Senator HOLLINGS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gorton.

STATEMENT OF HON. SLADE GORTON, U.S. SENATOR FROM WASHINGTON

Senator GORTON. Mr. Chairman, first I would just like to put a written opening statement in the record.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Gorton follows:]

PREPARED STATEMENT OF HON. SLADE GORTON, U.S. SENATOR FROM WASHINGTON

Deregulation of the airline industry has been a boon to hundreds of millions of travelers over the last 20 years. Numerous studies have demonstrated the widespread benefits of market forces governing economic decisions in the industry. Although there are some members of Congress who believe that deregulation was a mistake, it is quite unlikely that we will take steps to re-regulate the industry in any meaningful manner, and that is as it should be. Many more Americans are flying now than before deregulation. The social and economic benefits of more affordable air travel go without saying.

Although the free market environment has yielded great benefits, it is not without areas of concern. One such area is industry consolidation. It is rare for any market to thrive with fewer competitors. If the United-US Airways merger goes forward, there is the real possibility that the remaining four airlines among the top six will seek merger opportunities of their own. Recent media reports of talks among the other big carriers bear out the widely held view that a United-US Airways merger could lead other mergers.

Additional concentration in the industry might be a negative development. While some airports and regions enjoy the presence of many competitors, there are more than a few markets served only by one or two airlines. Single-carrier routes are likely to have higher airfares. There are certainly efficiencies and benefits to be derived from one or more large air carriers that can offer their customers extensive networks of routes. But there is also the possibility that an oligopoly or cartel will form, where certain regions or airports are dominated by a single carrier and competition is diminished in many ways.

In addition to the prospect of further consolidation, another aspect of this merger that deserves close scrutiny is the creation of DC Air. New entry is supposed to provide market discipline. Even the potential for new entry can have a positive impact in a market. A new entrant must be independent of its competitors, however, for market discipline to take effect. Given that DC Air will be leasing United aircraft and crews, it will be closely tied to an airline that it is supposed to compete against. I understand that the leasing and other arrangements are meant to be a temporary situation as DC Air gets up and flying, but it does raise questions about the independence of the airline.

There is an old joke that begins by asking someone whether he or she knows how to make a million dollars running an airline. The punch line is that you start with a hundred million dollars. Many wealthy individuals have lost fortunes trying to operate an airline. While I appreciate the fact that Mr. Johnson is putting up a considerable sum of his own money to start DC Air, the long-term viability of his new airline is far from certain. If creating DC Air paves the way for the merger going forward, and DC Air does not survive as a fully independent carrier, there will be no way to undo this merger or any other that may follow.

As with Alfred Kahn, the so-called "Father of Deregulation," I approach the problems associated with airline deregulation within the philosophical constraints of the beneficial competition that deregulation unleashed. I do not want to re-regulate the industry. But the federal government should be cautious about any development in the industry that may curtail meaningful competition. It may be that consolidation of the largest carriers would enhance competition. A few high cost airlines might create an opening for more low cost competitors. A wave of mergers may, however, lead to a public outcry for tighter control over the airlines. I think that would be a regrettable turn of events.

Senator GORTON. Second, I would like to say that it seems to me, as it does to the Chairman, that the duty of, the goal of the people up there is to enable the private sector to run an air transportation system that is safe and fast and frequent, and low cost, through the ability to create competitive markets and provide incentives to do what each of you is talking about doing, run highly competitive, efficient airlines.

I believe that the deregulation of air transportation was one of the great steps ever taken in the transportation system of the United States, and is fundamentally the reason you are here, and that clearly in a competitive world means that change is a constant, and our comfort with the status quo is illusory.

Having said all of that, with those goals I can also say that I do not have a tremendous number of parochial concerns as the Senator from the State of Washington. I do not think that this proposed merger is likely to have a profound effect on the way that people get back and forth to cities that I represent.

But I also have to say publicly, as I have to two of you at least privately, that in the proper definition of that term I am a skeptic. I do not believe that we here should be considering this merger in isolation.

I am strongly inclined to believe that it will force other large competitors into similar mergers, and it is counterintuitive to believe that where there are now six major airlines in the United States, in one sense that when that turns into three major airlines, that that will increase competition. Maybe it will, but it is certainly counterintuitive.

I listened with great interest and with a certain degree of optimism to what Mr. Johnson has said about running a low cost airline out of Reagan National, but it is counterintuitive at least to think that someone making a purchase from what Mr. Wolf delightfully describes as a mid-size mature cost carrier, which to me means a high cost inefficient carrier, that within a relatively short period of time its successor in a market like this is going to be a highly efficient low cost carrier.

It may be so, but it is clearly counterintuitive to come to that kind of conclusion, so it seems to me that while you have made a good case, you have an extremely high burden of proof in this connection, and our considerations have got to go beyond this merger and say, well, what happens when the next four in line, the Continentals and Northwests and Americans and Deltas respond, as they must, to this proposal, to the way in which air transportation is highly competitive and highly passenger-oriented in the United States?

I leave that with you, because it is a matter of concern that you have obviously attempted to deal with here but have not dealt with successfully to this point.

Now, I would really like to ask a few questions and be silent enough for long enough to get the answer, and I will start with you, Mr. Goodwin. Your testimony says that you have relatively little East Coast North-South traffic, and that it would not be practical to grow incrementally. Why not?

Mr. GOODWIN. Senator, when you look at a mature network carrier, as United is, we have a lot of opportunities to continue to fill out our franchise. When you start looking at incrementally growing in a marketplace where you have less than 1 percent of the traffic in a market, it is going to take a horrifically long time, an horrifically large amount of money to be able to make a commitment to provide any meaningful competition into a market like that.

400 airplanes that US Airways is currently operating to replicate their East Coast operations would be in excess of $12 billion in today's marketplace. Then we would have to go find people, facilities, and infrastructure which we all know is the subject of great concern in this industry, and I do not believe that you are going to be able to realistically look at that as a way to make a significant——

Senator GORTON. But from the point of view of your customers, at least, and their convenience, wouldn't you do just as good a job by a code-sharing arrangement? You would get your passengers where they want to go.

Mr. GOODWIN. A code-sharing arrangement with US Airways would perhaps provide display opportunities so that the customer would be able to see service in purchasing. That is a seamless product, but it still suffers from the problems of any code-share operation, with separate terminals, separate computer systems, separate personnel, in many cases separate policies that are not consistent from air carrier to air carrier.

And Senator, despite all of our efforts over the last 3 years, from the Star Alliance to try to be able to build consistency for our customers worldwide in a code-sharing environment, we still struggle with the inconsistencies because of the unique requirements.

Senator GORTON. You tell me you are going to be more efficient, but you also say you are not going to lay off any employees and you are going to operate all of the hubs. How are you going to become lower cost doing that?

Mr. WOLF. Senator, it is our commitment that we are not going to have any employees impacted by this transaction. We believe that is a very positive part of this merger, because all the labor agreements will be honored, all the employees will be ensured a job.

The ability to lower costs in the current US Airways network comes from being able to blend their route network with ours. A lot of the overhead, the significant costs that go with that are going to be spread over a worldwide network versus a North-South network that US Airways currently has to distribute their costs over.

Senator GORTON. Finally, and I have more—as the Chairman said we will submit some of these questions in writing—you said the acquisition of US Airways will provide, I think it is 93 destinations and one carrier service for 540 or 560 new city pairs. Are those destinations and pairs a matter of public record? Are you going to submit them to us?

Mr. GOODWIN. Yes, Senator, they are a matter of public record. They have been in all of the materials we have used. There are 64 domestic markets that we are adding, including some to the city of Seattle, as well as international locations.

Senator GORTON. Do we have them here for this Committee?

Mr. GOODWIN. Senator, we will make sure you have a copy before the day is out.

Senator GORTON. Thank you. Mr. Wolf, what if DOJ turns you down? What is the future of US Airways?

Mr. WOLF. We will continue to manage the business as aggressively as we can and try to find the answers someplace else.

Senator Gorton, I might add that selling our company and watching the name disappear was a big decision for our board. Before we ever got to that decision, quite frankly, we looked at buying every airline in the western world ourselves in order to increase our size, and for one reason or another, not being able to get the financing, not being realistic, not being able to buy United's 55 percent employee-owned, et cetera, et cetera, we never found a fit that we could legitimately hope that we could finance and conclude.

When I met with Mr. Goodwin some number of months ago, it was a conversation dealing with our participating, US Airways participating in the Star Alliance, and he brought the subject up, and the more we looked at it, and the more we wrung our hands about it, the more we finally concluded, it works for our three constituencies.

That is why we are going forward and doing it, but if it is not allowed, we will tend to our knitting and try to run the best airline in the world and try to find the answer someplace else.

Senator GORTON. Well, now I do have a parochial question for you, Mr. Wolf. What happens to your Airbus Industries orders if this purchase goes through?

Mr. WOLF. United Airlines would be obligated, and in fact has agreed, to honor all of our contractual commitments, be it airport leases or gates or aircraft purchases, et cetera.

Senator GORTON. That is not much of an advertisement for me.

Mr. WOLF. It is a free market, Senator.

Senator GORTON. Yes, it is. One other question for you.

You stated in a document submitted to the Department of Transportation with 519 current daily departures at Pittsburgh, 483 at Charlotte, 402 at Philadelphia, we operate the most pervasive route network in the Northeast and Mid-Atlantic regions of the United States, where almost 40 percent of all Transatlantic passengers begin or end their international journey. US Airways ranks first in 44 of the 56 major airports in the Eastern United States, end quote.

Now, you will be combined with United, and it dominates Dulles as the largest domestic carrier. If US Airways had the most pervasive network before the merger, what would your description be after the merger?

Mr. WOLF. I think we will have a network that we will now be able to serve, because we are not doing that today. We are going to provide an array of services to folks on the East Coast of the United States. What was the old US Airways system, now the new United system, that will far exceed anything that we could do.

Senator GORTON. Will it be more or less pervasive?

Mr. WOLF. It is going to be patterns of service we could never get to. I think I should add one other point. If you look at all of the international passengers US Airways carried last year and United Airlines carried last year, that is 13 million international passengers. In the global marketplace we are not even scratching the surface. British Airways carried over 30 million, Lufthansa 27, Air France 24, American Airlines carried 17½ million international passengers last year.

We are going to put a very strong football team onto the field to compete globally and succeed, in my opinion, significantly by having United's backing of US Airways. As we effectively disappear and become them, we are going to have international patterns of service that are going to dwarf anything we ever thought about before.

I mean, out of Philadelphia alone they are going to add Brussels and Amsterdam immediately. We recently started flying from Pittsburgh to Frankfurt. They are going to add another trip immediately. Our three trips are going out of Charlotte, which we are exceedingly proud of, to Paris, Frankfurt, and London. We upgrade to bigger aircraft almost immediately. This is going to be a very vibrant network, bringing all sorts of consumer benefits to all of those communities up and down the East Coast of the United States.

Senator GORTON. One more question, if I may be indulged, for Mr. Johnson. If you add up DC Air's proposed schedule and plans to operate 22 jet round-trips to eight markets, how can a carrier operate a low fare operation with this many destinations with so few round trips?

Southwest, as I understand, does six or seven round trips in each of its markets. How is DC going to be low fare with two round trips per market?

Mr. JOHNSON. Well, Senator, I think the advantage of DC Air, it flies to a very desirable close-in airport, Reagan National Airport. It is a slot-restrained airport, and people choose to fly there because they like the convenience of it. The way we will be able to lower our cost is that we will be operating lower cost aircraft and will have lower cost personnel, and those costs will be passed on to the customer.

Senator GORTON. Well, why? If it is all this good a deal, and you are low cost, don't you want to maximize your profits?

Mr. JOHNSON. Well, Senator, I think we have a very profitable airline now, and I think the objective is to keep it profitable by being competitive, and we will be flying against other competitive carriers, so we will not be able to maximize profits, so to speak, when you have got Southwest Airlines flying into Dulles Airport or BWI. There will be some pressures. We will be flying in competition against United, so there will be competition to keep our costs down, and we will do that.

Senator GORTON. Fritz, is Southwest flying to Charleston?

Senator HOLLINGS. No. We would love to get them.

Mr. JOHNSON. They are certainly free to do so. There is no restriction on them doing so.

Our position is from day one, we will get out of many of the high costs of US Air, for example, leasing jets from a company like Mesa or others at a lower cost than the operational cost of US Air and United, and moving away from having the costs associated with what Mr. Wolf was talking about, flying to Europe and marketing costs associated with trying to get people to fly to Europe on US Air.

Even, I dare say, changing the compensation structure of this company is going to have a huge impact on our ability to lower costs, so I am confident that we, with the desirable close-in Reagan National Airport, continuing to focus on serving these 3 million passengers with better service and lower cost service—the routes are profitable today, Senator. They are profitable today. Under lower cost they will be more profitable, but we also believe we can pass some of this on to the customer in the form of competitive prices.

Senator GORTON. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman. I just want to get one little thing out of the way here that has kind of been nagging at me a little bit.

Comments are made from time to time that if you have not been in the airline business as a chief executive, then therefore somehow you are not going to be able to do a decent job, and I would suggest that we have got four CEO's before us, and I think that probably Bob Johnson has been by far the most successful in terms of running his business, and has made the most money in terms of running his business, and has the most experience in terms of running his business.

Now, you can argue, if you want, that, well, he has not been in the airline business, which is an extremely competitive business. It is very hard to compete and make a lot of money in the airline business because of all that is going on, but this belief that those who have not been in the airline business before will not be able to be successful in it is bothersome to me, especially when you are dealing with somebody who has been so absolutely and totally successful in the corporate world.

So we do not have two CEO's here today. We have four CEO's, and my guess is that Mr. Johnson has probably been the most successful of them, and I wanted to make that point.

Second, a question to Jim Goodwin and Bob Johnson. You promised to carry your service on to every market you are servicing now, and that is very reassuring. On the other hand, when you put forward a merger proposition, that is the kind of thing you say.

It is like saying you are not going to lay people off, and I have talked with you, Jim Goodwin, and I believe that you mean that, but often circumstances are just such that it becomes very difficult not to do that in the reality of the marketplace as opposed to the rhetoric of a committee hearing room, and I would just like to hear you say it again. I guess this is more to you, Mr. Goodwin, than to Mr. Johnson.

Mr. GOODWIN. Senator, as I said to you several weeks ago, we view this transaction as very consumer friendly. We believe it brings a lot of connecting benefits to small and midsize cities, to a global network that today they do not have access to.

I also firmly believe that providing that access is a great economic development engine. We have seen it in a lot of places. We have seen more and more of our customers, our important business customers, moving to smaller cities. They are demanding more air service. They are demanding more access to a global network. We are committed to that.

That is the foundation of the hub-and-spoke carrier, the ability to bring small numbers of people to a collecting point and disperse them onto a larger network is what provides access to global businesses, global travelers, global leisure travelers, shippers, et cetera.

Our company has demonstrated that commitment, and we are committed to it in this transaction, Senator.

Mr. JOHNSON. Senator, if I could add to the question of serving the 43 cities, I can state without equivocation that my goal is to provide service to these 43 cities and these 43 cities only. With DC Air that is my purpose of making the acquisition.

And to the question about people who are coming into the airline industry from the outside, I think I am correct in pointing out that the current CEO of Delta did not have an airline background, and Jerry Greenwald, who formerly ran United Airlines, came out of Chrysler Corporation, I believe, and of course everybody knows Richard Branson, who has given competitive fits to British Airways all across the Atlantic, came from Virgin Records, the entertainment business.

And so, Senator, you are absolutely right, I think what it takes to be a successful CEO in any business is the ability to have a vision about your business, to motivate people to pursue that vision, to provide quality customer service to your customers, and to run an operation that reflects the values that you have in that business, and that is what I have done with my company, and that is what I would do with DC Air, and I do not see any impediment at all to hiring good talent.

Now, Mr. Leonard mentioned that I hired Bruce Ashby to serve as my acting president, and he comes from United and US Air. I mean, you cannot have it both ways. On the one hand, gee, the guy has no experience. He goes out and hires somebody with experience. Well, the experienced guy comes from—Bruce also worked for United, US Air, and Delta. Bruce is a very experienced airline executive, and I am going to hire a lot of other airline executives. I may try to hire a couple from Mr. Leonard. I can sort of dip into my pocketbook and be competitive.

So my point is, I am going to hire the best and brightest talent to run this airline, with my vision and with my commitment to service.

Senator ROCKEFELLER. Mr. Johnson, the point has been made about you providing lower cost service, and I am not sure that the point has been adequately made that one of the reasons that you would be able to do that were the merger successful is that your desire is to have a so-called simplified fleet—a fleet with all the same planes, the same maintenance programs, the same training programs—which becomes a major cost advantage.

Mr. JOHNSON. Senator, you are absolutely correct. Among the things I have learned by serving as a director of US Airways is understanding the cost structure of airlines, and those costs come in about three or four categories. The first one is obviously the cost of acquiring aircraft. The second is the cost of personnel, union costs. The third is fuel costs, and then the others are the overall operations in particular markets that you operate in.

I believe the most important thing to do in DC Air is to rationalize the fleet, to get a fleet rationalization that will allow you to have pilots who fly the same plane whether they are flying from Portland, Maine, or whether they are flying to West Virginia. They will move from one plane to another without any scope clauses or any restrictions.

I think the other thing to do is to get union agreements that reflect your goal of being a low cost carrier and I believe we can do that on the personnel.

Fuel cost, we will do like everybody else. We will be able to buy fuel as part of a consortium of independent airlines, and we will be able to buy fuel at other kinds of market costs, and so I think on the areas that we can be competitive where the costs are, we can absolutely become competitive right away.

But in addition to that, I think US Air and United will have huge cost, overhead cost, just in terms of senior executives, just in terms of facilities, and just in terms of marketing costs that we will not have, and as a result of that we believe we will be able to pass those reduced costs along to the customer in the form of competitive prices and better service.

Senator ROCKEFELLER. Thank you, Mr. Johnson.

The CHAIRMAN. May I just make one brief announcement? Members will be leaving because of the time, and I do not think that if we went to panel 2 at this time, that they would get the attention they deserve, and so therefore I am going to ask Hon. Nancy McFadden and Mr. Bert Foer to come tomorrow morning at 9:30, and we will reconvene this hearing at that time, rather than have them speak to an empty committee.

So we will complete the questioning from Senator Kerry and Senator Wyden with this panel, and we will reconvene tomorrow morning at 9:30 with panel number 2, and I apologize to Ms. McFadden and to Mr. Foer because of the length of this hearing, and I want to get their input, and so we will reschedule the rest of the hearing for tomorrow morning, after the completion of the questioning of this panel.

Senator Rockefeller.

Senator ROCKEFELLER. I will forego my final question.

The CHAIRMAN. No, there is no reason to do that.

Senator ROCKEFELLER. I choose to do so.

The CHAIRMAN. Thank you.

Senator Kerry.

Senator KERRY. I thank my colleague for his courtesy. It is an interesting discussion.

Let met begin by saying, Mr. Goodwin, I am surprised at your statement about the inability to "predict" what might happen here with respect to the consolidation merger down the road. I was in business privately for a very short period of time when I was also practicing law.

And I have learned enough about business in the 16 years I have been here and particularly this industry to say to a virtual certainty—virtual certainty—that there is no way that Delta, American and others are not going to be pursuing very rapidly for the very reasons that were contained in your letter, Mr. Wolf.

You cannot write a letter like that to the CEO of US Air and then come in with a new posture as a seller to United that suddenly erases that market pressure on anybody to be competitive. I think Mr. Leonard would agree. I mean, they are already talking. We all know this.

So our obligation is not just to look at the impact of your merger, but to look at the impact of what we know is going to happen here, what is going to happen to the marketplace.

Now, you raised a very good point. We also have an obligation not just to look domestically, but we cannot talk about globalization and the impact of the global arena without also making some judgments about that. And the capacity of single state airlines, what began as single state airlines and are now pretty much dominant. British Air, Lufthansa, for instance, they carry a lot more. And that has a global impact, et cetera. So I think we need to think about that. I just want to put that on the table.

Second, with respect to Mr. Johnson and the discussion that my good friend Fritz had, without becoming rhetorical about it, I understand completely where Mr. Johnson is coming from. I think it is a great deal for him. He would be crazy not to look at it and to want to try to do it. It has been a very profitable arena, those particular slots and that network. And there are rational reasons for you folks to divest of that in the context of this overall possibility.

And I completely understand the differential and the slots. It makes sense to keep it as a package. We have a public interest in making sure that those particular areas currently served continue to be served. That is an important guarantee that that would happen.

And clearly, there is a variation in value on those slots according to time, size of carrier, type of carrier, market served. Whether your assessment as the seller is the definitive of price, I do not know the answer to that question.

But I would assume answering to your board as a public transaction, that is going to be highly scrutinized, you have a serious interest in making certain that that does meet market value.

So, I think we can look at that carefully. And I am not as disturbed by that. I also see the transitional aspects of this. And I think there are great virtues to that in terms of the new aircraft that will be purchased, the new network setup. And there is a transitional capacity.

Here is what I am more concerned about still. And I am trying to figure it out. Mr. Goodwin, I know this is a very tough business, nothing easy about it. And the profits are not enormous at all. Your profits—what is the profit margin of United currently?

Mr. GOODWIN. Oh, about 7 percent, Senator.

Senator KERRY. And US Air is more hard pressed at this point in time. Would you share with us these current—you have labeled them mature—structural difficulties that make life so difficult for US Air particularly?

Mr. Wolf: Sure. I would be happy to do so. We had for a good number of years labor agreements that were woefully uncompetitive. And that is not because anybody was dumb or inattentive.

It really goes back to the days of Allegheny. In the regulated environment, you would settle a labor contract on terms that you knew were not necessarily justifiable economically, but what difference did it make? You flew to Washington the next day. You saw the Civil Aeronautics Board. You proved to them your costs went up—and they surely did—and they let you raise fares.

And you knew in your heart of hearts that labor agreement was going to be the floor for your competitors some 6 months later. And we had this sort of a spiral.

We then, Allegheny got into a merger syndrome with Piedmont and PSA. And as we did that and we put the labor agreements together, they became substantially more attractive quite frankly.

And then we got into the early part of the 1990s. We had a difficult economy. Fuel prices were going up, et cetera. And we started encountering staggering losses. In the end of the end, last year, starting with our pilots 2 years ago, and last year, we negotiated all new labor agreements with our labor unions and all of our employees. Not below competitive levels, but at precisely competitive levels. We were not asking them to give us a concessionary agreement. We wanted competitive levels. We now have those.

But in order to take advantage of them, we have got to substantially increase the size of our company. Because our unit costs are still the highest in the industry. It is because on average we fly a small airplane on a short stage length and we have to get substantially bigger. We need big airplanes flying international missions, transcon missions and that will average down our unit cost.

Now, the question is can we do it? Do we have the time to do it?

Senator KERRY. So the principal component of your current structural difficulty is the labor contracts that are the hangover from the regulated era?

Mr. WOLF. No, no. Because we have now concluded competitive labor agreements with all of our employees. Our remaining principal difficulty is that we are a mature cost carrier and the only one left that does not have a large operational base. United has mature costs. American has; Northwest, Delta have. But they are airlines that are substantially larger than us and they spread their cost over a much bigger base and then average them down.

Senator KERRY. Now, the theory is then that with this merger by virtue of the economies of scale, you are going to produce that cost.

Mr. WOLF. Yes.

Senator KERRY. But United is essentially going to assume the larger—I mean, they are going to be subsuming that maturity premium into their current profit which reduces your margin I assume, unless you raise prices.

Mr. GOODWIN. Senator, if I may, our labor cost structure today is quite comparable to the labor cost structure of US Airways. The ability to leverage their cost structure into our cost structure comes in the form of a lot of other things besides labor costs, facility utilization, maintenance facilities, parts opportunities, which in our industry add up to a significant amount of dollars.

Because of the quantity of fuel we buy, we buy fuel cheaper. Our underwritten liability insurance is lower because of our claims records. So his cost structure gets leveraged over a much larger global base. It is not going to show up as a labor cost savings per se.

Senator KERRY. No, I did not insinuate it would show up as a labor cost savings. But what I am saying is that if he is complaining of costs that make it difficult for him to compete and you are assuming those costs, you are going to have additional costs above and beyond what you have today. It is just that you are going to spread them around in a bigger network and hopefully have some economies that come through that, correct? And the benefits of having your larger route connectedness and so forth. And so big is better.

Mr. GOODWIN. In terms of absorbing the US Airways transaction, we are going to be able to spread his cost over a larger network. And too, by providing additional service and connectivity to his customer base, we are going to bring additional customers to the party as well. And at the end of the day, we believe our company will be as well off, but hopefully better off.

Senator KERRY. And you are going to do that for 2 years without raising fares?

Mr. GOODWIN. We have committed as part of this transaction that during 2 years following the completion of the transaction, we will not increase structured fares. That is correct.

Senator KERRY. Structured fares. There is a big difference between saying we will not increase structured fares and we will not increase fares. You could wipe out all the discount fares and leave people at the high level and not have increased fares under that statement.

Mr. GOODWIN. I do not believe we could do that, sir. First of all, structured fares include some discount fares. Structured fares are not only the standard first class coach fare structure, but they are also 14-day, 21-day advance purchase some markets, 7-day advance purchase markets, that consumers buy.

Senator KERRY. The vast majority of your fares are outside that. They are in the discount, are they not? I mean, you talked about 8,000 changes yesterday. None of those are structured. Those are discounts.

Mr. WOLF. We had 8,000 yesterday. The industry had 68,000 yesterday.

Senator KERRY. Those are not structured fares.

Mr. WOLF. I would suspect some of them are. As a result of Southwest announcing they are going to Buffalo, I would anticipate that had an effect on structured fares.

Senator KERRY. What I am saying is the vast majority are not.

Mr. WOLF. I do not know the answer.

Senator KERRY. Let us face it. The greater flexibility here is that you are going to have this huge arena up there that you have more opportunity not to change.

Mr. GOODWIN. The base fare structure is used also to price off for all the sales that go on in this industry. So if there were 8,000 sale fares out there yesterday, they were all based off of that 21-day fare.

Senator KERRY. Well, let me get to the heart of this. Obviously, Mr. Leonard has been a little bit left out of the discussion. I thought he made some very important and provocative comments which are also contained in your letter, Steve. I think it is important to explain that.

The heart of your letter is this assertion that in the domestic arena, the threat to unobstructed competition continues to grow. And you talk about a predatory practice by United's quick expansion effectively trying to target you.

Now, if all of a sudden, you have got 6,400 plus routes and AirTran and Southwest and all these others are struggling to get in the market and Delta—just take Delta and American, the closest competitor is going to be around 3,000 at that point, 2,700 routes.

I mean, that is a fairly dominant imbalance is it not? And I just want to put that into context. I am just trying to work through this. I do not have a conclusion. I just want to work through it. Mr. Leonard mentioned predatory practices, dominant problems already existent for people to be able to get in and compete. And in fairness, most of the entrants you talked about—JetBlue, Southwest, et cetera—are not competing in the major terminals. Do you want to comment on that, Mr. Leonard? And then you guys respond.

Mr. LEONARD. We have an example, literally as we speak, we had planned on going from Atlanta to Minneapolis. Very large market. Very, very high prices in that marketplace. We were going to add four trips, a fifth one later on. Northwest got wind of that fact. And 2 days, 3 days before we announced or were intending to announce that service, they added 40 percent capacity that took our route from about a half a million, to three quarters of a million dollar profit, to a $3.5 to $4 million loss.

Now, for Northwest, that is nothing. That is a very, very small rounding error at the end of their profitability. For us, it is an enormous amount and has a significant impact on our ability.

So as a result, we announced that instead of the fact that we were coming to Minneapolis, that we were not coming to Minneapolis. We subsequently reviewed that and added service through Midway which we think is a safer way for us to go. But we have run into that at Richmond against Delta and Mobile. We have documented six cases with the DOT of Delta's behavior. We announce we are going into a market. They add 28, 30, 35 percent capacity.

Senator KERRY. Why does that not qualify just as good old-fashioned American competition?

Mr. LEONARD. I think it goes to intent. We certainly expect people to match our fares. And we expect people to compete with us. But they do not compete. If they competed that way with each other, you would say it is good old-fashioned competition. They do not compete that way when Northwest moves into United's routes or American moves into Delta's route. But when a low cost carrier comes in and they do it because they know they have the market clout to take us out of the market and they view it as an investment to eliminate the competition. They are not looking to compete fairly. They are looking to eliminate it.

Senator KERRY. Steve, that was essentially your argument when you were fending only for the competitive interests of US Air, not the merged interest. How do you respond to the notion that in several markets where you have this kind of competition from Southwest, AirTran, JetBlue, et cetera, you have got a 40–60 percent reduction in the air fares in that particular market.

Mr. WOLF. A two point question. First, I want to clarify a quote in my letter. What I said in the letter was that United's significant expansion at Dulles Airport to feed its transcontinental and international flights, and these are routes that we fly out of National or to a smaller degree out of Dulles, was categorically not in US Airways' best interest. I mean simply stated: we got more competition. We did not want that at all. We did not want more competition.

It is, however, absolutely logical for United to do that, and, two, it certainly is in the best interest of the consumer. It was not in little old US Airways' best interest.

Let me go to the second point. There is no question what Southwest has done and continues to do, and carriers like AirTran and other low cost carriers do, as a result of their low startup costs.

Southwest provides point to point service. Only four airlines now carry more passengers. It is a very low cost carrier and it sells one thing. It sells price. I mean, it certainly has a safety orientation and it does a very good job. But it takes those low costs and turns them into low fares. That is what they do.

The rest of us do all sorts of other things if you will. And quite frankly, we are saddled with costs that go back some number of multiple decades which we are never going to shake. But we can put into place network patterns of service that are also very much in the consumer's best interest, carriers like AirTran and JetBlue and Southwest and National and others are going to continue to come and will continue to police the big guys. They will simply do it because the consumer does want low fares. And no one will allow themselves to pay more. Kodak will not allow its controller to pay more than its travel budget. And the consumer does not want to pay more either.

It is a nice mix. A big carrier with the big networks can serve the entire globe. And the low cost carrier is pushing them all the time in terms of price. I mean, it is a very nice mix. I think it works.

Mr. GOODWIN. Senator, just one other comment on Southwest. I think there are two points I would like to make that have not already been made. Number one, Southwest has built a network today that gives them access to 90 percent of the United States population base as a point-to-point carrier which is how they have started their business and have grown their business.

They now realize that in order to continue to sustain the service they are creating and to reach into new communities that did not have the mass, they are now becoming a connecting airline. And in fact, they have 13 connecting complexes on their airline today. Now they do not call them hubs. They call them focus cities. But 31 percent of their traffic today is now connecting online on Southwest which is a new phenomenon for them.

The other thing they do is Southwest has chosen to avoid the bigger airports, not necessarily because they do not want to be there. It gives them better operational reliability which they need in their low cost, high frequency turn around business. They cannot afford to have an airplane sit on a taxiway for 40 minutes to get in the air, when they have 20 minute turn arounds.

Mr. LEONARD. May I comment on that? Southwest reported yesterday that they cannot go to Minneapolis because they cannot get gates. That was in the newspaper yesterday. Southwest took 27 years to build. And it was highly protected in its early days at Love Field to give it a starting point. We could not start AirTran today. It would be virtually impossible for us to start AirTran today. Because we ended up with 22 gates in Atlanta as a result of Eastern's demise. Had we not had that gate position in Atlanta, and we were trying to start today in Atlanta. I can assure you there would not be one gate available for us. Or if there was one gate, it would only be one. You could not build a 22-level complex like we have today.

I was told yesterday that the carriers had just gotten slots at Chicago O'Hare. New entrants that are going into Chicago O'Hare. They got the slots as a result of AIR 21. But they cannot get any gates. The only gates they can get are at the international terminal where they have to pay 17 dollars a passenger.

So the barriers to entry are significant for new carriers. And it is gates, slots, predatory behavior.

Senator KERRY. Well, that is a difficult balance for us. Obviously I need to end up here. But the infrastructure is way behind. We all know that. But we have to be careful not to penalize some of these larger issues as we take the time to build out in the way that most airports, most states, most capital cities and others are now investing seriously to do. And that was the purpose of the move we made with Air 21. So I think we have to balance that. I do not want to abuse my time.

Yes, Mr. Goodwin? You wanted to respond.

Mr. GOODWIN. Senator Kerry, just to follow up on one of your opening comments about what will happen consolidation wise and that you find it difficult that I cannot state for a fact that American or Delta or Northwest will do something.

I also read the papers. I know they are talking to each other. At least, that is what I read. But I do not know whether there is a transaction that can be put together that does what this transaction does. This transaction puts together two networks that are highly complementary. It protects labor. It has got a lot of common benefits that most other combinations do not have.

And while there may be a lot of discussion going on and a lot of gnashing of the teeth, at the end of the day, I do not know whether they will be able to bring a product to the table that provides the consumer benefits that we have identified in this transaction.

Senator KERRY. Well, that is an interesting observation obviously. That is part of what has piqued our curiosity as we met with you. And I have sort of been agnostic about it and trying to understand it better. I mean, it is hard to imagine that they are not going to be able to find a way to be able to do that, one or the other.

Senator ROCKEFELLER. Senator Wyden.

Senator WYDEN. Thank you. I thank my colleague. Mr. Wolf, on April 11th—and you are not going to be able to see the headline. But the Washington Post ran a story that said airline service dips in three of four categories. And they go on in this article to single out one airline in this country for poor service and deteriorating service, and that is your airline.

The article states—and I want to quote here—that with respect to Arlington-based US Airways, and I quote, your airline "showed poor performance in all service categories," every single one. And your spokesman, and I will quote here again, was Richard Weintraub. And he said: "We've acknowledged the issues. The numbers speak for themselves."

So this was the article on April 11th. And I listened very carefully to your statement this morning where you said there were not any real problems with service. In fact, you said essentially your service is terrific, that you move enormous numbers of people constantly. I think I would like to begin by asking you what happened between April 11th, when your airline was singled out for deteriorating service, acknowledged by your spokesman in that article in the Washington Post, and this day just several months later where you say the service is so good.

Mr. WOLF. Clearly, an insightful observation which needs a distinct answer. I believe we are in the service business. We do not have a hard product. We do not have a television set or a refrigerator or a widget. We are in the service business. It has been my long held view that if you lose a passenger's bag, he or she only remembers it for the balance of his or her natural life and tells everybody about it in the world. It is the last thing you want to do.

In 1997 and 1998, having joined the company in the early part of 1996, we talked to all of our employees about what we wanted to do going forward. We had a five point business plan. The business plan lead to actions we were going to take to become the carrier of choice.

And in 1998 and in 1999—excuse me, in 1997 and 1998, we compared ourselves monthly to the big four: United, American, Delta and Northwest. And for the entire years of 1997 and 1998, our composite ranking was No. 1.

In 1999, we had two significant external events. One, we cut over to an entirely new information technology system. It was the largest 1-day cutover in the history of the world. We could not do it piecemeal. It is like going from the left lane to the right lane in the U.K. You cannot do half the cars today and half of them tomorrow.

As much as we put months and months into planning it, it was disruptive. And it was disruptive for some period of time. It effected our departure dependability and other key measurements.

And, two, in 1999, we negotiated ten labor agreements which were significant. And the sum of those two things had a fairly significant impact on our service for calendar year 1999, which, in our eyes, was abysmal. Not the worst in the industry, but abysmal.

We are back on track this year. In March of this year, we had the best arrival dependability performance in the history of the company. And our quality this year is back to where it was in 1997 and 1998. But the article is correct. 1999 was most unsatisfactory.

Senator WYDEN. But, excuse me, sir. In April, your spokesman is acknowledging that you had problems. You just said you corrected it in March.

Mr. WOLF. Oh, no, no. I think he is talking about the period of time in which the technology migration took place. We had significant problems. We had tremendous problems. And we got through it.

Senator WYDEN. Well, again, I am mystified by so much of what you all in this industry say. And I think this is why passengers are gnashing their teeth at airports across the country. I mean, here I pointed out in April that you are singled out for deteriorating service.

You have given me this explanation about how somehow between April and June, everything seemed to get better. This question about structured fares that Senator Kerry asked, I can tell you passengers are not going to be able to make any sense out of that answer at all. And as you know, there is enormous anger on this fare question.

And I can tell you when the Inspector General puts out his report in a couple of weeks, we are going to see that this industry once again is not being straight with the public on the question of making available the lowest information fare at a time that they have the information.

So I think you heard me say at the beginning I am going to do everything I can to keep Congress from voicing approval for this particular merger until we have looked at all of the implications of this for airline service, and heard about copycat mergers which my colleagues have talked about.

I have just a couple of other questions, again reflecting my interest in trying to turn this customer service matter around. Let me begin on this, Mr. Wolf, by saying that if the industry does consolidate further, what does that do to the incentives to put real resources into improving customer service? I mean, with fewer competitors and less competition, where is the pressure to improve service in order to retain customers? You have got them.

Mr. WOLF. Senator, I think the industry has a history of making huge capital investments on an annualized basis. I mean, little US Airways is going to take 58 new aircraft this year. The sticker price on these things are $48 million to $110 million apiece. We pay less than that because we buy in quantity.

We are adding gates in Boston. We are adding gates in Philadelphia. We are doing all the things that we can do to make the shoebox a little tiny bit bigger. Are we doing an adequate job comprehensively? We are doing an absolutely terrible job. During our natural life, the United States of America has built one new airport. And in doing that, it took one out of service simultaneously.

We add a few runways now and then. A little taxiway improvement. And we put some money into ATC. Does any of us think that the air traffic control system is what it should be? And I am not throwing any rocks at them. I am not sure they are even adequately funded.

We were talking a minute ago about some additional gates. I mean, we have to make a massive expenditure in infrastructure to accommodate the traveling public who is going to be knocking on

700 million trips taken by Americans this year. You have the same box that it was 10 years ago.

Senator WYDEN. But if you will excuse me, that is saying it is somebody else's problem. Senator Rockefeller in my view has done extraordinary work in terms of trying to get the funds to improve air traffic control. He has been out on the Senate floor again and again.

My concern is that you all in the private sector are not doing your share and are not following through, particularly in areas like these customer service commitments. We are going to see that when the Inspector General comes in with his reports. I will wait for that.

And I will wrap up by asking you to outline what exactly are the customer service commitments that you all are making as part of this merger? As far as I can tell, we have got something on the table involving fares. However, it is going to take me a while to decipher what your analysis of structured fares mean.

But tell me, if you would, what customer service commitments are being made on this merger specifically.

Mr. WOLF. We are making, in the personage of United, the surviving carrier, we are making two large commitments. One is not to raise structured fares for a 2-year period of time. And by the way, if they do that, it means the industry cannot raise structured fares for a 2-year period of time also. Because no one is going to give us an advantage of a lower fare.

The complexity comes into being, well, what do you do about the sales fares, of which there are thousands of them on a daily basis? Well, logically I think it says they are going to continue because we want to fill our seats. And even though we run stronger load factors today than we have in the past, 25 percent of the seats are empty on average every single day. And we want to put somebody in those seats. So we are going to have sales that go on into the indefinite future.

In terms of service, which is your question, we are going to be left with United's service levels, their established corporate levels as to how many seconds you answer telephone reservations, as to whether or not the aircraft did push back within 5 minutes or not, how many bags are delayed per 100,000 passengers on an annualized basis. How many consumer complaints do you get? We will continue to report those things to the Department of Transportation.

It is going to be, in many ways, the consumers from the small cities that we serve who benefit the most. Rather than connecting their bags onto another airline with two different employee groups involved in the transfer, the bags will remain on one airline.

Senator WYDEN. I am pretty sure the Inspector General is going to find that delays are increasing and that we have got a serious problem with delays. Are you all making any commitment with respect to delays?

Mr. WOLF. If you look at this week, Senator, I mean, our cancellation rate over the past 4 or 5 days has been horrendous for air traffic control delays. Our delays are absolutely outrageous, which is true of the industry. But it is our responsibility to get the airplane out on time. I am not saying it is anybody else's. The biggest thing we could do to correct delays——

Senator WYDEN. So what are you committing, as part of this merger, to do about it? I mean, I thank you for your candor and I appreciate it.

Mr. WOLF. Thank you.

Senator WYDEN. But I would like to know what is being done to turn this around. I mean, I sat in this Committee about a year ago and I got my head handed to me. We had a vote on the passenger bill of rights. It was 19-to-1. And I had all these colleagues that I respect tremendously say that we ought to have some more time. And I got shellacked. I respect all their wisdom and their seniority. But I would like to know what exactly is going to be different. You are acknowledging there is a problem and I appreciate it. But what I am looking for is to actually see something that commits you to doing something about the problems of delays. I think the Inspector General is going to come in again to illustrate the problem of overbooking. He is going to say that people are not being told and we are now finding a new legal distinction between what constitutes something that is overbooked and what is oversold. I am trying to figure out what that means as well. And people still are having trouble figuring out what the lowest fare is. And I do not get the feeling they would be able to understand what was told Senator Kerry about structured fares.

So I am going to let my friend Senator Cleland get his questions. But I wanted to give you one last chance to tell me on any of these areas like delays, like the overbooking, are you all making any commitments to deal with what you have even acknowledged this morning is a serious problem. Either of you gentlemen.

Mr. GOODWIN. Senator, there are probably no two people, maybe the three of us for sure, that are in the airline industry today that are frustrated by the delays that this industry is now experiencing and putting their customers through. And since deregulation, we have had 125 percent increase in consumers using the domestic air transportation system, 125 percent. As Chairman Wolf just said a minute ago, there has been one new airport constructed in this country.

Second, there are 70 percent more departures in the air today than there were 20 years ago, 70 percent. I do not know specifically how many air traffic controllers there are in towers today, but I would suspect that it is nowhere near 70 percent more than there was back in 1980. And I suspect it might even be less in that timeframe.

We are trying in the service business to provide more service in more crowded terminals and more crowded airplanes with an infrastructure that we have neglected for a long time. This Congress, this Committee, the House Transportation Committee worked hard to get AIR 21 passed. And for that, this industry is extremely grateful. Those funds are vital for us to begin the process of putting in place an infrastructure that we can even hope to improve our lot in life.

In the interim, what we are faced with is reducing service in order to avoid delays which today is being forced upon us by the system itself. United Airlines has had a thousand flights canceled this year over and above what was canceled last year in the first 5 months as a result of air traffic delays and weather—1,000 more. In the first 5 months, we have canceled almost three full days of productive product in the marketplace as a result of air traffic and weather. That is a significant impact.

The other thing we as an industry have to do is we need to build more gates. Chairman Leonard mentioned the problem in Minneapolis. That problem exists all over the country. But when we tried to build more gates, we are continually faced with the challenges of getting local communities and local governmental agencies to support those initiatives. People do not necessarily want more gates at airports. They view more gates at airports as more flights, more flights meaning more traffic congestion on the highway, more noise in the sky. But it also brings more competition and better service.

So there are a lot of things we want to do to help. But we are all going to have to work together in order to really truly improve the level of service that our customers deserve in this business.

Senator WYDEN. I am going to wrap up. I would only say that I do not question for a minute how important it is to deal with these infrastructure issues. And that is why I single out Senator Rockefeller who has been out there on air traffic control and asking questions.

But I will tell you and you still have not dealt with it today. It is why you fought the passenger bill of rights is that your industry will not commit in an enforceable way to give the consumer objective, straightforward information that you have in your possession and it would simplify their lives and improve their travel choices.

We are not calling for a constitutional right to a fluffy pillow here. We are saying that folks ought to get good objective information. And I hope after the Inspector General gives us this new report your industry will commit to doing your share on this customer service question. And that is to support an enforceable set of protections for the passengers on customer service. And I thank you, Senator.

Senator ROCKEFELLER. Thank you.

Senator Cleland.

STATEMENT OF HON. MAX CLELAND, U.S. SENATOR FROM GEORGIA

Senator CLELAND. I am lobbying for the fluffy pillow. I do not know about anybody else. But let me just thank you gentlemen for coming down and being here. Mr. Goodwin, I appreciate your statement. Just for the record, the solution in terms of infrastructure improvements is to build gates, not Bill Gates.

Mr. GOODWIN. Thank you for correcting the record, Senator.

Senator CLELAND. Thank you all for coming.

Mr. Leonard.

Mr. LEONARD. Yes, sir.

Senator CLELAND. AirTran has had a very positive impact on air traffic for the consumers in Georgia and Atlanta and the Southeast. I understand you have saved some several hundred million dollars for consumers there and lower air fares in Atlanta.

Mr. LEONARD. Yes, sir.

Senator CLELAND. Would you like to tell us a little bit about that story?

Mr. LEONARD. Well, we run a 22 gate complex in Atlanta. We are running about 140 flights a day. We think we will get that up to about 200. But if you take a look at the markets that we go into, fares typically drop 40 to 60 percent. The load increases by 50 percent. So we take people out of cars and off trains and buses and actually provide affordable transportation to people who otherwise would not be able to do it. The net effect of that is about $700 million in savings to the consumer in the Atlanta marketplace.

Senator CLELAND. That is a powerful impact. Now, tell me a little bit about your belief about the proposed merger of United and US Airways. How would that affect price competition in your opinion?

Mr. LEONARD. We believe that the United and US Air merger, the impact will not be significant. We believe there will be slight increase in pricing. But it will not be significant because the top six airlines behave like the top three today and they do not compete on pricing in any event. We believe that if we were able to provide a network system at Washington National, we could bring $600 million of savings to the consumer in that marketplace as well in the first year.

Senator CLELAND. And you have testified that the slots being given to DC Air under this merger should instead be given to other carriers and that such a relocation of the slots would have actually far more impact on passengers and fares than the merger itself. Favorably if other carriers were allowed into D.C. National, is that correct?

Mr. LEONARD. Yes, sir. We would respectfully disagree with DC Air's cost estimates. When we look at a carrier like ComAir, who is the largest regional jet carrier, I believe, in the country, if not the largest, one of the largest, their costs, unit costs, are considerably higher than ours. And they have a huge network.

So—I cannot explain how somebody would be operating a small number of jets could have cost advantages better than ComAir's. And even if they had costs equal to ComAir's, they would certainly be nowhere close to ours.

We have done an analysis on a 500 mile flight of the $75 fare, which is about our average fare. A regional jet would lose about $164 a flight. And we would make about $548 a flight. And that is all wrapped around the size of the airplane and the cost of operating smaller airplanes versus larger ones.

Senator CLELAND. And you have estimated you can save consumers an additional $600 million with a network at Reagan National. Is that correct?

Mr. LEONARD. That is correct.

Senator CLELAND. Is that because you are using the smaller—what is it? Boeing 717?

Mr. LEONARD. Boeing 717 which is the cleanest airplane in the sky today and also the quietest airplane in the sky today.

Senator CLELAND. Of course, noise is a big concern at National, and in any neighborhood in America. But you feel that your flying the 717 into National could not only save money, but deal with the noise problem there?

Mr. LEONARD. Absolutely. As I said, today it meets all the noise requirements. It is really the quietest airplane on both takeoff and landing certified today, much, much quieter than a CRJ.

Senator CLELAND. Thank you, very much for those observations. And I thank you very much for your service to Georgia and other parts of the country. Thank you, Mr. Chairman.

Mr. LEONARD. Thank you, Senator.

Senator ROCKEFELLER. I wish to thank all of our panelists for their patience and courtesy. And this hearing is adjourned.

[Whereupon, at 12:35 p.m. the hearing was adjourned.]

UNITED AIRLINES/US AIRWAYS MERGER

THURSDAY, JUNE 22, 2000

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

The Committee met, pursuant to notice, at 9:45 a.m. in room SR–253, Russell Senate Office Building, Hon. John McCain, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. Good morning. We reconvene today for round 2 of the Commerce Committee hearing on the proposed merger of United Airlines and US Airways. With the merger pending, the Department of Transportation General Counsel, Nancy McFadden, is restricted in her ability to comment specifically on the merger. We look forward, however, to her description of the transportation review process and the extent of the Department's role in preserving competition in the United States airline industry.

For the same reasons, Justice Department officials are unable to comment specifically on the merger. Albert Foer, president of the American Antitrust Institute, has graciously agreed to outline some of the key issues that the Antitrust Division should focus on in its review of the proposed merger.

Do any of the Members wish to make any comments before we proceed?

[No response.]

The CHAIRMAN. Thank you. Ms. McFadden, we will begin with you. Thank you for being here.

STATEMENT OF HON. NANCY E. MCFADDEN, GENERAL COUNSEL, DEPARTMENT OF TRANSPORTATION

Ms. MCFADDEN. Thank you, Mr. Chairman, and distinguished members of the Committee. I appreciate the opportunity to come before the Committee this morning to discuss the state of airline competition and to describe the Department of Transportation's role in reviewing airline mergers and acquisitions. I have submitted a written statement and ask that it be made a part of the record, Mr. Chairman, and I will briefly summarize that testimony for you this morning.

At the outset, let me assure you that the proposed United Airlines/US Airways transaction, indeed, any major transaction will be thoroughly examined by the Department of Transportation with the goal of preserving competition in the airline industry.

As the Chairman noted, and I thank you for that, we cannot, of course, discuss the specifics of the proposed transaction, but we understand the Committee's great interest in this matter and so let me briefly touch on the matter before you.

The structure of the airline business today reflects Congress' decision to deregulate the industry in 1978. As was discussed a lot yesterday, airlines have literally reshaped their point-to-point route systems into hub-and-spoke systems. Operating at a hub creates efficiency advantages for the carrier and service advantages for many travelers, but it also creates competitive disadvantages for nonhubbing airlines.

The resulting lack of competition in many hub routes usually causes fares in hub markets to be higher than fares in comparable nonhub markets and, as you noted yesterday, Mr. Chairman, for this reason it is the Department of Transportation's view that low fare airlines are the best hope for competition at the major airlines' hubs.

My written testimony describes a number of other developments since deregulation which have reshaped the industry: the wave of airline mergers in the 1980s, increasing globalization, and the development of international alliances, and the more recent phenomenon of domestic alliances.

In addition, in the 1990s we saw increased focus on the value of new airline entrants, especially in dominated hub markets, and the difficulties faced by those new entering carriers. Congress has addressed this issue most recently in several procompetition provision in AIR 21 and, as you know, the Department of Transportation has taken a number of other steps to promote competition and protect against anticompetitive practices.

Now, I paint this backdrop to give a sense of the state of airline competition, but also to make two points. First, we have learned a lot about the airline industry over the past 15 to 20 years. We simply have a greater understanding today than we did 15 years ago about how airlines act and react in a deregulated environment.

The second point I would like to make is the Justice Department and the Department of Transportation, particularly over the last 7 or so years, have shown the ability and will to work to preserve airline competition, often working hand-in-hand with Congress. We will bring to bear, as we closely scrutinize the proposed merger, the experience and expertise and hard lessons that we have learned over the past 15 to 20 years, as well as the will to act to preserve competition.

Let me turn briefly to the role that the Department of Transportation plays in the review of mergers and acquisitions. As has been noted, the Justice Department is, of course, responsible for enforcing the antitrust laws and determining whether to challenge any merger under those laws. The Department of Transportation will conduct its own analysis of the merger and submit its views to the Justice Department, as we have done in past cases. This process is confidential. In addition, the Department has separate regulatory authority and must grant its approval before some parts of the transaction may go forward.

First, as was discussed yesterday, the parties have announced plans to spin off most of US Airways operations at Washington

Reagan National Airport to a new airline. This new airline must obtain economic operating authority from the Department of Transportation as well as safety authority from the FAA.

In determining whether to grant economic operating authority, we must determine whether the firm is fit, willing, and able to perform air transportation and comply with applicable legal requirements. In determining fitness, we review an airline's financial resources, managerial capabilities, and compliance disposition. The FAA, under its safety authority, conducts a separate comprehensive safety fitness analysis of the new carrier.

Now, second, the proposed acquisition will also involve the transfer of US Airways international route authority in some limited entry markets. Here, too, the Department must first approve the transfer. We may approve a transfer only if we find that it is consistent with the public interest.

And third, the Department has the obligation to protect consumers from unfair and deceptive practices by airlines. In carrying out that responsibility, we will review the merger's arrangements to ensure that the rights of consumers are protected. For example, the merger may well affect the existing reciprocity benefits available to members of United and US Airways frequent flier programs. We will look at whether the airlines will give consumers reasonable notice and an opportunity to adjust to any changes in such programs.

Finally, let me briefly outline the factors we consider in our competitive analysis of our proposed airline merger. We look at the merger's likely impact on competition in all relevant markets. We will examine whether the acquisition will substantially reduce competition in relevant markets, and a key question will be whether the proposed spin-off of US Airways operations at Reagan National to DC Air will create an effective competitor in the Washington, D.C. markets affected by the merger.

We will additionally investigate whether the relatively large size of the airline created by combining United and US Airways will make entry into the industry by new airlines more difficult, and we will also examine the potential competitive reactions of other airlines.

In conclusion, let me reaffirm our commitment to continuing our efforts to ensure that consumers throughout the United States benefit from airline deregulation, not suffer from it. The need to ensure competition will guide our review of the United/US Airways transaction.

Thank you, Mr. Chairman. That completes my statement. I of course would be happy to answer any questions you or the members might have.

[The prepared statement of Ms. McFadden follows:]

PREPARED STATEMENT OF HON. NANCY E. MCFADDEN, GENERAL COUNSEL, DEPARTMENT OF TRANSPORTATION

Mr. Chairman, Ranking Member Hollings, and Members of the Committee:

I appreciate the opportunity to come before the Committee to discuss the state of airline competition and to describe the Department of Transportation's role in reviewing airline mergers and acquisitions. The hearing today is precipitated by the announcement by United Airlines and US Airways of a major merger proposal.

On behalf of Secretary Slater, I want to assure the Committee that we will maintain our commitment to preserving airline competition in order to ensure that consumers through the United States continue to benefit from airline deregulation, and that this proposed transaction, indeed any major transaction, will be thoroughly examined by the Department of Transportation with the goal of preserving competition in the airline industry.

We cannot, of course, discuss the specifics of any individual transaction. However, we understand the Committee's great interest in this matter, and so I would like to describe generally how the Department examines any such transaction.

My testimony today will cover three subjects: some background to the current state of competition in the airline industry, the Department's role in reviewing airline mergers and acquisitions, and the factors that we will look at in analyzing a merger or acquisition.

The structure of the airline business today reflects Congress' decision to deregulate the industry in 1978. Congress correctly determined that the public would obtain better service and fares if airlines had to respond to consumer demands and competition. Congress therefore phased out the economic regulatory regime that had long authorized the Civil Aeronautics Board to dictate where airlines could fly and what they could charge.

In responding to market demands and the need to improve their efficiency, airlines literally reshaped their point-to-point route systems into hub-and-spoke systems. Hub-and-spoke systems enable airlines to serve the maximum number of city-pair markets with a minimum number of airplanes and to maximize traffic flow by consolidating connecting passengers with different destinations on each flight. Operating at a hub creates service advantages for many travelers, since it gives travelers at hub cities many more flights and enables airlines to offer more service in markets that do not have enough traffic to sustain non-stop service. On the other hand, an airline operating a hub gains such great competitive advantages on the spoke routes at its hub that other airlines without a hub at one end point of such a spoke route find it hard to compete with the hubbing airline. The resulting lack of competition in many hub routes usually causes fares in hub markets to be higher than fares in comparable non-hub markets.

Another development in the first years after deregulation was new entry—quite a few firms entered the airline business (or began interstate service for the first time). Relatively few survived the 1980s, but one of those that did—Southwest Airlines—has since expanded its low-fare operating strategy throughout most of the country. Two other entrants of that era—America West and Midwest Express—are also operating successfully today.

The 1980s saw a wave of airline mergers. At that time, federal law still required all such transactions to obtain the prior approval of the Department of Transportation. The Department approved almost all of the merger proposals submitted to it before the complete phasing-in of deregulation ended the Department's approval authority over airline mergers and acquisitions. Since the end of 1988, the Department of Justice has been responsible for determining whether mergers and acquisitions in the airline business should be challenged as anticompetitive.

In the 1990s, airlines developed new strategies for delivering their services. They viewed the ability to offer a broader network of services as critical. This led to the creation of alliances in both domestic and international markets that included code-sharing arrangements and frequent flyer program reciprocity.

The development of international alliances has been part of the larger process of globalization. Responding to this increasing globalization, the Clinton-Gore Administration has worked hard to open up international markets to competition and entry by U.S. airlines. In the last seven-and-one-half years, the United States has reached open skies agreements with forty-six countries that allow any U.S. airline to serve points in those countries from any U.S. point and to set fares free of government regulation. As a result of these successful efforts, we have seen the development of global airline alliances that have promoted competition in thousands of city-pair markets throughout the world.

More recently, major U.S. airlines began forming alliances with one another. In 1998, United planned an alliance with Delta, Northwest with Continental, and

American with US Airways. These domestic alliances were different from the international alliances. The latter usually created new networks by linking route systems of U.S. and foreign airlines on an end-to-end basis and involved airlines that could not enter each other's domestic markets due to the constraints of bilateral aviation agreements. The alliances between U.S. airlines, on the other hand, involved airlines that already had the authority to enter any domestic market. These alliances were potentially more problematic.

In the face of these proposed domestic alliances, Congress enacted legislation requiring the major airlines to submit to the Department of Transportation any joint venture agreements between them that covered frequent flyer programs, code-sharing, and wet leases. The Department has used that authority to obtain modifications that eliminated potentially anticompetitive features in joint venture agreements. In addition, the Justice Department filed suit against Northwest's acquisition of the major block of Continental stock. The other two alliances—the United/Delta and American/US Airways alliances—have not gone beyond frequent flyer reciprocity arrangements and provisions for the reciprocal access to airport executive lounges.

In the 1990s, we also saw increased focus on the value of new airline entrants, especially their presence in dominated-hub markets, and the difficulties faced by those new entrant carriers. This Committee has spent much time over the past few years looking into airline competition and impediments to new entry. You have addressed this issue most recently in several pro-competition provisions in AIR 21, the FAA reauthorization act signed into law in April of this year. As you know, for example, the bill included a provision that airports dominated by one or two carriers must file a competition plan with the Department before raising passenger facility charges. And the DOT has taken a number of steps to promote competition and protect against anticompetitive practices. For example, the Department has focused on the possibility that the joint travel website being created by five major airlines might operate in a way that may reduce competition in the airline industry and the airline distribution business. The Committee has also had questions about the website and intends to hold a hearing on the subject. The Department has begun a study of the website firm, Orbitz, originally called T2, and recently asked Orbitz to provide detailed information on its organizational and operational plans and to provide copies of relevant documents.

As a result of all these developments, we have an industry that, for the most part, has proven deregulation to be a success. But deregulation can only be successful for the consumers it was meant to benefit if there is adequate competition in the airline industry. That is why close scrutiny of the proposed merger between United and US Airways is critical for the country's airline travelers.

I paint this backdrop to give a sense of the state of airline competition, but also to make two points. First, we have learned a lot about the airline industry over the past 15 years from these developments. We simply have a greater understanding of how airlines act and react in a deregulated environment. And second, the Justice Department and the Department of Transportation, particularly over the past seven-and-a-half years, have shown the ability and will to work to preserve airline competition, often working hand in hand with Congress. We will bring to bear, as we closely scrutinize any proposed merger, the experience and expertise we have honed over the past 15–20 years, as well as the will and ability to act to preserve competition.

Let me now address the role the Department of Transportation plays in the review of airline mergers and acquisitions. Both the Department of Justice and the Department of Transportation have responsibilities for reviewing the proposed transaction between United and US Airways.

The Justice Department is responsible for enforcing the antitrust laws and determining whether mergers and acquisitions in the airline industry should be challenged on competitive grounds. The statute now governing airline mergers, section 7 of the Clayton Act, prohibits mergers and acquisitions that may substantially lessen competition in any relevant market or tend to create a monopoly.

The Department of Transportation will conduct its own analysis of the merger and submit its views and any relevant information in its possession to the Justice Department, as we have done in past cases. This process is confidential. We have asked United and US Airways to provide us all the information necessary to thoroughly analyze the transaction. In doing that analysis, we will also rely on the fare and traffic data periodically reported to us by the airlines.

In addition, the Department has separate regulatory authority and must grant its approval before some parts of the transaction may go forward. First, the parties have announced plans to spin off most of US Airways' operations at Washington Reagan National Airport to a new airline. This new airline must obtain economic operating authority from the Department as well as safety authority from the FAA.

In determining whether to grant economic operating authority, we will determine whether the firm is "fit, willing, and able" to perform air transportation and comply with applicable legal requirements. In making fitness determinations, we review an airline's financial resources, managerial capabilities, and compliance disposition. The FAA, under its safety authority, conducts a separate, comprehensive safety fitness analysis of the new carrier before issuing the Air Carrier Certificate and Operations Specifications.

Second, the proposed acquisition will also involve the transfer of US Airways' international route authority in some limited-entry markets. Here too, the Department must first approve the transfer of US Airways' certificate authority, under 49 U.S.C. 41105. We may approve a transfer only if we find that it is consistent with the public interest. The Department by statute must specifically consider the transfer's impact on the viability of the parties to the transaction, on competition in the domestic airline industry, and on the trade position of the United States in the international air transportation market. The Department will also examine any other public interest issue raised by the transfer.

The Department will only decide whether to approve the transfer of the international route authority after it has established a formal record and given all interested persons the opportunity to comment on the proposed transfer. The Department's discussions with the Justice Department on the overall merger will include a discussion of the competitive effects of the transfer of US Airways' international routes. If the Department determines that the transfer would be contrary to the public interest on competitive grounds or for another reason, the Department may disapprove the transfer in whole or part. Alternatively, the Department may condition its approval on requirements that would protect the public interest.

Third, the Department additionally has the obligation to protect consumers from unfair and deceptive practices by airlines. In carrying out that responsibility, we will review the merger's arrangements to protect the rights of consumers. For example, the merger may well affect the existing reciprocity benefits available to members of the United and US Airways frequent flyer programs. We will look at whether the airlines will give consumers reasonable notice and an opportunity to adjust to any changes in such programs. If we find that the provisions in their frequent flyer agreements fail to provide adequate notice and an opportunity to obtain award travel, we will ask the airlines to modify the agreements. Accordingly, we have asked United and US Airways to provide us with their relevant frequent flyer program reciprocity agreements, and their plans for accommodating their members concerning any potential changes.

Finally, I would like to outline the factors we will consider in our competitive analysis of the proposed United/US Airways merger. We will be looking at the merger's likely impact on competition in all relevant markets. We will examine such issues as whether the acquisition will substantially reduce competition in relevant markets because other airlines either do not offer effective competition now or will be unlikely to enter if United raises fares or reduces service. A key question will be whether the proposed spin-off of US Airways' operations at Reagan National to DC Air will create an effective competitor in the Washington, D.C. markets affected by the merger.

The relevant markets include city-pair markets, both those served by the parties with nonstop flights and those served with connecting flights. In examining the markets affected by the merger, we may well consider flights operated by United from one airport in the same metropolitan area as competing with flights operated by US Airways from a different airport in the same area. If a significant number of travelers strongly prefer to use one airport, the relevant markets may also include routes between specific airports. In analyzing whether entry by other airlines into markets served by the combined airlines is likely, the Department will examine whether the combined market share of the merging airlines will become large enough at individual cities to discourage entry by other airlines. We must also consider whether airport facilities will be available to airlines wishing to enter markets served by United and US Airways.

We will additionally investigate whether the relatively large size of the airline created by combining United and US Airways will make entry into the industry by new airlines more difficult. We will also examine the potential competitive reactions of other airlines.

Looking at the merger's competitive effects will carry out Congress' judgment that market forces, not government regulators, should determine the routes flown by airlines and the fares charged by airlines. But market forces will enable consumers to obtain the best service at the best price only as long as the airline industry is competitive.

Members of Congress and local communities have understandably expressed concern about whether the service now provided by US Airways will be maintained after its acquisition by United. For example, some communities have questioned whether they will continue to have access to nonstop flights to Reagan National. We cannot directly answer these questions, since we cannot predict United's long-term plans for operating the combined business, and we have no way to guarantee that United or DC Air would maintain existing levels of service. Nor can we know whether other airlines—existing or new—might choose to inaugurate new services to these communities. Under deregulation, each airline decides for itself which routes it will fly and what fares it will charge. However, together with the Justice Department, we will seek to ensure that the proposed merger does not diminish competition and prevent other airlines from entering and competing in markets where United may reduce service or raise fares. The key question in determining whether the United/US Airways acquisition will lead to better or worse service and fares for consumers is whether the combined airline will face competition and therefore must meet the demands of consumers. The Justice Department will address that question by applying the antitrust laws. We at the Department of Transportation will provide the Justice Department with the results of our own analysis of that question.

Because of the Committee's longstanding interest in airline consumer protection issues, I would like to provide a brief status report on some of the actions the Department has already taken to implement the passenger rights provisions contained in AIR 21, the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century. For example—

- We have notified foreign carriers of their new obligations under the law to comply with the Air Carrier Access Act.
- We issued rules to implement the new smoking prohibitions that apply, for the first time, to foreign carriers flying to and from the U.S.
- We have notified all U.S. and foreign carriers of their new statutory obligations to add additional assurances for survivors and families of victims of aircraft accidents in airline family assistance plans on file with DOT and the NTSB.
- We have implemented procedures to enable us to investigate each Air Carrier Access Act complaint received by DOT.
- We will be meeting shortly with the Justice Department, National Council on Disability, and the Access Board to develop an outreach plan to provide information and technical assistance to air carriers and members of the disability community regarding Air Carrier Access Act requirements.
- An advisory Committee will soon be established to assist us in complying with the AIR 21 provision requiring the reporting of the nature and causes of flight delays.
- In the next month or two, we will begin to report complaints regarding the death, injury and loss of animals in air transportation as a separate category in our monthly Air Travel Consumer Report.
- We have already reported to Congress on the filing of voluntary customer service plans by the Air Transport Association carriers.

I would also note that, before AIR 21 was signed into law, we had doubled the minimum baggage liability limit imposed on domestic carriers and had begun to list Air Carrier Access Act complaints separately in our Air Travel Consumer Report. We will continue to treat airline consumer protection issues, in general, and the implementation of the AIR 21 mandated passenger rights provisions, in particular, with the highest priority. I must point out to the Committee, however, that without the additional funding provided by AIR 21 for consumer protection compliance and enforcement activities, the benefits to passengers of AIR 21 will largely be lost. Notably, the Senate-passed appropriations bill for the Department contains no additional funds for airline consumer protection activities, and the House-passed bill contains only an additional $300,000 for this purpose, far short of the $1.4 million requested by the Administration. We hope that this Committee will work to ensure the needed funding in the upcoming fiscal year.

In conclusion, I wish to reaffirm our commitment to ensuring that consumers throughout the United States continue to benefit from airline deregulation. That will require us to continue our efforts to promote airline competition. The need to ensure competition will both guide our review of the United/US Airways transaction and guarantee that we will carefully examine its potential impact, and it will underpin the use of our other economic regulatory authority over the airline industry.

Thank you Mr. Chairman. This completes my prepared statement, and I would be pleased to respond to your questions and those of the Committee.

The CHAIRMAN. Thank you very much, and again I want to thank you, Mr. Foer, for your patience yesterday, and I hope you understand why I did not think it would be a good idea to continue the hearing at that time.

Mr. Foer.

STATEMENT OF ALBERT A. FOER, PRESIDENT, AMERICAN ANTITRUST INSTITUTE

Mr. FOER. Thank you, Mr. Chairman. The American Antitrust Institute is an independent education, research, and advocacy organization and in my remarks I will focus on three questions: how well is airline competition working currently, what effect will this merger have on the industry and on consumers, and is there a viable remedy, short of blocking the merger?

Although at first glance the industry appears to be structured in a reasonably competitive way, one must also take into account other factors that reduce the intensity of rivalry: alliances that undermine the degree of competitive threat that an airline represents in regard to its allies, a hub-and-spoke system that results in elimination of most competition from most hubs and permits prices at such hubs to rise to high levels, high entry barriers, and other forms of collaboration, such as the T2 joint venture, that can reduce the intensity of competition.

Price discrimination, which depends on the presence of market power and also complicates the task of comparison shopping, has reached new levels of sophistication in the airline industry. So our summary view is that we have an air transportation system that contains important elements of both rivalry and collaboration in which rivals are constantly seeking ways to reduce the intensity of competition. The implication is that the United/US Airways merger must be scrutinized with great care in order to weigh the facts and reach a firm conclusion on its ramifications.

What effect will this merger have on this industry and on consumers? Perhaps the most critical issue is whether other mergers will be triggered in strategic response to the United/US Airways merger. Now, the Clayton Act requires consideration of trends to concentration. The US Airways merger should be considered not in the abstract, but in the context of what is likely to occur. Whether the decision is to stop the merger or to permit it, difficult predictions about the future of the industry have to be made.

Mr. Goodwin yesterday indicated that he could not make a prediction with absolute certainty about whether further mergers will occur. That is not the right standard. It is not absolute certainty. It is a prediction that is something less than speculation, but based on the best facts available. That prediction is going to have to be made one way or the other, because it is going to be necessary to ask the question, at what point will there be too little competition. If the line is not to be drawn here, where will it be drawn?

Whatever the decision, the public will have a right to expect a full explanation of what predictions were made and on what basis.

Is there a viable remedy short of blocking the merger? If the merger is permitted, there must be conditions that will ensure against loss of competition. The Antitrust Division should use its bargaining power to do more than assure that the recipient of divested assets is viable.

Divested assets must also be employed so that they pose the same threat to coordinated interaction and the same level of consumer choice as is now provided by US Airways. It is against this standard that United's proposal to spin off assets at Reagan National Airport must be measured and any additional terms or conditions for other overlap situations must be evaluated.

With respect to United's offer of a 2-year price freeze, we think great skepticism is appropriate, because such a freeze in the context of yield management techniques that continually change the mix of seats available at any particular price will be no more than a gimmick. Moreover, this is not a temporary merger but, like a diamond, is intended to be forever.

Determining whether this merger is legal, or how it can be made legal through various conditions that might be imposed requires the Antitrust Division to undertake a detailed evaluation of facts and to make sophisticated predictions. A thorough analysis in our opinion requires consideration of US Airways' ability to survive as a competitive airline, its role as a potential competitor, United's role as a potential competitor, and the likelihood that this merger will trigger additional mergers.

Ultimately, what is required is a vision of how concentrated we will allow the market for domestic air transportation to become. This can be established in the course of antitrust analysis, or it can become established by a specific Act of Congress, but once an industry becomes as concentrated as air transportation, it makes no sense to treat each merger on an ad hoc basis without a larger vision of where we are headed.

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

[The prepared statement of Mr. Foer follows:]

PREPARED STATEMENT OF ALBERT A. FOER, PRESIDENT, AMERICAN ANTITRUST INSTITUTE

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to present this statement on behalf of the American Antitrust Institute regarding the proposed acquisition of US Airways by United Airlines. I am Albert A. Foer, President of the American Antitrust Institute. The American Antitrust Institute is an independent non-profit education, research and advocacy organization. We are generally centrist and pro-competition in orientation and operate with the assistance of an advisory board composed of many of the leaders of the antitrust community, including academicians and practitioners in the fields of law, economics, and business.

It is always difficult for an outsider to comment on the impact of a particular merger. The Department of Justice, investigating whether the proposed acquisition of US Airways by United Airlines violates Section 7 of the Clayton Act, will have the advantage of proprietary information, strategic planning documents, commentary of industry experts, and detailed economic analysis to which we are not privy. Nevertheless, a transaction of this size, creating a single airline with over one-quarter of the national market and a dramatically larger share for many city pairs, naturally raises a variety of questions for consumers of air transportation. We will focus on three questions: How well is airline competition working currently? What effect will this merger have on competition and consumers? And is there a viable remedy short of blocking the merger?

1. How well is airline competition working currently?

The deregulation of air transportation that has occurred since 1978 has had mixed results. On the one hand, prices are relatively low for many routes and consumers are flying far more than they were in 1978. On the other hand, for city pairs where there is little, if any, competition, rates are inordinately high. Consumers often report that they do not feel very sovereign. The airlines have mastered the art of price discrimination, in an attempt to charge each customer the highest price that customer is willing to pay. Ironically, this price is called, in economics, the consumer's "reservation price." Price discrimination is only possible where there is market power and the unusually large role that price discrimination plays in air transportation reflects that the airlines do have a high degree of market power.

Where does this market power come from? On a national level, there are three dominant airlines of approximate parity (United, American, and Delta) but there are additional major players like US Airways, Northwestern, and Continental, which bring real competition to certain regions and routes. In addition, Southwestern has a significant impact as the low price maverick in those markets where it has a presence, and a modest number of small carriers also provide the consumer with a degree of choice. From this industrial structure alone, one might anticipate that the market would be performing in a reasonably competitive manner. But one must also look at several other factors, which may work to reduce the intensity of rivalry.

These include:

a) A system of alliances that may enhance the seamlessness of travel for many consumers but may also undermine the degree of competitive threat that an airline represents in regard to its allies. On the latter interpretation, we have only three truly separate major air systems.

b) A hub-and-spoke system that in conjunction with practices which are either aggressively competitive or illegally exclusionary efforts to maintain hub monopolies, depending on your perspective, eliminate most competition from most hubs and permit prices at such hubs to rise to high levels.

c) Other collaborative practices, such as the T–2 joint venture now being constructed by the major airlines for the purpose of either enhancing efficiency in the marketing of airplane seats or for destroying independent ticket agencies and electronic alternatives, again depending on your perspective.

Each of these features of the airline market has either been subjected to investigation by the Justice Department or is currently under scrutiny, as is the partial acquisition of Continental by Northwest. You can tell the story in two different ways: either we have a competitively structured air system that is continually finding new ways to enhance efficiency and better serve consumers; or we have a system that is in reality far less competitive than it appears to be.

If the former view is correct, then a merger of the 1st and the 6th airlines might not be terribly threatening to competition. If the latter view is correct, then this merger can only make a bad situation worse.

My own view is that the industry is somewhere in between, closer to the pessimistic end of the spectrum. In this case, we need to ask additional questions.

2. What effect will this merger have on the industry and on consumers?

The Clayton Act is an incipiency statute. The Congressional intent was for the law to stop mergers whose effect substantially "may" be to lessen competition. Congress did not want law enforcement to wait until the damage has already been done and it did not want a standard of absolute certainty. Congress understood that prediction is inherent in the process of merger evaluation.

The Clayton Act invites the Antitrust Division to take into account all of the likely effects of a merger. For example, if the United/US Airways deal were likely to trigger additional deals, it would be relevant to the determination of whether the United acquisition should be permitted. Recall that United, Delta, and American are currently more or less equals. News reports strongly suggest that American and Delta are already investigating mergers, both with others and with each other, in response to the dramatic expansion of United that will be accomplished if the merger is permitted. If American and Delta believe that they must maintain some rough size parity in order to maintain competitive parity, then additional mergers are reasonably likely. This presents a difficult problem for the Antitrust Division. It should not stop the United merger based on mere speculation about the future; but it should not close its eyes to reasonably strong evidence that other mergers will quickly follow. The confounding fact is, to let the merger go through represents as much a prediction as a decision to stop it.

The impact of this merger on consumers will depend on many factors. Those most immediately at risk, of course, are those dependent on airports that are currently served by both United and US Airways and who will find themselves deprived of one of what had already been a limited number of choices. Choice is what competition is all about. Price is often a workable proxy for choice, but even if it were taken off the table in this transaction through a meaningful promise not to raise prices, consumers would still be impacted in a negative way by the reduction of options. Why is it that when an airplane lands and taxies toward the terminal, the steward or stewardess so often says, "Thank you for flying with ABC Airline. We know you have a choice and we want you to choose us again next time you fly." I think this is a recognition by the airline that consumers are aware that in fact they really have few choices, but that choice is important to them. If we were to go from six major airlines to five, an important element of choice would be lost. But how often does a given consumer booking a given trip actually have six airlines to choose among? And if this merger triggers others, how much choice will be lost?

My point is that Justice cannot hide from the need to make predictions. It must collect as much information as possible that will help it to make the best predictions it can and then it must boldly make a judgment. Some of its information will not be public and cannot be made public, but the public will be owed an explanation of what prediction Justice ultimately relied upon and the reasoning by which Justice reached its judgment.

3. Is there a viable remedy short of blocking the merger?

Most mergers today are either permitted to be consummated or are conditionally approved, subject to the divestiture of overlapping assets. It is reported that United has proposed two concessions in order to take antitrust issues off the table. First, it will hold prices in place for two years. Second, it will spin off certain assets at Reagan National Airport in order to create a new regional carrier to be based there.

Before asking questions about these proposed concessions, it is necessary to put the matter in perspective. The Clayton Act is violated whenever competition may be substantially lessened in any line of commerce or in any geographic market. If there is one geographic market where the illegal effect may occur, the merger is technically illegal. Now, the agencies don't act on this severe interpretation because it would be wasteful of everyone's resources. If there were a minor overlap in one small market, and the whole merger were blocked, this would be easy to fix by selling off an offending asset and starting the merger all over again. To avoid this inefficient process, the antitrust agencies routinely negotiate with merging parties to fix the identified problem areas, without sending the parties back to square one. The agencies have substantial bargaining power, however, since they do have the right to go to court to stop a merger. They must use this power to keep the merger from the likelihood that its consummation will lessen competition. This is the standard against which United's proposals should be measured.

With respect to the two-year moratorium on price increases, the Justice Department should be skeptical. The merger, like a diamond, may be forever. If this merger makes it possible for United to raise prices in year three, as a result of increased market power, then it should be blocked and the two-year concession rejected. If there is not a likelihood of a price increase, one wonders why United raised the issue?

But in an industry where price discrimination is so sophisticated and widespread, it is also necessary to ask, what is meant by a price freeze? The mix of seats sold at different prices changes daily, sometimes hourly. To hold one seat at a low price while selling many more at a higher price, albeit no higher than the current highest price, would be a gimmick of no substantive value to consumers.

What about spinning off assets to a new airline that can fly in and out of Reagan National? The relevant questions appear to be: (a) will this new airline have enough assets to survive? (b) will the assets be sufficiently independent of United so that they can be used in direct competition against United? (c) will the assets include enough valuable routes so that the carrier can survive? (d) will the carrier have sufficiently competent and air-expert management to survive in a market place that will probably quickly come to include more competition from low-price Southwestern and from new regional jets? Or, put another way, from the viewpoint of the consumer, will this start-up realistically be able to step into US Airways' much larger shoes?

This question in itself subsumes another: what would be the fate of US Airways in the absence of this merger? Clearly, it has not always flown in calm skies and there has been speculation about its future. Justice will again have to make a prediction and the public will again be entitled to an explanation of the prediction. If US Airways in effect has no future, antitrust policy will have less reason to seek the continuity of its franchise. This is not to suggest the presence of a "failing company" defense, which is well-recognized in the antitrust law but is apparently not being claimed here. It is, rather, to say that the evaluation of a remedy must take into account the role that US Airways would likely have played, against which can be compared the de facto substitute player or players expected to replace US Airways.

Indeed, if there is good reason to believe that US Airways could have remained independent and healthy, one can ask whether US Airways might have been one of a small number of potential competitors that could enter the concentrated markets of other large carriers. It may have an impact on competition as a potential competitor, and if so, it is doubtful that a smaller newcomer will be able to play a similar role for many years. Conversely, United claims that it needs to expand into the northeast so that it can better serve consumers. This may establish United as an important potential entrant whose ability to enter from outside, without a merger, plays a role that should not be easily dismissed.

There is a final question we would pose: if the merger is to be allowed to go through, what are the best means for assuring that divestitures result in no loss of competition? Is it by allowing United to spin off selected assets to a hand-chosen competitor? Is it by auction of slots? And of course this question must be asked with regard to each route in which there the merger will raise concentration to unhealthy levels.

Conclusion

Determining whether this merger is legal or how it can be made legal through various conditions that might be imposed, requires the Justice Department to undertake a detailed evaluation of facts and to make sophisticated predictions. A thorough analysis, in our opinion, requires consideration of US Airways' ability to survive as a competitive airline, its role as a potential competitor, United's role as a potential competitor, and the likelihood that this merger will trigger additional mergers. Ultimately, what is required is a vision of how concentrated we will allow the market for domestic air transportation to become. This can be established in the course of antitrust analysis or it can become established by specific act of Congress. But once an industry becomes as concentrated as air transportation, it makes no sense to treat each merger on an ad hoc basis without a larger vision of where we are headed.

The CHAIRMAN. Thank you very much.

Mr. Foer, first of all, in your written testimony you talked more at length about this business of holding fares down for 2 years, and I agree with you, and I hope Ms. McFadden would agree, too, that sophistication and the complexities of the fare system today make it nearly impossible to know whether fares were held down over a 2-year period or not, and I do not mean to indict the would-be mergerers, but it is just such an incredibly complex system.

Ms. McFadden, I was a bit puzzled yesterday when Mr. Johnson testified that by acquiring regional jets to operate on the routes that he contemplates operating on and replacing other aircraft with the 717 that he would be able to lower prices when in fact the cost of operating the newer jet aircraft in a reasonable fashion are more expensive. I do not understand that computation. Do you have any view on that?

Ms. MCFADDEN. I am not sure I do, Mr. Chairman. I know that at least initially we did hear that the business plan for DC Air was to be a low fare competitor, but yesterday I think the answer was less clear to your questions about how, in fact, that was going to be done, but I cannot give you any specific answer in terms of the business plan, or how they can manage the economics of that.

The CHAIRMAN. I guess my point is, if you are going to have a low fare airline, and you acquire equipment that is more expensive to operate per passenger mile, it is hard to see how you are going to do that successfully over time.

I hope that both of you would have a chance to read Mr. Kahn's letter to me. I think it is a very important statement, just because he is viewed, appropriately, I think, as the, quote, father of airline deregulation, and I will not go through his entire letter, but he does make two, I think, important points, or he makes a lot of important points, but two of them are very important.

He talks about the likelihood that the merger would result in suppression of potential competition, and I quote, " would seem to be enhanced by what I take it would be United's explanation and justification, namely its need for a strong hub in the Northeast, but if United really does feel a need for a big hub in the Northeast, this suggests that it is, indeed, an important potential competitor for US Airways, and that denied the ability to acquire the hub in the easiest noncompetitive fashion, by acquisition, it might instead feel impelled to construct a hub of its own in direct competition with US Air."

The other point that he makes that I think is important that should be taken into account is that upon acquisition, the first claim on traffic feed does increase the pressure on other carriers. In other words both of you alluded to what is the ripple effect here. Does this mean we are now going to experience several other mergers within the airline industry, and we now get down to quote, big three airlines?

I would like to have your comments on both of those, and any other comments on Mr. Kahn's letter that you might have.

Ms. McFadden.

Ms. MCFADDEN. Well, I think, as you know, we have talked about Dr. Kahn in a number of contexts when we dealt with airline competition. We have great respect for him at the Department of Transportation, and the kinds of questions and concerns that he raises in the letter are exactly the kinds of questions and concerns that both the Justice Department and the Department of Transportation will be looking at in our competitive analysis, and they are valid questions and concerns.

The CHAIRMAN. Mr. Foer.

Mr. FOER. Dr. Kahn is on my advisory board. I had the opportunity to have lunch with him about a week ago and talk about some of this. I agree with him.

United yesterday said, well, we could not go incrementally to a new hub because that is too expensive and would take too long. How did they get the hubs where they are? Of course they can expand incrementally if there is enough demand and they really feel that they can operate a hub successfully in New England, so I think it is a good point, and one worth taking.

The contrary point is, if US Airways is still a viable competitor, and I know there are questions about that, but if they are, perhaps they should be considered a potential entrant into some of the markets dominated by other large carriers. Once they are gone, they are gone. There is not going to be anybody else that can step into that role as a potential entrant.

Now, the second point about strategic reactions is one that I think the Justice Department should look at extremely carefully. They will have the benefit of being able to interview competitors and perhaps seek out strategic documents within the industry, things that you can do in a nonpublic investigation. They can talk to securities analysts and others, and they will have to make a determination: will other mergers follow?

A number of Senators yesterday made explanations of why they think it is likely to happen. I think it is likely to happen, and it seems to me that Justice and also Congress have to take into account right now, if this one goes through and the next one is announced, how do you react then? Do you say, well, we have just closed the barn door and you guys are too late? Is that unfair?

I think we need to take the whole kit and caboodle into consideration right now and figure out, where do we want it to go?

The CHAIRMAN. Mr. Foer, if I could just add, we have notoriously short memories, but for a long time around here we believed that the previous administration should have not allowed the last round of mergers, or there was a strong argument that the previous administration, the Bush administration should not have allowed the last round of mergers because of the anticompetitive outcome of it, and so if we are staring at a potential round of mergers which certainly dwarfed those in size, when you are looking at the magnitude of them, I—let me just ask one more question. I have taken too much time.

And I understand the position you are in, Ms. McFadden, but studies by the GAO and by the Department of Transportation, which are very credible to me, clearly indicate—clearly indicate, and understandably, I mean, Economics 101—that where one airline dominates a hub then fares are measurably higher, and I think that is uniform, and we could do a snap study tomorrow and come up with the same conclusions.

So here we are, with the inescapable result of this merger being for more hubs, particularly in the Northeast, to have one airline dominate, which then means if you accept those studies, and I see no reason why anyone would reject those studies, that therefore there is going to be higher fares in more hubs, particularly in the Northeast part of America, does that make sense?

Ms. MCFADDEN. Well, let me answer your question this way, Mr. Chairman. First of all, we agree, and I thought that you did a terrific job in asking Mr. Goodwin the question about hub fare premiums yesterday. We agreed, and you are right, GAO agrees, and the Transportation Research Board last year agreed that at dominated hubs there are higher fares, and it is not just in slot controlled hubs. It is all hubs.

We have also seen at hubs where there is low fare competition that in fact the fares go down and service increases, and so you are exactly right, and I think that that is also going to be a question in the competitive analysis of this merger. Will the competitive environment, if this transaction is consummated, be such that entry into those hubs by low fare competitors is possible, because we do think that is a very, very important disciplining factor in the airline industry and really one of the only left at dominated hubs.

The CHAIRMAN. Mr. Foer.

Mr. FOER. I would agree.

The CHAIRMAN. Thank you.

Senator Dorgan.

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

Senator DORGAN. Mr. Chairman, thank you very much. Following up on that question, how many dominated hubs are there in the United States?

Ms. MCFADDEN. Senator, I should know the answer to that question.

Senator DORGAN. First of all, how many hubs are there, as you define dominated hubs? My understanding is that—well, let me withdraw the question.

Ms. MCFADDEN. About 10 to 12.

Senator DORGAN. My understanding is that there were 20 to 25 hubs of which 16 were dominated by carriers with more than 50 percent of the service at the hub.

Ms. MCFADDEN. I think that is roughly right.

Senator DORGAN. If that is the case, and you say, and I agree with you, that with respect to dominated hubs you have higher prices, it is the case, then, that in most hubs in America you have airlines that have retreated into dominant positions to control traffic at the hub and therefore extract higher prices. Is that the case?

Ms. MCFADDEN. I think that is the phenomenon we see, yes.

Senator DORGAN. I talked to a couple of airline executives yesterday, and almost everyone in the airline industry says that where this is heading is not just national, it is international. International alliances, where the big are going to get bigger, because if they do not get bigger they are going to lose. The big are going to win. The small are going to lose in this international system.

And I said, well, that might be your vision of things, but it may not be what this country chooses for its aviation system. I mean, we may choose to decide that we want to develop something different.

Now, back in the 1980s the chairman is quite correct that when the Civil Aeronautics Board under Dr. Kahn was eliminated and we moved down the deregulation road, the authority for the approval of mergers was temporarily given to the Department of Transportation. A couple of mergers were approved at DOT that the Department of Justice specifically opposed, and so we went through a wave—and this is about politics, just about how the bureaucracy works. We went through a wave that probably should not have happened.

Now, the question, of course, today is, while we have seen this aviation system reduced to a very few carriers, shall we approve a merger, shall the Department of Justice approve a merger that will allow one carrier to end up with 28 percent of the traffic, or perhaps more, and what does that do to consumers? What does that mean to our system? Is our system competitive after that?

Now, the New York Times today quotes an analyst who responds to the question, or the assertion by some that fewer carriers means more competition. One of the analysts in the New York Times says that is borderline lunacy. I would share that view. Do you share the view that fewer airline carriers will mean more competition? You do not share that view, do you, Ms. McFadden?

Ms. MCFADDEN. Not as a general proposition, though I would say that there are—and we have seen, for example, in international alliances there are benefits to creating networks, but I think that is the very question of “what line do you draw” in terms of concentration in an industry? When does the industry become noncompetitive? And that is the very question that is before us.

Senator DORGAN. It is true there are benefits, there would be benefits to having just one airline carrier. They would probably be less likely to lose your luggage transferring between carriers, so you could make the case hypothetically there are benefits to having no competition at all, just one carrier. That is the ultimate seamless transportation, is it not?

But that benefit is largely irrelevant, and is antithetical to the kind of system we have, the free market system that relies on competition to be the regulator in this market system, and now the clogged arteries in the system are coming, of course, from mergers and acquisitions in which you reduce this to very few companies, and they retreat to monopoly hubs in which they are unregulated, so you have unregulated monopoly hubs extracting prices that are higher than are justified.

Mr. Foer, let me say to you that it is the Lord’s work to be working on antitrust issues. Almost nobody cares about them. All the big money is on the other side of the issue, and you are a very lonely voice but a very important one for this country, because all of us who believe in this market system also have to believe that it is our job to protect the market system, to be able to work the way it was expected to work. A free market means just that, a free marketplace in which prices are unregulated and robust competition works to everybody’s advantage, so I just want to thank you for the work you are doing.

Let me just ask a couple of very brief questions. I know my time is short. The Clayton Act—Mr. Foer, you referred to the Clayton Act in your testimony. The Clayton Act, as anticipated by Congress, at least as you read it and as I read it, would suggest that defensive mergers that will inevitably come if this merger is approved also should be considered with respect to whether this merger should be approved. That is, what does this merger do in terms of other potential mergers in the future?

Mr. FOER. Section 7 of the Clayton Act is known as an incipiency statute. The reason for that is, it contains words like “may,” “may have the effect of substantially lessening competition.” It does not say it has to have the effect, and Congress passed the legislation in order to get at situations that had not yet ripened into monopoly but had the potential for reducing competition substantially.

That means you have got to look at the trends. You have got to look at not only what has already happened, but what you feel reasonably certain, not absolutely certain, is going to happen, and that is why I think it is entirely appropriate to take into account good, solid evidence that additional mergers are likely to occur.

Senator DORGAN. The testimony yesterday was interesting, because the CEOs of both companies said, in effect, we don’t know what is going to happen if this merger is approved. We cannot and you cannot really evaluate what might happen with other mergers.

I am wondering, I doubt whether there is anybody in this room who believes that there will not be dramatic and almost immediate announcements of additional mergers in the airline industry. I would ask the two of you if you have some notion of that as well.

Mr. FOER. Well, you know, we could be wrong. All the press accounts and everything else could be wrong. Maybe they will not occur, but we have to look at what is likely, and we have to base it on evidence which can be obtained. If everybody knew the future, we would all make a fortune in the stock market, but we can make educated guesses, and we have to realize that to not do anything is also to make a prediction about how things are going to happen. You just cannot avoid making predictions here.

Senator DORGAN. The companies will behave in their self-interest. That is what they should do, and every company among the remaining companies in this country will believe they are at a disadvantage unless they bulk up, develop some additional muscle with which to compete with this new larger carrier. Would you not agree, Ms. McFadden?

Ms. MCFADDEN. Well, certainly we have heard the same speculation, and I think there is some logic to that, I would agree, and we have said that our competitive analysis has got to be forward-looking and not just on the pure contours of this merger, but what is the competitive landscape going to be, and that includes looking at the potential competitive reactions of what other competitors will, in fact, be compelled to do, not just speculation, but what do we think competition will really force them to do?

Mr. FOER. May I say one more thing to that? We are also hearing claims about efficiencies and consumer benefits. Fine, but those are speculations. Those are predictions. They may be wrong also, so this is the nature of the game we are in. We are all talking about the future, and nobody is going to know for certain, but we have to do the best we can.

Senator DORGAN. Mr. Chairman, might I ask one additional question? I will be brief.

Ms. McFadden, the allegation by some is that there is a lot of competition in this industry. In fact, I think the larger carriers have retreated into circumstances where they have avoided a lot of competition, but they say look, there are a lot of new startup companies. There are a lot of new airline companies starting up out there. What percent of the traffic in America today is carried by the new startup companies vis-a-vis the large five or six carriers?

Ms. MCFADDEN. Senator, I do not have an exact figure. We will get that, but it is very small. We have seen some new startup carriers. We have been glad about that. We think that the Congress and the Department of Transportation have worked hard to try to foster an environment where that is possible, but it is not a complete wave of new entrant carriers.

Senator DORGAN. It is a fewer percent than on one hand I would expect.

Ms. MCFADDEN. I would expect that is true.

Senator DORGAN. When a new startup does attempt to come into a marketplace, the common carrier uses overrides for travel agents saying, we will pay you a premium if you do not have your passengers go on this new airline. The new airline immediately reduces fares to match the competition, eliminates the Saturday night stay, pays overrides, does a whole series of things and squashes the new carrier like a bug, quickly and easily, and that is what has happened with respect to the aviation industry in this country.

All of us want, I think, an aviation industry, an airline industry that works, that is profitable, that is safe, and that is competitive, and that offers consumers multiple choices at decent prices. We all want that, and just as I conclude I would say that I think the last thing we need with respect to the current system in this country is more concentration. We need more competition. We need more choices, and better prices for the American consumer. That is what we need in this industry.

Mr. Chairman, you have been indulgent. Thank you very much.

The CHAIRMAN. Thank you. Senator Gorton.

STATEMENT OF HON. SLADE GORTON, U.S. SENATOR FROM WASHINGTON

Senator GORTON. First, Mr. Chairman, a comment for you and for our staff, if I may.

You will remember yesterday I asked the United Airlines CEO about the 96 new routes and the 540 or whatever it was new pairs, and he responded very promptly. We got that answer in my office last night.

Now, I immediately turned to the market I know best, Seattle, and it was my impression, and I do not know whether this is true or not, but it was my impression that all or most of the new United flights were flights that are going right now under the US Airways logo, rather than being some new service, and that those hundreds of pairings, when they listed many small cities, would simply mean that you would go and you would always have a United decal on the back of your plane, but today you could make exactly the same destination with the same number of stops, but you would change from United to US Airways.

Since I guess the Committee has that, it would seem to me appropriate if we could learn whether that impression is true, whether there was new service as opposed to just service under one flag that is now under two flags. That could be covered by a code-sharing arrangement and not a merger. It sounded like a whole lot of new service. It did not look to me like it was a whole lot of new service, at least initially.

And now for Mr. Foer, you say, I think quite correctly, that the most critical issue is whether other mergers will be triggered in strategic response to this merger, something, of course, the witnesses we have had before us declined to speculate on. I think you may have answered this. Am I correct, is it your view that it is more likely than not that each of the other four members of the big six would feel strongly impelled to merge to roughly match in size the new United/US Airways airline?

Mr. FOER. This would be my guess, based on public information, but there is a lot of other information available to be obtained by the Justice Department and analyzed, and I think we should rely to some extent at least on what they are able to find out about this.

It seems as a logical thing—you have got three major airlines that are more or less in parity in size. If one of them suddenly becomes much, much larger than the other two, I do not think the other two are going to sit there and take it. I think—Senator Wyden talks about the copy cat factor. It is pretty well established, that there are many reasons that companies merge, and only one of them that occasionally is really verifiable is to gain efficiencies and serve the public better.

This is always the reason put out in public, but there are a lot of other things going on, and it is very difficult for any of us to know what all those other things might be in this case. I think Justice is in a position, and DOT is in a position, to ferret this out, and importantly to explain to you and to the public what their reasoning is when they reach some conclusions.

Senator GORTON. But it is reasonable for us to at least be apprehensive, if not to predict that relatively soon six majors would be three majors.

Mr. FOER. I think that is something that almost should be a presumption to be overcome by evidence to the contrary.

Senator GORTON. Well, I want to tell you I certainly agree with that answer.

You have another point that you made that I would like you to amplify on. One of the other things the DOT should consider is US Airways' ability to survive as a competitive airline if this merger does not take place, and Mr. Wolf is eloquent in stating that he is the only medium sized, I think mature cost—that was a marvelous phrase—airline left. Does your crystal ball tell you anything about the survival of US Airways on its own?

Mr. FOER. Well, he did say that if the merger were turned down, that he would continue to plug along and find alternatives, but that he would be operating at a disadvantage as a high cost carrier. I do not have a crystal ball on this. I think it is the type of information that needs to be analyzed by the Departments when they do their review.

In the antitrust laws, we have a failing company doctrine. If you can prove that the acquired company is about to fail, then the merger goes through even if it is anticompetitive. That is not at issue here. They have not raised that.

There is also something called "the floundering company" doctrine, which does not exist, and has never been recognized. If a company is merely floundering, that is not an excuse to permit an anticompetitive merger to go through.

On the other hand, in a realistic assessment of what is going on and what a proper remedy might be if they decide to let the merger go through, US Air's abilities would be something relevant to take into account.

Senator GORTON. Well, Mr. Wolf in a sense was rather proud of the fact that he was alone in this category, because, as he pointed out, two of the other airlines that were in that category no longer are, because they went through bankruptcy proceedings.

Would you agree—my observation in that connection is that that may have been tough on the shareholders, but it was not at all bad for the traveling public. Continental, it seems to me, is much more competitive now that it chucked off that high cost in that fashion. Should it matter in the slightest to us whether US Airways becomes a more efficient airline by management efficiencies or going through bankruptcy?

Mr. FOER. We would hope it would be through efficiencies Bankruptcy creates a lot of problems in itself, and it is hard to predict where you come out, whether the same airline continues in existence, whether routes are canceled, and where the assets go. It is hard to predict at this point. We are always better off, I think, if the airline can learn from its past and make changes and not only remain a competitor but perhaps become a more viable competitor. That would be the optimal result for the public.

Senator GORTON. It does seem clear to this Senator at least that US Airways has tried as hard as it possibly could to do that, without necessarily notable success, but Senator Dorgan, one way we predict the future is to study the past, and while we have had some airlines simply go out of business because they could not meet competition, and just disappeared, we have also had, say in the last 10 years, a number of airline mergers.

Can you comment, or maybe Ms. McFadden can comment on what has been the actual impact on the mergers that have taken place in the last 10 years, in your view? Have they lessened competition and the quality of service, or have they increased competition and the quality of service, either in general terms or with a specific answer as to specific mergers? That seems to me to be the best way to predict the future. What has happened when airlines have merged in the last 10 years?

Mr. FOER. I am not a sufficient historian of the industry to feel comfortable answering. My seat-of-the-pants answer is that we have fewer airlines, and that in itself might not be bad except for the way the industry has become structured. It is honeycombed with things that are not very competitive.

The alliances, some would argue, have already reduced the number of domestic carriers to three. Those alliances are not mergers, but they are partial mergers, and they have reduced the incentive of one airline to do something that might harm one of its allies, because at risk, then, is the alliance.

You have to take that into account. You have to take the hub system into account. You have to take the predatory practices that allegedly are occurring at the hubs, you have to take all of this price discrimination and what that does, and how it makes it difficult for the consumer to shop. There are so many aspects to the industry I do not know that we can tie our current observation to any particular merger. The overall trend, though, has been toward consolidation, and I do not think it has worked very well for the consumer.

Ms. MCFADDEN. Senator, I would only add that I do not think I am sufficiently equipped to answer in terms of a historical perspective that much, other than to say that I think it depends. I think that, for example, both the Department of Transportation and the Department of Justice saw competitive benefits to a number of the mergers that we saw in the 1980s.

There were two that the Department of Justice disagreed with the Department of Transportation on, and I think the Department of Transportation now has probably learned a lot from what has happened with respect to those two mergers.

The difference, with respect to those two mergers, was that they were airlines that shared a hub, and so I think there are questions of whether or not those have produced competitive benefits that the Department of Transportation anticipated at the time. There are at least questions about that, but I think there have been a number of mergers that have really been good for the industry and have produced competitive benefits.

Senator GORTON. Where they did not share hubs.

Ms. MCFADDEN. Where they did not share hubs, yes, sir.

Senator GORTON. This one, there is no hub-sharing, is there?

Ms. MCFADDEN. Not directly. The Washington, D.C. area, viewed as a single market, has both present, and this is one of the reasons why they have proposed the spin-off.

Senator GORTON. I guess the Chairman is not here. I think Senator Wyden was next. Thank you both.

STATEMENT OF HON. RON WYDEN, U.S. SENATOR FROM OREGON

Senator WYDEN. I thank my colleague. I can tell you I am now on my fourth hour of listening to testimony on this issue over 2 days, and my sense is that the only way you can justify approving this merger is if you are willing to send a message that this country will tolerate an airline industry with just three major carriers, and I am not prepared to send that message at this point, and I have a couple of questions that I want to ask.

Now, Ms. McFadden, you said that the ramifications for the industry overall would be a factor in your judgment here. That is really not the test I am looking for, so I do not want to get into something you cannot talk about, but I want to examine a couple of very specific theories here.

First, what I am interested in on this merger is that central to your analysis here will be the ramifications for the overall industry. Can you make a commitment this morning that central to your analysis, not just a factor, but central to your analysis will be what this means for the industry at large?

Ms. MCFADDEN. Senator—and let me just make sure I am careful about saying we will be doing a competitive analysis and we will be sharing that with the Justice Department. It is the Justice Department that will make the judgment here, but in terms of looking at the industry and what the competitive environment will be if this transaction is consummated, that is, in fact, what we will be looking at, and we will share our views with the Justice Department.

Senator WYDEN. Will you use the word central rather than it is just a factor? I am looking for how important this will be. That is why I am using the word central. My colleagues have asked about this as well. Can you commit now that central to your analysis will be the question of how this is going to affect the industry at large?

Ms. MCFADDEN. Senator, I think that I can say that it is going to be very important, central to our analysis we will share with the Justice Department, yes.

Senator WYDEN. Good. That is what I was looking for.

The second question, and again the abstract is, at this point, if you approve a big merger what arguments in theory would you make to block subsequent mergers of comparable size? Again, set aside this one, but if you approve a big merger, what arguments would you make to block others?

Ms. MCFADDEN. Well, I think in terms of the analysis, you have to look at so many different factors, in terms of the benefits that allegedly accrue from the combination and weigh those with the competitive disadvantages, that each merger in some ways has got to be judged on its own. It is possible, and the Justice Department has discussed situations in other industries in which they have approved a large merger and then said no to the next one, and so I think there are some instances in which that is possible.

Senator WYDEN. Can you supply us some information in the airline sector where that might be the case, and again, I want to allow you to do your job, because you all need to be objective on this, but it just seems to me that once you allow one of these, so you have got somebody out there who is bigger than everybody else on the block, the competitors come in and say, look, we cannot match this scale and reach, and you have got to let us go as well.

Mr. FOER. Senator, if I might, I was in the room of another committee after the merger between British Petroleum and Amoco, and the chairman of Exxon was asked about why he was now trying to merge with Mobil, and his answer was, well, we just permitted this other merger and now they are a lot larger than we are, and it would be unfair and put us at a competitive disadvantage if our merger is not approved, and sure enough, it was approved.

Senator WYDEN. I think the transportation inspector general is going to come in in a few days and he is going to say that these airline commitments with respect to voluntary protection of passengers and customer service are not worth a whole lot more than the paper that they are written on, and we had a vote last year, and I basically got my head handed to me on this, and I am hopeful that we will be able to take a fresh look at it after we get this information from the transportation inspector general, and the reason that this is topical right now, my sense is that mergers, and particularly this one, is going to push customer service issues even lower down the list of airlines' priorities.

In fact, in the situation we are talking about, we have got carriers that made commitments last year on customer service improvements, and you saw yesterday, I held up the Washington Post, and they singled out US Airways as falling down in the last year in every single area of customer service, every one, and now what are you all prepared to do, as you look at these mergers, to try to turn this situation around and make customer service a bigger priority when you are looking at mergers?

Ms. MCFADDEN. Senator, I think we are going to try to do as much as we can within the constraints of the authority that we have. We do have authority, the Department of Transportation has authority to protect against unfair and deceptive practices with respect to consumers.

That is really our only consumer protection authority, and we try to use that as much as we can, and as I noted in my testimony, we are going to apply that authority to our look at this merger. What promises, what commitments are these carriers making with respect to their accommodation to consumers, but this is going to be judged on a competitive analysis.

Now, I will say that competition, when there is competition, there usually is better service. I think they are linked, but in terms of our authority to really include customer service in terms of the specific kinds of commitments they made in their customer service plans as a central part of the analysis that we will do here, we have got limited authority.

Senator WYDEN. Well, my understanding is, the authority is very limited, and if all we have got to hang our hat on is the deceptive practices provisions we are not going to be able to do much for consumers there. What would be wrong with changing the law and specifically stipulating that customer service ought to be a criteria in reviewing mergers? What is wrong with that?

Ms. MCFADDEN. Senator, I do not think I have off the top of my head a view in terms of what is wrong with that. Certainly there are some examples. The Surface Transportation Board judges railroad mergers on a broader standard than just antitrust laws. They judge mergers on a public interest standard, so there is some room in there.

Senator WYDEN. Would you be for that? Would you be for changing the law at this point and saying that customers and their ability to get decent service ought to count for more when we review mergers?

Ms. MCFADDEN. Senator, I am not sure I would be prepared to answer that right now. I would like to consult with my colleagues.

Senator WYDEN. Well, I am not going to belabor this any further, but I will tell you that just from the standpoint of integrating these various systems and procedures alone, I am convinced that we are going to see customer service face additional problems.

We have got airlines that have not followed through on the pledges that they made last year, and I hope that you all will use every ounce of your existing authority, and hopefully we will get some recommendations that we ought to change the law.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cleland.

STATEMENT OF HON. MAX CLELAND, U.S. SENATOR FROM GEORGIA

Senator CLELAND. Thank you very much, Mr. Chairman.

Mr. Chairman, I think we have a real issue here, a very fundamental key question about quo vadis, which way, which way is this industry going?

I think it was Justice Oliver Wendell Holmes that said it is not so much that we are moving, but in which direction are we moving, and that to me is one of the fundamental questions that I would like you all to comment on.

I was in Washington as head of the Veterans Administration some 20 years ago, when deregulation was the fad, and Alfred Kahn was the chief apostle of that. He headed the CAB, the Civil Aeronautics Board, which had been created in the late 1930s to promote domestic aviation, but all of a sudden there was a fad in the early 1980s to deregulate, the airline industry in particular.

The Chairman wrote Mr. Kahn and Mr. Kahn has responded in a letter about what he thought about this merger particularly. It is interesting that the last sentence that Mr. Kahn indicates in his letter is this. He said, we may be confronting a very radical consolidation of the industry, which cannot be a matter of indifference to people like you and me who have regarded deregulation as a striking success thus far, close quote.

It does seem to me, Mr. Foer, that over a period of time an absolutely deregulated industry or an absolutely deregulated economy tends to monopoly. That is the direction that it naturally, inherently goes.

I mean, Adam Smith in 1776, in the Wealth of Nations, talked about an invisible hand in a completely open marketplace. The truth of the matter is, the invisible hand tends to monopoly, and monopoly means less choices, higher prices for the consumer, and so when we talk about an industry consolidating, whether it is trucking or telecommunications or the airline industry, it does seem to me that we are moving in the wrong direction.

The Government has to be, as maybe Galbraith has said, a countervailing power. Well, there are countervailing agencies, the Department of Transportation, and Ms. McFadden, the Justice Department, this Committee in terms of oversight.

But Mr. Foer, I would like to ask you the question, if this merger goes through, what does that say to you in terms of the direction we are moving, and is that healthy for competition? Is that healthy for prices out there available to the American flying public?

Mr. FOER. Well, I agree, Senator, with the general way in which you have stated the question. Deregulation was a bargain with the American public, and the bargain was, we are going to take away the heavy hand of Government, which was setting prices and entry conditions and approving routes and so forth, but in return we are going to have a competitive market system in which competition, where the airlines strive for the custom of the consumer, will be a sufficient regulator.

That meant a lot of antitrust oversight. The reality is that antitrust has not done a sufficient job with this industry, so half of the bargain has not been kept.

I do not think we are at the point where we should give up on the bargain. I think we are at the point where we have to say we want more antitrust resources available to the Federal Government. We want to take a look at our laws and make sure they are working satisfactorily in terms of antitrust, and we want to keep the pressure on the antitrust agencies to deliver the type of industry that we have a right to expect.

Now, I do not want to prejudge the merger totally. I am very skeptical about it, and I have set out my reasons. I would like to see the Justice Department and the Department of Transportation give it the most careful scrutiny, and do it in a transparent way so that we understand what their logic is, what their reasoning is, what kind of evidence, recognizing we cannot see all of the evidence, but give us a chance to understand what their reasoning is.

I think that the law today is sufficiently flexible that if there is a will to stop this merger, and there are good arguments for stopping it, that it can be stopped, and that is sort of my presumption, is that it ought to be stopped, but I am still open-minded enough to see what develops.

Senator CLELAND. Is your presumption that other members of the big six—there are about six major airlines. It is interesting that over the last 20 years with the elimination of the ICC and the assumption of the Interstate Commerce Commission's role for surface transportation, particularly railroads, into the Surface Transportation Board at DOT, now, with deregulation of the railroads, now there are only six major railroads, so we are down now to about six major airlines.

If two of the top six, whoever they are, merge and increase the hubs—and the Chairman has mentioned, I think, something that is painfully obvious. If you have a hub, the high prices, and you dominate that market over 50 percent, your prices are going to be higher for the consumer. I mean, we just see that.

If two of the big six merge, increase the hubs, and they have not pledged to this Committee that they are going to hold down prices for consumers for more than 2 years, does that not say to you that maybe this might be something that might not be in the interest of consumers and the traveling public, and particularly in terms of pricing?

Mr. FOER. Actually, two of the six are already merging, Northwest and Continental, which are being challenged in court by Justice, but that is already a long way down the road, so we are already moving in the direction that you are speaking of.

I think three airlines would be a very dangerous situation, if we had a strong sense that we were moving toward three, and I think we are partly there already, both because of Northwest, Continental, and because of the alliance system. Then we would be in a dangerous position, because three airlines nationally, but that does not mean you are going to have three available on any given route. A lot of routes will be strictly monopolized.

Senator CLELAND. I rest my case. I mean, we just started off, it tends to monopoly.

It is interesting that at the turn of the 20th Century there were more than 20 car manufacturers. Those cars are relatively unknown now, and by the 1930s there were only three major manufacturers of cars, and that is what we have today. One of those three is the largest corporation in the world, General Motors.

In the telecommunications world we see massive mergers going on at this moment, and we have this potential merger before us in the airline industry. I just wonder if that is not where we are going.

Unless there is strong antitrust enforcement, unless we all pay attention to the positive role that Government can play in enhancing competition and keeping competition, then we will see in the telecommunications industry, in the surface transportation industry, in the airline industry and in other industries in terms of American commerce an incredible tendency toward monopoly, higher prices, domination of the market, and something that is not necessarily in the interest of our consumers.

One point about pricing, in Atlanta, Delta has Atlanta as the hub. It is the major carrier there. AirTran comes in and the chairman just testified yesterday that with AirTran even not competing for Delta's particular market has, in effect, saved hundreds of millions of dollars for the traveling public there.

Now, Joe Leonard and AirTran would like to have the opportunity to come into National. It is interesting that this merger would automatically create a virtual airline, DC Air, that takes over 222 slots at National. There have not been any new slots approved at National in new carriers for 15 years, and all of a sudden, boom, you hand this golden goose to a virtual airline that does not even exist yet.

Would it not make more sense, even if this merger went through, that you just opened up those available slots for real competition for other new entrants, particularly at National?

Mr. FOER. Well, I think that is an issue, again, that requires a lot of analysis, but getting the standard right is the first thing, and the standard is, if you are going to let the merger go through, and you are going to condition it on some divestitures, those divestitures have to retain the same level of competition that was there before.

It would be nice if it could make it more competitive, but at least legally I think the legal standard is it has to maintain the same level of competition, and so there are a lot of reasons to look at this particular proposal of the spin-off to see whether it really can work, and also whether there are other alternatives that might do the job better for the public.

But this is a very detailed and sophisticated analysis that has to be made. I have my mind open on that. I think I pointed out in my written statement that the agencies have been focusing more on divestitures.

In the last year the FTC issued a report last August that looked at previous divestitures and concluded that a lot of them did not work so well, and as a result they have been taking a stronger position in many of the cases that come before them, insisting that if there is a divestiture, that the party acquiring the divested assets be identified up-front, that the divestiture take place fairly quickly, that the acquiring company actually can provide a high level of competition.

They are doing a better job on that, and I think the Congress ought to be encouraging them to continue in that very important direction, and this is a good case where you can do that.

Senator CLELAND. Ms. McFadden, just one final question. In your analysis of the way the airline industry in America is evolving, and your understanding of the fact that we are in a global environment, and that whether you are in telecommunications, transportation, aviation, or whatever, one has to compete globally, and therefore one seeks new routes and new alliances and so forth.

Given that reality, is it your feeling that we are going to maybe end up with three or four, I do not know how many, major global carriers that reach out to the far corners of the globe, and then maybe with another subset of carriers, basically a network, that network the continental United States and maybe Mexico or the Caribbean, but that you have got the big global ones that do all of the nonstops to Frankfurt and China and Africa and so forth, and then you have the network carriers that move people from L.A. to New York or Chicago or Atlanta? Do you have that fear at all that that is where we are going?

Ms. McFADDEN. I am not a great prognosticator on the industry, but I would say there are a number of industry analysts that say that is where the industry is going, a few number of global airlines and then other kinds of regional domestic airlines to feed those.

I do not have a good sense of that. I think it is certainly a possibility and, as you have said, partly the globalization of our economy is partly a driving force for that, and it is something that we do think is important, and we have got to support our industries. That is why we have been so strong in trying to open up markets and get open skies agreements and that kind of thing. It is a reality, the increasing globalization of our economy.

Senator CLELAND. A fascinating subject, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Cleland.

I want to thank the witnesses. I do not want to open a whole new line of questioning, but there is also the question of the economic viability of US Airways if this merger is not allowed, which is another aspect of this equation which I am sure you will be considering, Ms. McFadden.

I thank all of you for your incredible patience for 2 days now. We do not usually subject you to that. I thank you. You have been very helpful to this Committee, and I think that without reaching any conclusions, that this may be a very important watershed as far as the future of consolidations and mergers within the airline industry is concerned. I thank you very much.

Ms. McFADDEN. Thank you, Mr. Chairman.

The CHAIRMAN. This hearing is adjourned.

[Whereupon, at 10:55 a.m., the Committee adjourned.]

APPENDIX

Response to Written Questions Submitted by Hon. Slade Gorton to DC Air

Question 1. Are there any limitations on the fares DC Air can charge? Can DC Air close markets and put frequency into other markets?

Answer. Although there is no legal limit or cap governing DC Air's fares or its schedule (other than restrictions imposed by slot controls, the perimeter rule, and EAS requirements at Washington DCA), competition and market forces will discipline fares and influence our schedule. Like other carriers, we will retain the flexibility to refine our schedule as we see fit to best serve our customers and to respond to changing market demand. DC Air has also made a strong commitment to continue service to all of the small and mid-sized communities currently served by US Airways from DCA.

Question 2. Under your agreement with United and US Airways, please describe market and fare limitations for DC Air at Reagan National. Could you pull service from the smaller markets and go to Chicago and Miami? Are you required to serve the small markets that have been listed in your airline's proposed schedule?

Answer. There are no market or fare limitations for DC Air at Reagan National, or any other airport, under the agreement. However, competition and market forces will discipline fares and influence our schedule. As with other airlines in a competitive market, DC Air will retain the flexibility to refine our schedule as we see fit to best serve our customers and to respond to changing market demand.

DC Air has also made a strong commitment to continue service from DCA to the small and mid-sized communities currently served by US Airways. This commitment reflects both a recognition of the importance of Washington DCA service to these communities and the expectation that the service has been, and will remain, profitable. Unlike a major carrier whose primary interest in Washington DCA would be to increase service between Washington DCA and its hubs, our sole business is Washington, DC. The route system is a profitable and efficient network for a DC-based carrier, and DC Air has no economic motivation to withdraw service from well developed, profitable markets.

The regional jets that we plan to operate will also provide added flexibility in matching frequencies to consumer demand in the various small and mid-sized markets. In the event that market conditions change dramatically, DC Air will have—and must have—the capability to refine our route system to respond to changing market demand, as would any airline faced with similar conditions.

Question 3. You say that DC Air will serve Philadelphia and Pittsburgh with turboprops. Will your turboprop operations be low-fare? Are there limitations on what aircraft you can operate? Will you code-share at that market? Are there restrictions on who you can code-share with at any airport? Which frequent flyer program are you going to use? Can you use any frequent flyer program?

Answer. Although DC Air has announced our intention to become an all-jet carrier, the timing of delivery of new jets is subject to the availability of delivery positions from the manufacturer of the aircraft selected. In the interim period, we will operate turboprops in some markets, including Philadelphia and Pittsburgh. There are no limitations on the aircraft that DC Air can operate.

There is no plan, commitment, understanding, restriction, or obligation for DC Air to code-share in any of its markets. However, DC Air will enter into discussions with all major carriers about partnering opportunities that may arise, including code-share and/or frequent flyer arrangements.

DC Air will be an attractive frequent flyer partner for a number of airlines due to our desirable route structure, and we see opportunities to enter into multiple relationships to the mutual benefit of all carriers involved, as well as to our passengers, who would be able to select from a number of frequent flyer program alternatives when flying DC Air. Such relationships have precedent in the industry.

Question 4. Could you add service at BWI and Dulles to other points?

Answer. DC Air will have the ability to add service anytime, anywhere. However, we have no immediate plans to expand beyond the route network discussed in the hearing.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO DC AIR

Question 1. How will DC Air be able to sustain a low fare operation with regional jets and turboprops? The economics seem to suggest that you would need to sell more seats at low fares than you have with these aircraft, in order to cover the plane's cost.

Answer. DC Air's costs are estimated to be significantly below US Airways' costs for the same operations, because we will have a focused fleet of aircraft and lower overhead and labor costs as a regional carrier. This will allow DC Air to pass some savings along to its customers. Because DC Air will serve many small and mid-sized markets, we cannot profitably support large jet service on every route.

Question 2. I have information showing that US Airways has some of the highest operational costs in the industry. How are you planning to sustain a low fare operation if you take on US Airways' cost structure through a wet lease arrangement?

Answer. DC Air will not inherit US Airways' cost structure. Rather, we will have the same costs that any other regional carrier would have, with the exception of the 10 wet-leased aircraft and a few other temporary transition and startup-related costs. These temporary, transition costs will be phased out over time.

Question 3. Does DC Air contemplate a codeshare arrangement with United at any point? If so, on all or only some of its routes?

Answer. DC Air plans to enter into discussions with all airlines interested in partnering relationships as we build our franchise. DC Air has no commitment, obligation, or understanding with United with respect to code-share arrangements.

DC Air will be an attractive frequent flyer partner for a number of airlines due to our desirable route structure, and we see opportunities to enter into multiple relationships to the mutual benefit of all carriers involved, as well as to our passengers, who would be able to select from a number of frequent flyer program alternatives when flying DC Air.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO JAMES E. GOODWIN

Question 1. If the merger is approved, I have heard that the combined airline would be largest in the world and 50 percent larger than your nearest competitor. How do you respond to critics' charges that your new market power and substantial hub dominance would lead to monopoly airfares for consumers?

Answer. After the merger, United would be the largest airline by a few percentage points, but its overall share will not be that high (certainly compared to other industries) and the airline industry itself is not concentrated. With regard to market power, the merger can only lead to market power if the two airlines have significant competitive overlaps and the United and US Airways networks are complementary, meaning few overlaps exist. One area of overlap was Washington D.C. and United has addressed that concern by proposing to divest US Airways' operations at Reagan National to DC Air. United plans to work with the Justice Department to address any other significant competitive overlap that might exist. With regard to hub presence, United and US Airways have little presence at each other's hubs, so the merger will have little effect in terms of shares at the carriers' eight hubs. The DC Air divestiture will address the only hub airport at which the merger could have been viewed as arguably having a significant effect at a hub airport.

Question 2. In recent years the railroad industry has consolidated aggressively, and today only six large railroads remain in the U.S. and Canada. Some critics of your proposed merger fear that it would create tremendous pressure for the kind of consolidation in the airline industry that we have witnessed in the rail industry—to the detriment of competition and consumer choice. How would you respond?

Answer. It is impossible for me to speculate what other carriers may or may not do in response to our proposed merger. However, I can say several things with certainty. First, the airline industry is highly competitive with network carriers and low-cost carriers competing vigorously against one another. I expect such competition to remain robust in the wake of our merger. Second, I believe our merger will uniquely produce significant consumer benefits due to the highly complementary nature of our two networks. Finally, United believes that when the facts of our proposed merger are carefully reviewed by the Justice Department and the Department of Transportation, they will agree that the transaction produces significant consumer benefits and is in the public interest.

Question 3. Some charge that the gates at Reagan National are being sold to DC Air well below wholesale prices. What is your response to this charge? How should your shareholders make sense of this, if true?

Answer. DC Air, an independent carrier, is purchasing these assets from us at what we believe to be fair market price. The price was agreed upon during the give-and-take of on an arm's length negotiation.

Question 4. US Airways is a high cost carrier. How will the merger enable United to reduce costs? When will such cost reductions be achieved? How can we be certain that consumers will reap the benefit of these cost reductions through reduced fares?

Answer. The greatest benefits for United will come from increased revenues generated as United provides new nonstop and connecting service worldwide. However, United does believe it will also achieve cost savings by combining the two companies' operations. For example, US Airways' costs will now be spread over a much larger system. Also, United and US Airways own duplicative assets at many airports such as ramps and the merger will allow United to lower costs by more efficiently using assets for both carriers' operations. United also anticipates significant savings in terms of maintenance costs, advertising costs, and liability insurance costs because of the merger.

United believes these cost savings will begin accruing soon after the merger closes and will be achieved on an ongoing basis over time. Given the possibility of changing market conditions, United cannot commit with certainty that the merger will necessarily result in more competitive fares. However, it seems quite possible that the merger could lead to lower industry fares. Hub and spoke networks exhibit what are called "economies of density," meaning that the cost of providing service throughout a network falls as the number of endpoints served by the network increases. Because an airline with a larger network can offer more destinations to travelers at each endpoint within its network, a larger network increases traffic on the airline's spoke routes. This increase in traffic allows the airline to take advantage of scale economies in terms of larger aircraft to lower costs. Hence, United expects that the merger will facilitate increasing traffic throughout its network, which will lead to lower costs and competitive fares.

Question 5. You have agreed not to raise fares for two years, except for fuel price fluctuations and inflation. Does this cap include all fares, including your restricted fare categories? Would you consider keeping the number of low-fare tickets on a flight the same for this two-year period?

Answer. As part of the proposed merger, United has committed that it will not increase point to point structure fares (except for increases in fuel cost and CPI) for two years following the merger.

"Point to point" is intended to communicate the significance of United's commitment in terms of the number of markets and avoid confusion that might result from the more technical term (origin destination city pair). For every point that United serves, we usually publish fares to every other point in our route system, regardless of whether our service is non-stop or requires a connection. Thus, from Allentown, PA we offer service and publish fares not just to Chicago & Washington (non-stop), but also for cities ranging from Albuquerque, NM to Yakima, WA. Counting all of the cities that United serves domestically, our commitment extends to more than 18,000 current United markets.

The structure fares exist in each and every market served by mainline United in the 48 states (not West Coast Shuttle). Structure fares are commonly understood within the industry as certain fare codes which exist in every market. Included in structure fares are—

Structure First Class (Fare codes prefixed by FUA-)
Structure Business Class (where available) (Fare codes prefixed by CUA-)
Structure Unrestricted Economy Class (Fare codes prefixed by YUA- or BUA-)
Structure 14 Day Advance Purchase Excursion Fares (Fare codes prefixed with ME14-)
Structure 14 Day Advance Purchase Excursion Fares for Off-Peak Days (Fare codes prefixed with MOE14-)
Structure 21 Day Advance Purchase Excursion Fares (Fare codes prefixed with HIE21-)
Structure 21 Day Advance Purchase Excursion Fares for Off-Peak Days (Fare codes prefixed with HOE21-)

In making this voluntary commitment, United chose to focus on the structure fares because these will be easy to monitor. Other types of fares would be very difficult to monitor and are not part of the commitment. At any given time, United has approximately 750,000 fares in its domestic 48 states tariffs and many of these fares change often—averaging approximately 56,000 fare changes each weekday. Many of these changes involve short term promotional fare sales which are filed to build traffic.

All of the structure fares are available for purchase through United's web site and other internet channels. However, internet sites also contain many other kinds of promotional and other discount products which are not covered by the commitment.

United plans to monitor this commitment itself through internal policies, controls and reporting. Beyond our own internal compliance efforts, our commitment is structured in a way that ensures the ease of oversight by consumers and government officials. First, the fares covered by the commitment are clearly and easily identified (by fare code) so that they can easily be monitored over time. Second, fare information is so readily available that, if United were to increase any of the structure fares other than for CPI or fuel, it would be very easily and quickly detected. Fares are publicly available and easily accessed through any of several means—Airline Tariff Publishing Co. (an electronic publisher or clearinghouse of fare information), thousands of professional travel agents (through their computer reservations systems), and inquiry to United's own telephone reservations. All of these sources contain the prices for each of the various fare codes and make it easy for anyone to monitor fares over time.

In response to the second part of your question, the number of discount seats that we have available on particular flights is constantly changing. This is because revenue management's basic purpose is to balance the number of discount seats sold far in advance with those seats sold close to departure. Once the airplane departs, the opportunity to sell empty seats is forever lost. We only get one chance to get the right mix of discount seats and full fare seats in order to fill the airplane. Over the two-year period alluded to your question, it is impossible to accurately determine in advance the optimum mix of full fare and discount seats on particular flights due to market conditions which constantly change. To the extent we were to set that mix in advance as the question suggests, that could be detrimental to consumers since the number of discount seats determined by the marketplace at any particular time could be greater than the artificial level set in advance. Importantly, to maximize the revenue from each flight, we will continue to be forced by the marketplace to offer discount fares to fill as many seats as possible on each airplane. We believe consumers will benefit most if the marketplace determines the optimum number of such discounted seats.

Question 6. How will United insure the maintenance of low fare competition in the Washington, D.C. area?

Answer. The benefits of the DC Air divestiture are that it will create a new low cost competitor with a substantial number of slots at Reagan National where none exists today. Hence, the merger and divestiture will create low cost competition that will lead to lower fares. Beyond creating a new low cost carrier presence at Reagan National, DC Air will step in the shoes of US Airways at that airport and maintain the competition that exists between United and US Airways today. Moreover, in the case of routes between Reagan National and three cities—Pittsburgh, Philadelphia and Charlotte—United will enter those routes and compete with DC Air in providing service to Reagan National. Today, only US Airways provides any service to Charlotte from a Washington airport and only US Airways provides service to Reagan National from Philadelphia or Pittsburgh.

Question 7. You are currently negotiating a new contract with your pilots and have been doing so for some time. Why is it in their best interest to accept this merger proposal?

Answer. It is in our pilots best interest to accept this merger proposal due to the greater job security and promise encompassed by a more durable, stable and comprehensive airline which United will certainly be after the merger.

Question 8. What are your plans for US Airways' wholly-owned feeder airlines: Allegheny; Piedmont and PSA?

Answer. We have not yet made a final decision on the ownership structure of US Airways' wholly-owned commuter partners after the merger. However, we have a commercial need to retain the passenger feed that these regional carriers provide to the current US Airways hubs. Accordingly, we intend to conclude agreements that will allow us to fully maintain that passenger feed in the future.

Question 9. Could you comment on why it would be more advantageous for United to subsidize the start-up of an entirely new airline as opposed to having an existing airline pay market prices for assets like slots and gates?

United is not "subsidizing" DC Air; it is entering into an arm's length relationship to divest assets to a third party to create a new airline that will have low costs and provide a new competitive force in Washington D.C. It would have been possible to address issues of competitive overlap in Washington D.C. by divesting these assets to another airline. But United believes that DC Air, because of its low costs and regional focus, will have a unique ability to maintain and enhance competition in Washington D.C., and that the Justice Department would therefore prefer such a divestiture to divesting these assets to another airline.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. SLADE GORTON TO JAMES E. GOODWIN

Question 1. Over the past several years, the Congress has increased the amount of funds authorized for the Essential Air Service program, which ensures that small communities continue to receive scheduled air service. One of United's affiliates, Great Lakes Aviation, is an EAS carrier. Great Lakes has recently told the General Accounting Office that United is not particularly committed to continue serving those communities, as they are not profitable operations. While much of your testimony has addressed the millions of people who stand to benefit from this merger, what can you tell us about United's commitment to continuing to serve small communities?

Answer. United is strongly committed to serving small city markets. Currently, we are the largest EAS carrier in the US. We also offer more small city air service in the Midwest than any other carrier. United is already delivering on its promise to expand our service to communities like these. Thanks to this Committee and this Congress, the easing of High Density Rule at Chicago O'Hare has allowed us to add flights from O'Hare to a number of small and medium-sized communities. Within the last few months, United Express introduced service to Bloomington and Springfield, Ill. And by September, we will be offering 21 new daily United Express flights—mostly on regional jets—to destinations that will also include Tulsa, Okla., Columbia, S.C., and Little Rock, Ark.

We believe the network efficiencies resulting from the merger will better position United to fully capitalize on opportunities in small city markets. Bangor, Maine is just one of many examples. As a result of the merger, consumers in Bangor will have far greater choice of convenient single-carrier service throughout the US. In addition, they will gain new one-stop, single-carrier service to important international destinations such as Tokyo. Simply put, as our network expands and strengthens, our ability to serve small city markets improves.

Question 2. United has a fairly extensive hub network in the US, with large operations in Chicago and Denver. In addition, Washington Dulles, San Francisco, and Los Angeles provide some domestic hub service, as well as providing international gateway service to Europe and Asia. US Airways operates large hubs at Pittsburgh and Charlotte, with smaller hub operations in Philadelphia and, to a lesser extent, BWI.

a. Why would United want to run three European gateways (excluding Chicago) at Washington Dulles, Charlotte and Philadelphia? What economic advantage does that provide the company? Doesn't it make sense economically to consolidate those operations at one, or at most two, locations?

Answer. We believe that using Dulles, Charlotte and Philadelphia in combination as transatlantic gateway hubs will provide added convenience for customers. We also believe it is a commercially sound decision that will enable us to more efficiently serve the growing transatlantic market.

First, all three airports have strong local traffic bases for our transatlantic flights. In other words, there already is strong demand for transatlantic service originating in each of these markets. We anticipate local traffic will continue to grow in each of these markets and our decision will position us well to respond to customer demand.

Second, working in unison, these three transatlantic gateway hubs are needed to better position us to capitalize on growing opportunities in European travel. Revenue growth in many of these hub markets has been very impressive. For instance, between the third quarter of 1994 and 1999, revenue in the Charlotte-London market has grown 187 percent. During this same period, Dulles-London revenue has grown 96 percent and Philadelphia-Munich revenue has risen 1,232 percent. We want to serve these growing markets as effectively as possible and to participate fully in growing transatlantic opportunities. We believe this operational strategy will position us to do so.

Finally, this operational strategy will provide commercial flexibility as we integrate our two networks. In some cases, it may be more direct and convenient for passengers if they connect through Charlotte. In other cases, it may be more convenient for passengers if we route them through Dulles or Philadelphia. The key, however, is that we will have the flexibility to craft a connecting travel agenda that is most convenient for our transatlantic customers. At the same time, this strategy will afford us important flexibility to respond to facility constraints at each airport thereby enabling us to run the most efficient transatlantic network operations possible.

b. What benefit does the Pittsburgh operation provide United that it does not or would reap at Chicago or Dulles?

Answer. We are very pleased by the prospect of adding Pittsburgh to family of hub airports which form the backbone of our global network.

Pittsburgh has a sizable and growing local market of traffic. For the year ending the third quarter of 1999, that local market alone was approximately $1.1 billion. We look forward to having the chance to serve these passengers and expect that Pittsburgh local traffic will continue to grow.

Also, Pittsburgh will give us an ideally located hub to serve regional traffic on the East Coast. Regrettably, United has been historically weak in servicing local communities on the East Coast, especially north-south passenger traffic. Our recent expansion at Dulles has helped to a limited extent. However, it became very clear to us that our passengers' demand for better and more efficient service in the Northeast and along the East Coast could not be met absent the addition of a new hub airport such as Pittsburgh. With the addition of a Pittsburgh hub to our network, we believe United will be ideally positioned to respond fully to our customers' demand for better single-carrier service to large and small communities along the East Coast and throughout the Northeast.

Question 3. What routes are United and DC Air likely to compete on? Will they compete at Denver, Philadelphia, Pittsburgh, O'Hare or Chicago? What price competition is there in those markets now?

Answer. Since DC Air largely will be providing service on origin and destination routes via Reagan National while such service for United is focussed at Washington Dulles, passengers on hundreds of routes to and from the Nation's Capitol will have the competitive choice between DC Air's Reagan National service or our Dulles service. In addition to this competitive choice between Reagan National and Dulles, we intend to compete vigorously with DC Air from Reagan National to Charlotte, Philadelphia and Pittsburgh. Important to consumers, this service will inject a new competitive option in these markets. Currently, passengers flying between Reagan National and either Charlotte, Philadelphia or Pittsburgh have only one commercial option. As a result of the merger, consumers now will have a competitive choice between DC Air or United to these cities via Reagan National.

Question 4. Does United compete with other large carriers at their hubs? If so, please explain how?

Answer. United competes vigorously with other airlines at their hubs and we are continuing to add service to other airlines' hubs. We generally provide service from other airlines' hubs to our hubs and from there, passengers can use connecting flights to reach the wide choice of destinations that the United network offers. In the last year, United has added service from Los Angeles to Continental's hub at Houston and American's hub at Dallas-Fort Worth and in September we will be adding serving from Los Angeles to Delta's Salt Lake City hub. All these routes provide access to United's extensive network to Hawaii and the South Pacific and as an example, a customer can fly on United from Dallas-Fort Worth to Los Angeles to Honolulu which provides competition to American's Dallas-Fort Worth to Honolulu nonstop service. Nationwide, United flies to every hub operated by another airline in the United States.

The following list shows how extensive United's service to other airlines' hubs is:

American Airlines

Dallas-Fort Worth: UA flies from Chicago, Washington Dulles, Denver, San Francisco and Los Angeles

Miami: UA flies from Chicago, Reagan Washington National, Washington Dulles, Denver, San Francisco and Los Angeles, as well as New York, Atlanta, Orlando, Santiago, Sao Paulo, Caracas, Buenos Aires and Rio de Janeiro

San Juan: UA flies from Chicago and Washington Dulles

Delta Air Lines

Atlanta: UA flies from Chicago, Washington, Denver, San Francisco and Los Angeles

Cincinnati: UA flies from Chicago

Salt Lake City: UA flies from Chicago, Denver, San Francisco and Los Angeles (beginning September 2000)

Northwest Airlines

Detroit: UA flies from Chicago, Denver and Washington

Minneapolis: UA flies from Chicago and Denver

Memphis: UA flies from Chicago and Denver

Continental Airlines

Newark: UA flies from Chicago, Denver, Los Angeles and San Francisco, United Express flies from Washington Dulles

Cleveland: UA flies from Chicago and Denver, United Express flies from Washington Dulles

Houston: UA flies from Chicago, Denver, Los Angeles and San Francisco

TWA

St. Louis: UA flies from Chicago and Denver

America West Airlines

Las Vegas: United flies from Chicago, Washington Dulles, Denver, San Francisco and Los Angeles

Phoenix: United flies from Chicago, Washington Dulles, Denver, San Francisco and Los Angeles

In addition to this competition that United directly provides at the hubs of other network carriers, United's hubs vigorously compete with other hub airports for connecting traffic. Such inter-hub competition is a source of important indirect competition that significantly benefits consumers. For instance, United intends for the proposed merger to strengthen Charlotte's ability to act as a competitive counterbalance to Atlanta in the Southeast. While this is not a case of United directly adding more service to Delta's hub in Atlanta, from the standpoint of consumers, it is an important addition of new competitive choice in the Southeast.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. ERNEST F. HOLLINGS TO JAMES E. GOODWIN

Question 1. You are divesting US Airways operations at Reagan, knowing that DOJ would have an antitrust problem with your deal, particularly in the Washington area, given United's dominance at Dulles and US Airways dominance at Reagan. At other hubs where you will likewise dominate the area, why shouldn't we see, as a precondition to permitting this deal to go through, that United divest a substantial portion of its gates at the 8 hubs you will control?

Answer. The DC Air divestiture is based on the Justice Department's likely concerns about nonstop overlaps between the two airlines from Washington D.C., i.e., United from Washington Dulles and US Airways from Reagan National. Such nonstop overlaps occur because both airlines have substantial operations in Washington D.C.: United has a hub at Dulles and US Airways has a significant base of operations at Reagan National. In the other hub cities, there are virtually no nonstop overlaps because only one airline or the other has a significant base of operations at the airport. Because there are no significant overlaps at the other hubs, no divestitures such as DC Air are needed to address potential anticompetitive concerns resulting from the merger.

Question 2. According to SalomonSmithBarney, the transaction will provide significant revenue benefits to the combined carrier (report of May 31). Can you explain the rationale for these benefits, and also explain if these benefits are primarily derived from passengers choosing the combined carrier over another carrier?

Answer. Broadly speaking, there are three categories of revenue benefits from the merger. First, the merger will lead to greatly improved overall connectivity, as US Airways' East Coast network is combined with United's network. This greater connectivity will allow United to provide service on 560 city pair routes along with providing new connecting options and more frequencies on city pair routes served by one airline or the other today. United's new and improved competitive presence on these routes will enhance competition, improve the quality of service on these routes for passengers, and lead to additional sales and revenues for United. Second, the merger will greatly improve United's overall network service, making United a more attractive option for frequent flyers and business travelers seeking greater travel flexibility. A higher quality airline network means improved consumer welfare and more sales and revenues for United. Third, the merger's synergies will allow United to redeploy aircraft and other assets from unprofitable routes to city pair routes that are underserved today. Hence, United will provide nonstop service on many city pairs where no nonstop service is available today. This new service will lead to a more efficient allocation of aircraft, generate significant consumer welfare benefits, and lead to revenue synergies as United replaces unprofitable routes with routes where it can offer a profitable new service. Overall, these revenue benefits reflect both stimulation from improved quality of service and taking passenger share from other airlines that cannot match United's improved service.

Question 3. Pilot Contracts—are there clauses in the UA-ALPA contract that may present issues for the transaction, and if so, what are those provisions. Please submit the relevant excerpts.

Answer. The United pilot contract contains a typical provision requiring that it be applied to the combined pilot workforce after the closing of a merger. The US Airways pilot contract contains a similar provision calling for it to remain in effect after the closing of a merger. Because this is a common situation for pilot agreements in a merger, the pilots union, of which both groups are members, has a Merger Policy that reconciles this conflict. This Policy calls for a fence agreement that keeps the pilot operations separate until an integrated seniority list can be agreed to (or arbitrated if necessary) and the pilots and United have reached agreement in a single collective bargaining agreement. United has advised both pilot groups that it is agreeable to the application of the union's Merger Policy in this transaction.

Question 4. According to the SEC information provided by you, the combined carrier will be the largest carrier in 5 of the 6 biggest metropolitan areas. Why do you believe that from a competition policy stand point such concentrations should rest in one carrier's hands?

Answer. United may become the largest airline in five of the six largest metropolitan areas, but that does not mean that these markets are concentrated in any meaningful sense. Competition in these metropolitan areas is fierce. For example, in Chicago, two airlines have hubs at Chicago O'Hare (United and American) and two other low cost airlines have major bases of operations at Chicago Midway (Southwest and American Trans Air). In New York, United would not have a hub, while Continental would have a hub at Newark, and Delta and American have major operations at New York LaGuardia and JFK. In Los Angeles, United does have a hub, but it competes fiercely with American, Delta, and Southwest, among others, at Los Angeles International, not to mention competition from other airlines serving other proximate airports in the area. In San Francisco, United has a hub, but Southwest is the #1 carrier at nearby Oakland and American is the #1 carrier at nearby San Jose. United faces strong competition throughout the Bay Area. In short, the six largest metropolitan areas are fiercely competitive, not concentrated.

United's concentration across these six airports will simply parallel its market position across the country. After the merger, United would have the largest airline by a few percentage points, but its overall share will not be that high (certainly compared to other industries) and the airline industry itself is not concentrated.

Question 5. One of the reasons cited in your SEC document details how an interline connection today would be on the 8th screen of a CRS display, but that the combined carrier's flight would now show up on the first screen. What are the revenue benefit estimates of the change in screen placement?

Answer. United has not quantified the specific revenue benefits of CRS display separate from the overall improved connectivity of the combined network. That reflects the fact that revenue benefits from CRS screen display placement are simply a reflection of the overall improvement in quality of service that will result from the merger. A flight itinerary's ordering on a CRS display is based in part on the quality of service of the flight. Hence, because passengers do not like interline flights, these flights are unlikely to show up early in the CRS screen displays. The merger will allow United to greatly improve the on-line connectivity of the combined network, leading to itineraries of higher quality for passengers. Naturally, because CRS screen display order is a function of the quality of a flight itinerary, the merger's improvement of the combined network's quality of service leads to improved CRS screen display placement.

Question 6. Why is "seamless service" so important in this day and age of alliances, interlining and shared frequent flyer programs?

Answer. Consumer demand for convenient, hassle free travel continues to evolve. When customers told the airline industry they did not like the inconvenience of having to check-in multiple times when they connected with another carrier, the industry responded with interline agreements that made single check-in possible for connecting travel on different carriers. Similarly, as passengers began demanding seamless global travel, the customer-driven response has been global network alliances such as the Star Alliance which provide consumers with seamless travel options worldwide. These improvements in service have been welcomed by our customers, especially our international passengers who rely on the Star Alliance.

Most recently, consumers have increasingly told us that they want us to take an additional step forward by creating a truly national airline that offers single-carrier service to as many domestic city-pairs as possible. We listened to the marketplace and concluded our proposed merger with US Airways to be the most economical and practical way to quickly respond to consumer preference for hassle-free, single-carrier service. Responding fully to the travel preferences of consumers is an evolutionary process. Our proposed merger builds on the progress we made through interline agreements and alliances.

Question 7. It has been rumored that US Airways got a good deal from Airbus in acquiring a fleet of new planes. The US–US SEC document, slide 47 suggests that the US Airways-Airbus contract is "one of kind". How valuable was the Airbus deal to United, and what is meant by that phrase, and please describe the contract.

Answer. In considering the transaction, United did not specifically value the aircraft contract between US Airways and Airbus. While we wish to be as helpful as possible in responding to any specific questions you may have about that contract, such questions are better addressed to US Airways which has far greater knowledge of it than United.

Question 8. The European Commission has indicated that it will review the transaction. When do you anticipate filing notification with them? Do you anticipate that the EC review will be limited to flights into and out of Europe, or do you expect that other issues will be considered?

Answer. We anticipate that we will formally notify the merger to the EU, after close consultation with the EU Merger Task Force, in early or mid-September. In its review of the merger, we understand the Commission will primarily concentrate on the effect of the merger on transatlantic competition. It is important to note that United and US Airways do not provide the same US–EU city pairs with non-stop service. In addition, the effect of the merger in the transatlantic market will be minimal. United operates 8.1 percent of the seats available between the U.S. and Europe, while US Airways' transatlantic operations account for just under 3 percent. Even when taking into account Lufthansa's and SAS's shares of capacity—7.1 percent and 1.7 percent, respectively—the proposed transaction results in only a minimal increase of the transatlantic alliance share of seats between the U.S. and EU of less than 3 percent, from 16.9 percent to 19.8 percent. By comparison, BA and AA alone have 20.6 percent (13.1 percent and 7.5 percent respectively).

The Commission has indicated that it may also consider transatlantic service provided by United's alliance partner, Lufthansa. Both US Airways and Lufthansa provide non-stop service in only one city pair—FRA–PHL. The Commission may seek to impose conditions in this market. Otherwise, we expect that the Commission will conclude that the merger does not lead to a reduction in competition in the transatlantic market.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO JAMES E. GOODWIN

Question 1. Does United plan to offer service from Reagan National (DCA) to any markets that DC Air proposes to serve from Reagan National? If so, what markets, with what frequency, and with what type of aircraft.

Answer. Yes, we intend to compete vigorously with DC Air from DCA to Charlotte, Philadelphia and Pittsburgh. Important to consumers, this service will inject a new competitive option in these markets. Currently, passengers flying between Reagan National and either Charlotte, Philadelphia or Pittsburgh have only one commercial option. As a result of the merger, consumers now will have a competitive choice between DC Air or United. In the DCA-Charlotte market, we intend to offer 10 all-jet daily frequencies. In the DCA-Philadelphia market, we will offer nine daily frequencies using a combination of jet and turboprop service. Finally, in the DCA-Pittsburgh market, we will offer six all-jet daily frequencies.

Question 2. One of the purported benefits of your merger proposal is a commitment not to increase fares for two years. It appears to me, however, that this commitment may result in no real benefits for consumers.

a. First, you have reserved the ability to increase prices to reflect inflation and fuel cost increases. Haven't fare increases traditionally lagged behind Consumer Price Index and fuel cost increases?

Answer. Viewed over any period of several years, airline yield (revenue per seat mile) trends have lagged CPI increases and fuel cost increases. However, the results for any individual year are mixed.

Industry data for years 1980–1999 shows that in 5 of the last 20 years, airline yields have increased by more than CPI. During the other 15 years, airline yields have lagged CPI. (Source: Air Transport Association, http://www.air-transport.org/public/industry/27.asp)

Looking at fuel, airline yields have increased by more than fuel in 13 of the past 20 years. Fuel prices have proven to be more volatile than CPI. (Source: Comparison of above Air Transport Association data with United's average jet fuel cost reported in UAL Annual Reports).

Attachment 1* to my answers is a graph showing trends in industry yields, CPI trends and United's annual jet fuel cost.

b. Second, won't yield management techniques effectively give United the ability to continue to increase fares by simply offering fewer seats at discounted fares, or by placing other restrictions on the availability of discounted fares?

Answer. Revenue management's basic purpose is to balance the number of discount seats sold far in advance with those seats sold close to departure. Once the airplane departs, the opportunity to sell empty seats is forever lost. We only get one chance to get the right mix of discount seats and full fare seats in order to fill the airplane. Accordingly, it would not be in the interest of United and its employee-owners to simply eliminate discount seats as the question suggests. Today, we estimate revenue demand for every individual flight. We save enough seats to meet the needs of last minute, on-demand travelers. The rest of the seats are available to leisure customers at discounted fares. These discounted seats are necessary to help fill up airplanes by stimulating additional customer demand. To maximize the revenue from each flight, we will continue to be forced by the marketplace to offer discount seats to fill as many seats as possible on each airplane.

Question 3. According to information released on the proposed merger, United has promised not to raise fares for the next two years except in response to changes in the price of fuel and to cover inflation.

Could you explain whether that pledge covers all fares or only certain fares?

What does it mean that the pledge applies to "point to point structural" fares? What are such fares? Do these fares include discount fares such as Internet specials and corporate discounts?

How can the public be assured that United has held to this pledge?

Answer. As part of the proposed merger, United has committed that it will not increase point to point structure fares (except for increases in fuel cost and CPI) for two years following the merger.

"Point to point" is intended to communicate the significance of United's commitment in terms of the number of markets and avoid confusion that might result from the more technical term (origin destination city pair). For every point that United serves, we usually publish fares to every other point in our route system, regardless of whether our service is non-stop or requires a connection. Thus, from Allentown, PA we offer service and publish fares not just to Chicago & Washington (non-stop), but also for cities ranging from Albuquerque, NM to Yakima, WA. Counting all of the cities that United serves domestically, our commitment extends to more than 18,000 current United markets.

The structure fares exist in each and every market served by mainline United in the 48 states (not West Coast Shuttle). Structure fares are commonly understood within the industry as certain fare codes which exist in every market. Included in structure fares are—

Structure First Class (Fare codes prefixed by FUA-)
Structure Business Class (where available) (Fare codes prefixed by CUA-)
Structure Unrestricted Economy Class (Fare codes prefixed by YUA- or BUA-)

* Attachment 1 has been retained in the Committee's files.

Structure 14 Day Advance Purchase Excursion Fares (Fare codes prefixed with ME14-)

Structure 14 Day Advance Purchase Excursion Fares for Off-Peak Days (Fare codes prefixed with MOE14-)

Structure 21 Day Advance Purchase Excursion Fares (Fare codes prefixed with HE21-)

Structure 21 Day Advance Purchase Excursion Fares for Off-Peak Days (Fare codes prefixed with HOE21-)

In making this voluntary commitment, United chose to focus on the structure fares because these will be easy to monitor. Other types of fares would be very difficult to monitor and are not part of the commitment. At any given time, United has approximately 750,000 fares in its domestic 48 states tariffs and many of these fares change often—averaging approximately 56,000 fare changes each weekday. Many of these changes involve short term promotional fare sales which are filed to build traffic.

Corporate discounts exist where large corporations negotiate volume discounts. Corporations that commit to certain sales volume goals negotiate for a percentage discount off of published fares. Since these are individually negotiated discounts and not part of our regular tariffs, these corporate discounts are not included in the commitment. However, many of the fare codes most often purchased by these corporate customers are covered by the commitment. The structure unrestricted economy fares (YUA- or BUA-) are the types of unrestricted fare most frequently used by business travelers who book trips on short notice and demand schedule flexibility.

All of the structure fares are available for purchase through United's web site and other internet channels. However, internet sites also contain many other kinds of promotional and other discount products which are not covered by the commitment.

United plans to monitor this commitment itself through internal policies, controls and reporting. Beyond our own internal compliance efforts, our commitment is structured in a way that ensures the ease of oversight by consumers and government officials. First, the fares covered by the commitment are clearly and easily identified (by fare code) so that they can easily be monitored over time. Second, fare information is so readily available that, if United were to increase any of the structure fares other than for CPI or fuel, it would be very easily and quickly detected. Fares are publicly available and easily accessed through any of several means—Airline Tariff Publishing Co. (an electronic publisher or clearinghouse of fare information), thousands of professional travel agents (through their computer reservations systems), and inquiry to United's own telephone reservations. All of these sources contain the prices for each of the various fare codes and make it easy for anyone to monitor fares over time.

Question 4. In what origin and destination markets do United and US Airways currently overlap, on both non-stop and one-stop flights?

Answer. Of the many origin and destination markets that United and US Airways currently serve separately, our highly complementary networks overlap on very few routes. Attachment 2* to my answers shows the limited overlap markets in non-stop and direct, one-stop service that does not involve a change of aircraft.

Question 5. If United and US Airways merge as currently planned, what origin and destination markets will be entirely new? In other words, what service will be offered after the merger that is not offered by either carrier today?

Answer. As I told the Committee in my oral testimony, the hallmark of this proposed merger is expanded consumer choice for single-carrier service. Unlike previous mergers which reduced service, the proposed United-US Airways merger will immediately expand both point-to-point and connecting service. Over time, we anticipate service options to expand even further to respond fully to passenger demand. In total, we plan to immediately offer new service in 560 city-pair markets. Of these, there will be new service offered in 303 domestic city-pair markets and 257 international city-pair markets. Attachment 3* to my answers shows the new non-stop service we plan to initiate once the merger is finalized. Attachment 4* identifies all North American cities with planned new one-stop or two-stop service to points in the US, Canada and Mexico.

Question 6. Which markets does United intend to serve from Reagan National after the merger? How many frequencies and what types of aircraft will be operated in each of those markets?

*Attachments have been retained in the Committee's files.

Answer. We intend to offer 16 all-jet frequencies to New York LaGuardia, 16 all-jet frequencies to Chicago O'Hare, 15 all-jet frequencies to Boston, 10 all-jet frequencies to Charlotte, nine frequencies to Philadelphia offering a combination of jet and turboprop service, six all-jet frequencies to Pittsburgh and one jet frequency to Miami. As I mentioned in response to question 1, our service to Charlotte, Philadelphia and Pittsburgh will give consumers a competitive alternative in those markets that passengers currently do not have.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN D. ROCKEFELLER IV TO JAMES E. GOODWIN

Question 1. In addition to being the world's largest airline, United is also the world's largest employee owned airline. I believe the pilots own 25% of the stock and that overall, employees own 55%. What happens to the ESOP if the transaction goes forward? Will US Airways employees be allowed to participate? If so, will it dilute the value of the stock? Will the employee groups continue to be represented on the UA Board?

Answer. Under the terms of the ESOP, all ESOP stock will be allocated by the end of 2000. After that, there is no more stock for allocation to participants. Under the structure of the ESOP, no new participants have been added since April 2000. Based on this, no new employees of United or US Airways will be added to the ESOP. The ALPA, JAM and management/salaried employees will continue to have representation on the Board of Directors.

Question 2. United has stated that no jobs will be lost for two years. When US Airways closed its reservation centers in Nashville, Reno and Utica, hundreds of workers lost their jobs. There will have to be some sort of redeployment of people to make the combined carrier more efficient. Your pledge on jobs—first, does it include jobs at the reservation centers? Second—while no jobs may be lost, will transfers or retraining be provided if shifts are necessary?

Answer. First, our two-year job protection pledge applies to US Airways employees at reservation centers. Second, since the hallmark of our proposed merger is to expand service not reduce it, we do not anticipate that any positions at reservation centers will be lost during the two-year period following completion of the merger. United stands firmly behind our pledge to provide two years of job protection for all US Airways employees.

Question 3. United has stated that it will impose a freeze on airfares ("structural fares"). According to Travel Weekly, United is only pledging to maintain its standard, unrestricted walkup fares: its standard first class, its standard 14 and 21 day advance fares. Consumer price and fuel adjustments are not covered. United, however, did not say it would not change the mix of seats offered at various prices. What does this mean in practice, and how will it be monitored?

Answer. As part of the proposed merger, United has committed that it will not increase point to point structure fares (except for increases in fuel cost and CPI) for two years following the merger.

"Point to point" is intended to communicate the significance of United's commitment in terms of the number of markets and avoid confusion that might result from the more technical term (origin destination city pair). For every point that United serves, we usually publish fares to every other point in our route system, regardless of whether our service is non-stop or requires a connection. Thus, from Allentown, PA we offer service and publish fares not just to Chicago & Washington (non-stop), but also for cities ranging from Albuquerque, NM to Yakima, WA. Counting all of the cities that United serves domestically, our commitment extends to more than 18,000 current United markets.

The structure fares exist in each and every market served by mainline United in the 48 states (not West Coast Shuttle). Structure fares are commonly understood within the industry as certain fare codes which exist in every market. Included in structure fares are—

Structure First Class (Fare codes prefixed by FUA-)
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Structure 14 Day Advance Purchase Excursion Fares (Fare codes prefixed with ML14-)
Structure 14 Day Advance Purchase Excursion Fares for Off-Peak Days (Fare codes prefixed with MOE14-)
Structure 21 Day Advance Purchase Excursion Fares (Fare codes prefixed with HE21-)

Structure 21 Day Advance Purchase Excursion Fares for Off-Peak Days (Fare codes prefixed with HOE21-)

In making this voluntary commitment, United chose to focus on the structure fares because these will be easy to monitor. Other types of fares would be very difficult to monitor and are not part of the commitment. At any given time, United has approximately 750,000 fares in its domestic 48 states tariffs and many of these fares change often—averaging approximately 56,000 fare changes each weekday. Many of these changes involve short term promotional fare sales which are filed to build traffic.

Corporate discounts exist where large corporations negotiate volume discounts. Corporations that commit to certain sales volume goals negotiate for a percentage discount off of published fares. Since these are individually negotiated discounts and not part of our regular tariffs, these corporate discounts are not included in the commitment. However, many of the fare codes most often purchased by these corporate customers are covered by the commitment. The structure unrestricted economy fares (YUA- or BUA-) are the types of unrestricted fare most frequently used by business travelers who book trips on short notice and demand schedule flexibility.

All of the structure fares are available for purchase through United's web site and other internet channels. However, internet sites also contain many other kinds of promotional and other discount products which are not covered by the commitment.

United plans to monitor this commitment itself through internal policies, controls and reporting. Beyond our own internal compliance efforts, our commitment is structured in a way that ensures the ease of oversight by consumers and government officials. First, the fares covered by the commitment are clearly and easily identified (by fare code) so that they can easily be monitored over time. Second, fare information is so readily available that, if United were to increase any of the structure fares other than for CPI or fuel, it would be very easily and quickly detected. Fares are publicly available and easily accessed through any of several means—Airline Tariff Publishing Co. (an electronic publisher or clearinghouse of fare information), thousands of professional travel agents (through their computer reservations systems), and inquiry to United's own telephone reservations. All of these sources contain the prices for each of the various fare codes and make it easy for anyone to monitor fares over time.

Question 4. United, according to your SEC documents, has indicated that unprofitable routes ultimately will be closed. Right now, United's cost structure is lower than US Airways, 9.78 cents compared to 13.39 cents. What do you estimate the new cost will be? How will that affect your costs vis-à-vis the term "Unprofitable"?

Answer. We do not have an exact cost estimate for the combined carrier. The difference in costs is driven by a difference in the stage length of the average operations at the respective companies. For 1999, United's average system stage length was longer compared with that of US Airways. Accordingly, we were able to average down our costs more effectively than US Airways due to their low stage length operations.

There will be some cost savings achieved by combining the two companies' operations. For example, US Airways' costs will now be spread over a much larger system. Also, United and US Airways own duplicative assets at many airports such as ramps and the merger will allow United to lower costs by more efficiently using assets for both carriers' operations. United also anticipates significant savings in terms of maintenance costs, advertising costs, and liability insurance costs because of the merger. As a result of these savings, we estimate that had our stage length been the same as US Airways, our unit cost would have been somewhat lower than theirs. We will base decisions on the profitability of flying particular routes after the merger on financial data for such routes, including the extent to which efficiencies from the merger lower operating costs.

Question 5. You claim that the merger will provide new opportunities for many cities, opening up areas formerly served by US Airways to United's more extensive international operations, for example. I fought, and will continue to fight, to make sure that carriers improve their customer service. Right now, according to DOT statistics, United is last (10th) in on time service and US Airways is 7th (April 2000). In the rail area, we had a merger creating the largest railroad in the country. There were service problems for months on end. How will you be able to treat the customers to better service if the deal is approved? How long will it take to integrate the two operations and how long will it take you to sort out the delay situation for each of you, if the merger does not go through?

Answer. At the outset, let me assure you that there is no one more concerned about customer service challenges at United than me. We are a customer service business. We can and must do a better job serving our valued passengers. Be assured that improving the level of service we provide on a sustained basis is a key priority for United and one in which I am personally engaged.

In addition to addressing current customer service issues, this commitment to improved customer service is a key focus as we begin planning to integrate the United and US Airways operations. Our goal is a seamless transition where customer service will not just remain unharmed, but in fact will improve. That is our goal. As I have said, the genesis of this merger is the demand of our customers for improved and expanded single-carrier service in as many city-pairs as possible. Accordingly, we believe the merger itself will create improved customer satisfaction with the product we offer. However, we fully realize that we must improve the service that accompanies our flight offerings. I am committed to that goal.

In terms of the length of time needed to integrate our operations, we are hopeful it can be accomplished quickly. However, we realize the challenges we face. That is why we already are holding extensive internal discussions on integration tactics and strategies. As I said, our goal will be a seamless transition that will be transparent to customers and one that will result in an overall improvement in customer service.

Question 6. Why is "seamless service" so important in this day and age of alliances, interlining and shared frequent flyer programs?

Answer. Consumer demand for convenient, hassle-free travel continues to evolve. When customers told the airline industry they did not like the inconvenience of having to check-in multiple times when they connected with another carrier, the industry responded with interline agreements that made single check-in possible for connecting travel on different carriers. Similarly, as passengers began demanding seamless global travel, the customer-driven response has been global network alliances such as the Star Alliance which provide consumers with seamless travel options worldwide. These improvements in service have been welcomed by our customers, especially our international passengers who rely on the Star Alliance.

Most recently, consumers have increasingly told us that they want us to take an additional step forward by creating a truly national airline that offers single-carrier service to as many domestic city-pairs as possible. We listened to the marketplace and concluded our proposed merger with US Airways to be the most economical and practical way to quickly respond to consumer preference for hassle-free, single-carrier service. Responding fully to the travel preferences of consumers is an evolutionary process. Our proposed merger builds on the progress we made through interline agreements and alliances.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO JOSEPH LEONARD

Question 1. How do you believe the proposed merger of United-US Airways would affect price competition?

Answer. Major carriers do not compete on price today—they instead compete using scheduled flights and frequent traveler programs. To that end, the six largest carriers already have formed three marketing alliances that are largely focused on expanding and exploiting the strengths of the frequent traveler programs. United-Delta, Northwest-Continental and American-US Airways have all consolidated their loyalty programs with each other as well as with various International carriers. These global alliances have a tremendous impact on consumer choice and competition.

We do not believe that the formal consolidation of these alliances, albeit with changes in the principle partners, will significantly change price competition. True price competition only occurs when low cost, low fare airlines enter a market. This merger underscores the importance of the need for vigilance against anti-competitive and predatory practices in the industry by DOT as well as DOJ. It also underscores the importance of ensuring that no airports are closed to new entrants. Deregulation can only exist if there are open markets and a level playing field. This need exists with or without this merger. Unfortunately, the DOT has failed to exercise its regulatory authority to promote competition in the industry. In fact, they have taken no enforcement action or initiated any formal investigation of complaints regarding anti-competitive behavior.

Answer 2. You have testified that the slots being given to DC Air under the merger agreement should instead be given to other, new entrant carriers and that such a reallocation of the slots would have far more impact on passengers and fares than the merger itself. Could you please elaborate on your statement? The slot issue aside, what is it about this merger that is of concern to your airline?

Answer. AirTran Airways believes that this merger presents a unique opportunity to significantly improve competition in the airline industry. As you are well aware, AirTran Airways has had a tremendous impact on airfares and created huge public benefit with our low fare network at Atlanta Hartsfield. Hartsfield is now the busiest airport in the world in terms of passengers enplaned. The economic benefit to travelers to and from Atlanta was approximately $700 million last year and the benefits are not limited to the Atlanta markets. Passengers traveling from the Midwest to the Southeast benefit from the competitive pricing and service we provide via Atlanta. The city of Atlanta and state of Georgia have repeatedly documented the beneficial impact of healthy low fare competition in terms of economic development, corporate relocations and job creation. Kodak moved their marketing division to Atlanta, citing low fare air service as a principal reason. These benefits are a direct result of the opportunity AirTran Airways had to create a low fare network at Hartsfield—specifically the availability of 18 gates—as well as dedication and focus on providing quality low fare service and maintaining low costs.

The United-US Airways merger will not significantly change competition or concentration in Western or Midwest U.S., it will however increase hub and regional concentration along the Eastern seaboard and into the Midwest. This concentration presents a potentially anti-competitive concern that even the merging carriers recognized and plan the Reagan National divestiture to address. The question is will this divestiture satisfy the requirement to create effective competition. The answer is not as planned by the merging carriers.

The hub concentration resulting from the merger is the most significant competitive issue, it is critical that the divestiture of the Reagan National slots occur and more critical that it is done in a way that results in effective competition. This competition needs to address not only the Washington area, but also the entire eastern seaboard. Without an effective low fare network to counter balance this hub concentration consumers will be harmed. In the long run, new entrant service will not survive in this part of the country.

The Reagan National slots should be reallocated as a whole in order to not only continue service to existing communities, but to provide an effective low fare network that can compete with the merged carriers. This network must be provided by a carrier with a demonstrated ability to profitably compete and maintain low fare service. True competition will not result from a virtual airline that will for a long period time be reliant on it's largest competitor and which may never be able to achieve a competitive cost structure. A dominant carrier in a market should not be able to identify its only "competitor."

AirTran Airways is uniquely positioned to provide this competitive service. The public benefit and competitive impact is well documented by DOT, DOJ, GAO and others. We have a fleet of 51 aircraft with options and orders to 88 new Boeing 717s. We have the experience, dedication and ability to create a competitive low cost network at Reagan National airport that will provide an effective counter balance to the consolidation of major carriers that has already occurred.

Another less apparent benefit of low cost competition is the impact it has on the efficiency of the incumbent carriers. It is clear that Delta is a much stronger, more efficient carrier as a result of competing with AirTran Airways. They have focused on their own costs and now have the lowest cost among major carriers and have recently reported record profits.

Question 3. You have stated you will save consumers an additional $600 million with a network at Reagan National. How are you estimating your savings?

Answer. The methodology we used to estimate savings is the same process used by DOT and GAO in calculating the impact of low fare competition. All major carriers and industry experts also use this methodology to forecast demand and market impact of new entry.

Our savings estimates are based on Industry O&D passenger and fare information as reported to DOT. Traditionally when we enter a market industry average fares decrease by at least 40% in direct markets and 10% to 40% in connect markets. For example, fares from Washington Dulles, where AirTran Airways competes are less than half of those at Reagan National. Passenger demand in markets we enter increases up to 50% or more. Upon resuming service to New York LaGuardia in the first quarter of 1998, passenger traffic increased by 62% versus the year earlier quarter. The savings estimate is based on the decrease in average fares and the forecasted passengers in impacted city-pair markets. For example:

Passenger traveling in:	Savings w/ Current Passengers (in millions)	Savings w/ Stimulated Passengers (in millions)	Sample Market	Estimated Savings (in millions)
Nonstop DCA Markets	$182.3	$273.5	DCA—Buffalo	$6.3
Connections via Atlanta	$87.7	$131.6	DCA—Gulfport/Biloxi	$1.3
Connections via DCA	$52.0	$293.9	Rochester—Raleigh/ Durham	$2.9
Total Estimated Annual Savings	**$322.0**	**$699.0**		

There are three types of markets that would be impacted by a low fare AirTran network a Reagan National airport, 1) Nonstop city-pairs from DCA, such as Buffalo, 2) markets with new low fare access to DCA from our Atlanta network, such as Gulfport-Biloxi and 3) market that would have new low fare connect service as part of a Reagan National hub network, such as Rochester-Raleigh/Durham.

Question 4. Critics of the merger charge that it will jump start other mergers in the industry. How would low-cost carriers, such as AirTran, fair in a consolidated market?

Answer. As noted earlier, the major carriers are already aligned in marketing alliances. While the partnerships may change and realign the competitive environment for new entrant and low cost carriers will not change. The lack of enforcement of existing DOT regulatory authority is the biggest threat to fair and reasonable competition. Further consolidation will enable majors to more easily shift capacity and target new entrant competition, but given the current lack of vigilance, there is little impediment to those sort of anti-competitive practices today. Mergers will however allow carriers to further control corporate customers, travel agencies, an airport facilities.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. SLADE GORTON TO JOSEPH LEONARD

Question. What is the status AirTran's complaint regarding anti-competitive practices that was filed at DOT last July?

Answer. At this point, there has been no formal investigation of the issues raised in AirTran Airways' filings with DOT last year. Last month, the DOT General Counsel advised us that an informal investigation was being initiated. We have received no other information or details.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. ERNEST F. HOLLINGS TO JOSEPH LEONARD

Question 1. Would AirTran Airways move into, for example, Philadelphia, if a substantial number of gates were available, and be able to provide competitive service to the combined carrier?

Answer. AirTran Airways has been tremendously successful in creating a low fare network at Atlanta, competing with Delta airlines in local markets, as well as creating competition and price discipline throughout the Eastern United States. Our recent success, including six consecutive quarterly profits, has been hard fought. There are several key components to our success.

We have maintained our focus on creating consumer value by keeping costs low, providing a quality product and low fares. Careful planning and reasonable growth has allowed us to build a network that appeals to both business and leisure passengers. We offer the amenities of major carriers, such as seat assignments, business class and a frequent traveler program, but with affordable fares that never include roundtrip purchase or a Saturday night stay.

We have persevered against the most extreme anti-competitive practices of the major carriers, most notably Delta and Northwest. This predatory behavior has been outlined in filings made last year to both the Department of Justice and Department of Transportation, but has not resulted in formal investigations or enforcement action. In fact, without congressional intervention, the DOT has made no progress in promoting fair and reasonable competition in the industry.

Most importantly, AirTran Airways was created based on the opportunity to acquire 18 gates at Atlanta Hartsfield International Airport—which we have expanded to 22 gates. This allowed us to build the network that we operate today and that has been cited by the GAO, DOT, DOJ and others as having such a tremendous impact on competition in the airline industry. As I testified before your Committee, passengers traveling to and from Atlanta saved $700 million last year as a result of the competition we bring to the market. Since our inception, Atlanta has outgrown the industry and is now the busiest airport in the world in terms of passengers served.

In order to effectively compete in a hub city like Atlanta or Philadelphia, it is necessary to have a network that can withstand the competitive forces the incumbent carrier will bring to the table. We currently have 1 gate at Philadelphia, which we sublease from United, versus the combined carrier's 43 gates. By contrast in Atlanta we have 22 gates versus Delta's more than 100. We have explored the possibility of expanding Philadelphia service. The airport has plans to construct four new gates at the airport. If we could obtain those gates, we would have the ability to create a small focus city. This would be significantly smaller than our Atlanta operation or even the DC Air spinoff for National Airport. Four gates would allow about 32 to 40 departures per day (between 8 to 10 per gate) and service to 10 or 11 city-pairs. This would clearly be beneficial to the consumers in those markets, and would have some limited effect on regional competition. It will not however, create the competitive impact and market discipline that we could provide with the potential gates and slots at Reagan National. We estimate the benefit to consumers of an AirTran Airways low fare network at Reagan National would easily exceed $690 million per year. AirTran Airways has a demonstrated ability to profitably compete with major carriers and provide the type of quality, low fare service that was envisioned by Congress in the deregulation act.

Question 2. You are now operating about 8–9% of the flights out of Atlanta. You do not serve the Charleston-Atlanta market. Can you explain why you would not enter a market of that size?

Answer. We have held discussions with the Charleston airport and continue to evaluate the potential for entering the market. This past year we did initiate service to Myrtle Beach and have served Hilton Head / Savannah for several years. In order to expand to small and medium markets, it is essential that you also enter major markets. Our inability to serve National Airport has hindered our ability to expand to markets such as Charleston.

If we are given the opportunity to compete at Reagan National, we will not only serve Charleston from Reagan National, but would be much better positioned to add service to our Atlanta network and create low fare competition not only to the Northeast but to all the Eastern United States as well as Texas and the upper Midwest.

Question 3. Should we condition this merger on DOT issuing final rules on predatory pricing?

Question 4. With the combined carriers' market power, is it unreasonable to require the carriers to agree on a definition of predatory fares—and then hold them accountable?

Answer. We agree that some enforcement of competition to limit predatory activity is necessary. However, predatory pricing is too narrow a scope to effectively limit anti-competitive behavior in the airline industry. The economic arguments for predatory pricing are exceptionally difficult to prove and generally are applied post-mortem to competition. Roger Fones, Chief Transportation, Energy, and Agricultural Section of the Antitrust Division at DOJ very effectively outlined the issue in a speech to the American Bar Association:

> The claims of predation that we find most credible involve not only price cuts, but also significant capacity expansion by incumbents. Our starting presumption is that Incumbent's pre-entry schedules are optimal for efficiently operating its network. And if the existing network is optimal, the added cost of carrying an additional passenger on the existing network can be quite small. Thus, in the absence of additional reasons to be suspicious, we are unlikely to pursue a predation complaint where Incumbent made few or no changes to its network operations post-entry, even if it cut fares significantly.
>
> Claims of predation are more credible when they involve not only price cuts, but also significant capacity increases or other changes in network operations by Incumbent. Entry by Incumbent into a route it was not currently serving would seldom be a normal competitive response to a rival. If the route were not profitable for Incumbent before Upstart entered, why would it be profitable afterwards?

[Remarks before the American Bar Association Forum on Air and Space Law, June 12, 1997.]

We recently outlined to DOT and DOJ AirTran Airways' experience in attempting to add competitive service to Minneapolis-St. Paul—a hub that is often cited as the most expensive in the nation. While negotiating with Metropolitan Airport Authority in the twin cities, Northwest became aware of our intent to serve the Atlanta-Minneapolis-St. Paul market and just two weeks prior to our public announcement increased capacity by an unprecedented 40%. This anti-competitive action effectively blocked our entry in this market. We modified our plans and added service between Minneapolis and Chicago-Midway, which was beneficial to travelers in that market, but limited the full public benefit of low fare competition directly to our Atlanta hub network.

The scope of predatory activity is not limited to scheduled capacity and pricing, but includes the effects of frequent traveler program, marketing promotions specifically targeted at new entrant carriers, travel agency overrides and incentives which punish corporations/travel agencies for supporting competition as well as the unavailability of airport facilities in hub markets.

Under the Deregulation Act the DOT was given the authority to enforce competition on a much broader scale than traditional antitrust laws. DOT General Counsel Nancy McFadden testified to this fact before the House Aviation Subcommittee on Aviation, Committee on Transportation and Infrastructure:

> Section 41712 of our organic statute (formerly section 411) task the Secretary, when he or she considers it to be in the public interest, to "decide whether an air carrier . . . is engaged in an unfair or deceptive practice or an unfair method of competition" and to take appropriate action to end any abuse. Nothing in the terms of that section excludes and type of unfair competitive conduct from its reach.
>
> In addition, other provisions of the statute make it clear that Congress expected us to take action when major airlines engage in conduct that unreasonably threatens competition in airline markets. The statute's policy section specifically directs the Secretary, in carrying out his responsibilities, to consider that the public interest requires "preventing unfair, deceptive, predatory, or anti-competitive practices." The statue also directs him or her to consider in the public interest "avoiding unreasonable industry concentration, excessive market domination, monopoly powers, and other conditions that would tend to allow [a carrier] unreasonably to increase prices, reduce services, or exclude competition . . ." 49 U.S.C. 40101(a)(9) and (13)
>
> [Testimony before the House Subcommittee on Aviation, April 23, 1998]

Clearly, Congress intended DOT to maintain regulatory authority and to actively pursue fair and reasonable competition in the industry. The fact remains however, that DOT has not acted on a single complaint or initiated any formal investigations of predatory activity or unfair competitive practices despite being presented with overwhelming evidence.

DOT has the authority and the ability to actively monitor and take enforcement action to ensure a competitive industry. Doing so is clearly in the public interest. Congress should require the DOT to move quickly to investigate existing complaints and to take appropriate enforcement action. Unless the Department states that it will address these issues, actions against new entrants will increase. As mergers occur, the large carriers increase their ability to engage in such behavior.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO JOSEPH LEONARD

Question 1. As a low fare carrier, and being as objective as you can be as a potential competitor, what do you think of DC Air's business plan?

Answer. The divestiture of the Reagan National service by United is required in order to reduce the valid antitrust concern over monopolization of not only the Washington Metropolitan area, but also the hub concentration on the Eastern seaboard. Therefore, the carrier that ultimately assumes that network operation must be able to provide and sustain true competition in the marketplace.

We do not believe that the proposed DC Air can remedy the competitive situation that would exist following the United-US Airways merger. The infrastructure required to operate a 222 flight network is large and exceptionally complex. Systems, manuals and procedure including ground operations, maintenance, dispatch, training, safety and regulatory compliance, as well as facilities, marketing, reservations and accounting all must be in place and approved by DOT prior to the first operation. In addition to that, station personnel and flight crews must undergo background checks and extensive training prior to employment. All of these factors must be considered in the certification process by FAA as well as a fitness review by DOT.

DC Air's plan is to lease facilities, personnel and systems from United airlines and United affiliate carriers to either expedite or bypass the normal new entrant requirements which have historically taken several years. Even if this unusual process is approved, the resulting carrier will be exceptionally dependent on the carrier it is theoretically formed to compete with.

The key issue is can DC Air be an effective competitor to the merged United-US Airways?

First, will DC Air have a competitive cost structure? The answer to that question is clearly no. Given that DC Air will lease United aircraft, flight crews, maintenance, and facilities and be reliant on United for reservations, distribution and accounting support, it will have a very high cost structure. It is logical that leasing services from a high cost carrier will come at a high cost and result in a small airline with higher than average costs.

DC Air has publicly stated it will offer "competitive" fares rather than low fares, which is a recognition of higher operating costs. It is safe to presume that "competitive" means the same high fares as are currently available in these markets, since there is no direct competition at Reagan National and no low fare competition in the same city pairs.

Second, will DC Air provide significant capacity along the eastern United States to compete with the combined United-US Airways? Again, the answer is no. DC Air has repeatedly stated an interest in smaller regional jet aircraft. The plan as detailed in United's SEC filing indicates competitive seats in the network would decline by 30 to 60 percent in most markets. Smaller aircraft and reduced capacity adds pressure on fares; as supply goes down, price comes up.

In summary, the business plan for DC Air does not satisfy the requirement to create competition, nor does it remedy the competitive issues created by the proposed merger. AirTran Airways is a low fare carrier with a demonstrated ability to profitably compete against major carriers and operate a low fare network. AirTran Airways is prepared to create the type of competitive network at Washington Reagan National called for in the proposed merger of United and US Airways.

Question 2. JetBlue has announced its intent to seek 10 to 15 slots at Reagan National in the context of the proposed merger. How can JetBlue make a go of it with so few slots, when you maintain that a carrier would need between 50 and 100 slots a Reagan National?

Answer. JetBlue's proposal is to add service between Reagan National and New York's JFK airport. While this would create a new type of competition to the Shuttle services operated by US Airways (United) and Delta, it would create competition in only a single route (this new competition would be at the expense of smaller communities). AirTran Airways' proposal is to establish a low fare network at Reagan National that will maintain service to the 43 communities currently served by US Airways, but stimulate new demand with significantly lower fares.

The public benefits of low fare competition has been well documented by the DOT and GAO, among others, and the estimated impact of a low fare network at Reagan National would save consumers approximately $700 million per year. The consumer benefit would not be limited to the local Washington markets. For example, consumers flying from upstate New York to the Southeast would get new low fare service via DCA as well. This is particularly important in terms of the merger due to the hub concentration in the eastern U.S. with United hubs at Charlotte, Philadelphia, Pittsburgh and Washington-Dulles.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. JOHN D. ROCKEFELLER IV TO JOSEPH LEONARD

Question 1. Other than the question of the independence of DC Air—which I assume the DOJ will look at carefully—why should we give you the Reagan slots? Would you give the same assurances that Mr. Johnson is willing to do, with the same commitment to Washington that he has demonstrated over the years?

Answer. AirTran Airways has a demonstrated ability to profitably operate a low fare network under the most intense competitive pressure. The benefit of the competition created by AirTran has been well documented by the DOT and GAO—as I mentioned in my testimony before your Committee, the value to passengers to and from Atlanta last year was $700 million. By our estimation the low fare competition we would bring to the Washington Metropolitan area would result in savings of over

$400 million per year, with an additional $230 million in savings for passengers making connections at Reagan National.

With the increased hub concentration resulting from the merged carrier, a low fare network, provided by a low cost carrier, is in the public interest in that it would create the type of price discipline necessary to limit potential market domination along the eastern seaboard. A viable low cost network is the only effective counter measure to hub concentration—major carriers do not compete on price today and will not following this merger.

AirTran Airways is committed to expanding our network. We have orders or options for 88 new Boeing 717 aircraft and will receive at least 1 per month for the next thirty-nine months. We can regulate our growth by staging retirements based on market opportunities. We are uniquely positioned to provide continuing service to the 43 communities currently served by US Airways and are committed to not only serving these cities, but doing so with our brand of quality low fare service.

In addition to the well documented public benefits created by AirTran Airways service and the hub competition we would provide, improving our network strength will give us the ability to not only maintain service in markets like Charleston, but significantly improve our ability to add these cities to our Atlanta network. Thus, by entering the DCA market, AirTran would create direct low fare service for West Virginia residents not only to Reagan National and Atlanta, but to connecting cities throughout the Eastern United States.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO STEPHEN M. WOLF

Question 1. In a document submitted to the Department of Transportation, you stated:

> With 519 current daily departures at Pittsburgh, 483 at Charlotte, and 402 at Philadelphia, we operate the most pervasive route network in the northeast and mid-Atlantic regions of the United States, where almost 40 percent of all transatlantic passengers begin or end in their international journey. . . . US Airways ranks first in 44 of the 56 major airports in the eastern United States.

If US Airways had the "most pervasive network" in the northeast before the merger, how would you describe it after the merger? Do you believe this should cause the consumer concern?

Answer. This merger brings together two route structures that have little overlap United's east-west routes and western presence and US Airways' north-south network in the eastern United States. Indeed, with respect to the Northeast where US Airways has a large and longstanding presence, United has a relatively modest presence. Thus, the combination of United with US Airways will not measurably increase United's presence in the Northeast beyond US Airways' current operations. In addition, competition from new entrant carriers in the Northeast is growing immeasurably. Southwest, JetBlue, and AirTran have all recently increased their presence in the Northeast. Southwest alone has over 200 additional aircraft on order, which it has publicly announced are to be targeted for East Coast expansion.

Furthermore, the benefits of the merger are overwhelming for the consumers of both airlines and the many communities across the country that US Airways and United serve. Importantly, while US Airways today has an extensive presence in the Northeast, it lacks critical access to transcontinental and global markets. The result is that US Airways' passengers lack the convenient service to markets on the West Coast, Latin America, and Asia that they demand and deserve. This merger will link US Airways' predominantly eastern network to United's global system resulting in a truly national carrier that efficiently serves all four corners of this country, as well as international markets. The combined United will provide on-line service for the first time to over 4,000 city-pairs. The merged carrier will also offer 64 new daily nonstop flights in the United States and 29 new daily international flights. United has also publicly committed to a two-year freeze on structure fares, except for CPI and fuel cost adjustments. And, the proposed merger expressly provides for the creation of an independent, new entrant carrier, DC Air, based at Ronald Reagan Washington National Airport. For these reasons, among many others, consumers will benefit greatly from this merger.

Question 2. Consider last year's United/US Airways combined market share at the following airports.

Charlotte—70.1%
Chicago O'Hare—50.4%

Denver—57.5%
Philadelphia—59. 5%
Pittsburgh—72.4%
San Francisco—51.8%
Washington (Dulles)—56.4%
Washington (National)—35.5%

Given these figures, do you believe the merger will foster competition and low fares, and as Mr. Goodwin maintains, expand customer choice? If so, how?

Answer. The proposed United-US Airways merger will foster competition, greater consumer choice, and low fares. The combined carrier's route network will inject new competition into more than 500 city-pairs currently served by only one carrier. It will create first-time on-line service to over 4,000 city-pairs, and 93 new nonstop flights to international and domestic destinations. The combined carrier will also provide consumers with new single-carrier service in approximately 560 new city-pair markets, thereby further providing consumers with expanded service options.

Of the airports listed above, only Washington National Airport and Chicago O'Hare currently have slot constraints, and O'Hare's slot regime will be eliminated in 2002. Accordingly, access for new entrants and expanded opportunities for other more established carriers are available at the airports listed above. Even at slot-constrained Washington National, new entrants (e.g., National, Frontier, Spirit) have recently obtained access under AIR 21. Importantly, this merger specifically provides for the creation of an independent, new entrant air carrier based at Washington National Airport with nonstop service to 43 communities.

Question 3. What do you say to critics who express concern that the merger will combine the number one and number two carriers in five northeast airports?

Answer. This concern is misplaced. US Airways and United have very little overlap in their route structures. They similarly have little overlapping operations at their respective hubs. As such, this merger will not measurably increase concentration. Where there was a potential concentration issue, namely Washington, D.C., because of United's presence at Dulles and US Airways' operations at Washington National, we addressed the issue head-on with the creation of an independent, new entrant carrier, DC Air. By bringing together two complementary route structures that have little overlap, this merger will expand consumer choices and enhance, not diminish, competition. Moreover, competition is intense in the Northeast. Not only do the major carriers compete vigorously for traffic over their domestic and international networks, but low-cost carriers such as Southwest and JetBlue are undergoing significant expansion into northeastern markets, transforming East Coast markets with the introduction of point-to-point service at lower fares.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. SLADE GORTON TO STEPHEN M. WOLF

Question 1. For the past several years, while the airline industry has been making record profits, US Airways has continued to struggle making money. It has been generally unable to secure global alliances that have benefited other major airlines, has not succeeded in securing wide entry to Great Britain, and continues to labor under a heavy cost structure. If DOJ approves the merger and the economy drops into a downturn, how will the merged carrier be able to continue its operations at all its newly acquired hubs?

Answer. We are confident that the merged carrier will be able to continue operations at Charlotte, Pittsburgh, and Philadelphia during an economic downturn for several reasons. First, by combining the complementary route structures of United and US Airways, this merger will create more growth, more jobs, and greater service opportunities. This is evident in the 93 new non-stop flights, many of which are being added at Philadelphia, Pittsburgh, and Charlotte, that will be initiated as a result of the merger. Second, by maintaining these network hubs, United will continue to serve the substantial connecting traffic that US Airways has long flowed through its hubs. Third, United is connecting these new hubs to its global system, including the STAR alliance. This will increase traffic flows from the cities served today by US Airways by opening up hundreds of new single carrier one-stop city pair connections.

Question 2. As is well known, the proposed arrangement between United and US Airways includes the creation of a new corporate airline, DC Air. This operation would, at first, rely completely on aircraft and personnel wet-leased from the merged entity. How did you decide what routes that DC Air would operate, and which ones might be retained by the merged United?

Answer. When we recognized the possible concentration in the Washington, D.C. area resulting from this merger, it was determined to divest certain assets at slot-constrained Washington National Airport. Rather than pick and choose, we agreed to divest every route operated by US Airways at Reagan Washington National Airport—so that a new entrant carrier would have a strong, viable basis for operation and so that all cities currently receiving service by US Airways would continue to be served. The lone exceptions were splitting the slots for flights to the three US Airways hubs (Philadelphia, Pittsburgh, and Charlotte), so that passengers would not lose access to the broad competitive United network from those cities, and the operations currently known as the US Airways Shuttle.

To sell or otherwise divest our National Airport assets (e.g., slots, facilities) on a piecemeal basis would practically ensure that many of the small and mid-sized communities that, over the last 50 years, have come to rely on US Airways and US Airways Express would lose their non-stop service. Other carriers, including low-cost competitors, would utilize these slots and facilities to strengthen or otherwise enhance their most profitable current services—services to their hubs or to their other focus cities. Other carriers would not be willing to use these assets to operate flights to the 43 small and mid-sized communities to which DC Air has committed that it will continue service.

Question 3. Clearly, the proposed arrangement seems like a good deal for US Airways' frequent flyers, who would gain access to a larger number of destinations than that currently offered by its own program. Yet United has begun converting its fleet into an "economy plus" configuration, in which it has removed one row of seats to provide additional legroom for some passengers. Because the merged airline will now be serving roughly 50 percent more frequent flyers but restricting its capacity, could you explain how those frequent flyers are going to be able to redeem their award travel?

Answer. US Airways passengers will benefit greatly by gaining access to the worldwide reach of United's frequent flyer program. United has developed an outstanding frequent flyer program and is fully committed to providing all of the benefits associated with its program to US Airways passengers. The decision by United to address customer concerns about cramped passenger cabins and a lack of legroom will not preclude frequent flyer members from redeeming their mileage for award travel. While United's frequent flyer program will grow with the addition of US Airways' Dividend Miles program, United will also be obtaining all of the aircraft in US Airways' fleet as well as US Airways' options for many more such aircraft in the near future. Not only will aircraft capacity be substantially increased, but the merged carrier will have greater flexibility in allocating appropriately sized aircraft to specific routes.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. ERNEST F. HOLLINGS TO STEPHEN M. WOLF

Question 1. US Airways has an agreement with SABRE to provide its computer reservation system services. What are the terms of that agreement if US Airways chooses to change to the Galileo system (assuming that once the deal is approved, the CRS services will be provided by Galileo)?

Answer. US Airways' agreement with Sabre, which after lengthy negotiations was consummated on December 15, 1997, is subject to a strict confidentiality provision which prohibits US Airways from disclosing the terms of that agreement under circumstances such as this. Accordingly, US Airways is not at liberty to describe what would result, if anything, should US Airways terminate its relationship with Sabre. US Airways, however, has no intention of altering this relationship. After the merger is finalized, any decision to change the Sabre agreement would be made by United as the surviving earner.

Question 2. Pilot Contracts—it has been rumored that the US Airways pilots' contract has a clause that will give them $250 million if there is a change in ownership. Please explain the impact of such a provision, or similar provisions that could affect the proposed deal.

Answer. The US Airways pilots' contract includes a Letter Agreement that requires, under certain specific circumstances, a $250 million payment to the pilots in the event of an acquisition. This payment, however, is not required merely upon a change in ownership, and thus the closing of the proposed transaction will not trigger such a payment.

Question 3. According to SalomonSmithBarney, the transaction will provide significant revenue benefits to the combined carrier (report on May 31). Can you explain the rationale for those benefits, and also explain if those benefits are primarily derived from passengers choosing the combined carrier over another carrier?

Answer. The revenue benefits that United anticipates as a result of the merger stem from the hundreds of new city-pair routes that United will offer by integrating US Airways' route network into its own. Because the route networks of US Airways and United cover largely different areas of the country and have little overlap, their combination will result in a truly efficient nationwide carrier, providing passengers for both airlines hundreds of new travel options that simply were unavailable before. This expanded network will make United a much more attractive option for travelers, resulting not only in existing passengers choosing United over another carrier but also stimulating new demand.

Question 4. According to SEC information provided by you, the combined carrier will be the largest carrier in 5 of the 6 biggest metropolitan areas. Why do you believe that from a competition policy standpoint such concentrations should rest in one carrier's hands?

Answer. While the combined carrier will be the largest carrier in 5 of the 6 biggest metropolitan areas after the merger, this does not mean that there will be less competition. To the contrary, because US Airways and United have very little overlap, this merger will bring together two complementary route systems producing significant benefits for passengers and enhancing what is already an intensely competitive marketplace. For example:

- The combined carrier's route network will continue to compete vigorously with the hub-based networks of other carriers (e.g., American at Chicago O'Hare, Delta and Continental at New York). It will inject new competition into more than 500 city-pairs currently served by only one carrier. The combined carrier will also offer one-airline, seamless service in approximately 560 new city-pairs.
- Overall services offered by the combined carrier will be greatly expanded, including new, first-time on-line service to over 4,000 city-pairs, and 93 new non-stop flights to international and domestic destinations.
- The merger will also greatly enhance the ability of US Airways' existing hubs in Pittsburgh, Philadelphia, and Charlotte to compete with other hubs and international gateways, such as Newark, Atlanta, Cleveland, and Detroit.
- With respect to fares or pricing, United has publicly committed to an unprecedented, and easily monitored, two-year freeze on structure fares (except for CPI and fuel cost adjustments).

Competition is and will remain intense in each of the six largest metropolitan areas of the country. The major network carriers will continue to compete with each other in each area for domestic and international traffic over their respective networks, while low cost carriers, such as Southwest and JetBlue, will continue to offer lower fares in regional markets.

Question 5. Should we condition this merger on DOT issuing final rules on predatory pricing?

Answer. This merger will bring unprecedented benefits to the traveling public by creating a truly nationwide network and enhancing competition. United has also publicly committed to an unprecedented, and easily monitored, two-year freeze on structure fares (excluding CPI and fuel cost adjustments). It is on these grounds that the merger should be approved.

The Department of Transportation has issued its proposed rules on predatory pricing and currently is reviewing the hundreds of comments that it received in response to its proposal. This process is not related to the evaluation of the merger currently being conducted by the Department of Justice.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO STEPHEN M. WOLF

Question 1. Mr. Wolf, did the merger parties consider proposing to divest the carriers' hub-to-hub routes, such as Charlotte to Denver, or Pittsburgh to San Francisco, for instance? If so, who did you anticipate would operate those hub-to-hub routes?

Answer. Because there is very little overlap in the networks of the two carriers, there are only four routes where US Airways and United currently are the only carriers providing scheduled non-stop service: Charlotte to Chicago (O'Hare), Philadelphia to Denver, Philadelphia to San Francisco, and Philadelphia to Los Angeles. Although we never considered elimination of service on these or any other hub-to-hub routes, we did consider divestiture of such assets as may be appropriate to stimulate new entry by other carriers. Any such divestiture would vary by route depending on local competition and could include such things as gates, ticket counter space, and other similar facilities.

We believe there are several existing carriers that could successfully operate service in these markets. Because there are no slots or other restrictions at the affected airports except O'Hare (where slots will be eliminated in 2002), this kind of entry is not only possible, but likely.

Question 2. Early reports following your merger announcement were that Metrojet will go away, which could further reduce competition in the Washington metropolitan area. Tell me as much as you can about what will happen to Metrojet as a result of the merger.

Answer. United operates a west coast service similar to MetroJet which is called Shuttle by United. Mr. Goodwin testified before the House Transportation and Infrastructure Committee on June 13, 2000, that post-merger United may introduce Shuttle by United to the east coast, which would effectively continue to offer a low fare product similar to US Airways' MetroJet.

Question 3. My sense is that wet leases are common in the airline industry. Do you know of another instance, however, where a major air carrier has entered into a wet lease agreement with one of its low fare competitors?

Answer. Wet leases are common in the airline industry, both in the domestic context as well as the international arena. However, because we are not privy to the lease agreements of other carriers, we cannot confirm another instance where a major carrier has entered into a wet lease agreement with one of its low fare competitors. Based on published news reports, however, we do know that such wet lease arrangements have been contemplated. These instances include possible agreements between America West and Midway and between America West and American Trans Air.

Question 4. In your testimony, you made much of the fact that only one new airport has been built in the U.S. in recent memory, and that airport merely replaced an old one. You also discussed how constrained the aviation system is. Why then do the major airlines oppose the construction of a third airport in the Chicago area at Peotone? How do you reconcile your testimony with any proposal to expand capacity by building a new airport?

US Airways has a very limited presence in the Chicago area. It thus makes little sense for us to spread our operations across three different airports in the Chicago area. Accordingly, if a new airport were to be built at Peotone or elsewhere in the Chicago area, it might not be economically or operationally sensible for US Airways to serve the airport. Nonetheless, there is little question that the aviation infrastructure of this country has been pushed to its limits and is in dire need of improvements. There are more people traveling today at cheaper fares to more destinations than ever before. This Committee has taken steps under the recently enacted reauthorization legislation to address the situation, and for that we are grateful. But this should only be the beginning. We look forward to working further with the Committee so that our airports have the capacity to provide the traveling public with the frequency and quality of service it deserves.

Prepared Statement of Kent G. George, Executive Director, Allegheny County Airport Authority

Good morning, Mr. Chairman and Committee Members. My name is Kent George and I am the Executive Director of the Allegheny County Airport Authority. I would like to thank the Committee for this opportunity to present our region's views on United Airlines' $11.6 billion acquisition of US Airways.

In the early 1980s unemployment in Pittsburgh was at its height following the closure of virtually all the major steel mills. The region suffered the largest job loss per capita in our country's history. By the early 1990s, the city was only reporting half the job growth of the national average.

We have been working diligently to recover, and finally our region is beginning to grow. 120,000 people are employed in the technology field. That represents 12% of the workforce and 18% of the payroll. Our colleges and universities are world-renowned and we stand among the top ten centers in medical research.

Today, Pittsburgh is the corporate headquarters of many Fortune 500 companies. We have numerous business parks nurturing both U.S. and foreign investment. Multinational companies like Sony and Bayer have located in the region and many local corporations like H.J. Heinz, Alcoa and PPG continue to succeed in the global marketplace.

Pittsburgh International Airport (PIT) is the world's gateway for Pittsburgh, southwestern Pennsylvania, northern West Virginia, and eastern Ohio. It is an integral part of the economic fabric of its serving area, creating over 18,000 direct airport-related jobs and over $3.5 billion a year in economic impact.

PIT has received worldwide recognition for its now famous Airmall®, featuring over 100 retail, specialty services and food and beverage stores all at guaranteed street prices. Its distinctive 900-acre X-shaped terminal is designed to give connecting passengers easy access to all 75 gates without ever changing levels or terminals.

And just last year, because of it's traveler-friendly design, the readers of *Condé Nast Traveler* magazine voted Pittsburgh International Airport the best airport in North America and the third best airport in the world.

Pittsburgh International is an expanding airport with a significant list of development projects. Next month, we will open a Hyatt airport hotel and conference center. We also plan to more than double the cargo ramp and building capacity, and we are creating a Business Aviation Center and a 300,000 square foot Airside Business Park.

PIT covers more than 12,000 acres, making it the third-largest airport complex in the U.S., so large that you could fit Atlanta and Chicago O'Hare airports within its boundaries. The huge amount of space we have available gives us many advantages. The apron is large enough for one aircraft to pull back from the gate while another is pulling into the same space. The system of taxiways surrounding the entire airside building allows aircraft to exit the runways at a greater speed, taxi in either direction and avoid delays. And we have excess airspace and airfield capacity to accommodate future growth.

Located roughly midway between New York and Chicago, Pittsburgh lies within one hour's flying time of nearly 50 percent of the U.S. and Canadian populations or 71.3 million people, and 63 percent of U.S. manufacturing output.

And don't worry about the weather. Smooth operations regardless of the weather make PIT North America's airport of choice for reliability.

Clearly, Pittsburgh International Airport is one of the Southwestern Pennsylvania region's most significant assets. Presently, US Airways has a major hub agreement at Pittsburgh International Airport generating 515 flights per day both domestically and internationally. With United Airlines and US Airways announcement on May 23, 2000, I am deeply concerned not only about the continued presence of a major hub at Pittsburgh International Airport, but also for the continued employment of the approximately 11,700 employees of US Airways in southwestern Pennsylvania.

With the announced acquisition by United of US Airways, it is imperative that a number of matters that affect our region are contained in any Conditions of Approval, which the Department of Justice and Department of Transportation would make, if they should decide to grant approval for this merger.

While the discussions I have had with James Goodwin of United Airlines and Stephen Wolf of US Airways have been very positive, contracts between parties often do not turn out as contemplated. Therefore, I request that this Committee urge the Department of Justice to ensure the following items are addressed in their Order:

1. With the hardship endured by our region in the 1970s and 1980s, one of our foremost concerns is for the approximately 11,700 individuals currently employed by US Airways in Southwestern Pennsylvania, eastern Ohio and northern West Virginia. We need an absolute commitment contained in the Conditions of Approval of this merger that these jobs will be maintained in our region beyond United's two-year pledge.

2. The taxpayers of Allegheny County provided the financial vehicle through bonds to fund the construction of the $800-million Midfield Terminal Complex at Pittsburgh International Airport. US Airways is the principal guarantor on those bonds. US Airways presently uses nearly 90 percent of the midfield terminal and pays the majority of the outstanding debt, which totals over $700 million. We need written assurances that United Airlines will assume US Airways existing lease and guarantee payment of all future obligations of US Airways.

3. With significant federal support and the expectation that it would be a major hub, Pittsburgh International Airport opened in 1992. US Airways currently operates approximately 515 flights a day to 110 non-stop destinations throughout the U.S. and Europe from Pittsburgh International Airport. The Airport is the economic engine of the region and provides us access to the world and the world access to our region. While United flies mostly east-west domestic flights and international routes, and US Airways strength is in its north-south routes on the East Coast, we must be certain that the existing level of service is maintained and included in the

Conditions of Approval of the merger. On a long-term basis, Pittsburgh must remain a significant US domestic hub.

4. By year's end, US Airways and United Airlines will have an extensive fleet of Airbus aircraft with numerous new aircraft on order. Both airlines have indicated a need for a new maintenance facility to perform maintenance and safety checks on these aircraft. An excellent, trained workforce is available right now in southwestern Pennsylvania to perform these tasks and the needed facilities have already been designed for construction at Pittsburgh International Airport. We ask your help in urging United Airlines to follow through with US Airways plans to construct this facility, and commit to do so within the next two years.

Pittsburgh International Airport is strategically located in North America to reach much of the population of the United States and Canada within in 1-hour flying time. National and international travelers give Pittsburgh International Airport an A+ rating. Our workforce and work ethic are second to none. We are capable of handling any aircraft used today and our facilities are easily expandable.

Not only is Pittsburgh International Airport an economic generator in terms of jobs, but it serves as a major connection hub, linking Pittsburgh businesses, passengers and cargo with cities around the world. It is extremely well located in every sense and its physical structure is flexible, functional, attractive and expandable.

Mr. Chairman and Committee members, I ask your assistance to strongly convey to the Departments of Justice and Transportation our need for guarantees to preserve the economic future of a region rich in resources. Pittsburgh is poised for takeoff. Thank you for the opportunity to present this information to you today.

Prepared Statement of David Neeleman, Chief Executive Officer, JetBlue Airways Corporation

Mr. Chairman, Ranking Member Hollings and Other distinguished members:

Please accept this written submittal on behalf of JetBlue Airway's more than 600 employees.

JetBlue Airways is *New York's low fare hometown airline.* This is more than a marketing slogan, its really who we are.

As a new entrant, low fare carrier, I am convinced that the only way to always offer the traveling public affordable airfares is to remain a low cost company. In order for JetBlue to remain a low cost company, we needed: unprecedented financing, $130 million; a fleet of brand new modern jets, the Airbus A320; a sound business plan, offering low fares and great service to the world's busiest travel market New York City; and finally an experienced and exceptional management team. I believe we have all four of these ingredients and thus far, the traveling public seems to agree.

These cornerstones of our business, coupled with a focus on productivity and efficiency, have allowed us to hire at above market wages and to deliver "the JetBlue Experience" to more than 200,000 customers.

Having inaugurated service in February of this year with flights between New York City and Buffalo, we just took delivery of our fourth new aircraft last week. After the live satellite television screens are installed at each of its 162 leather seats, it will enter low fare service next week to and from Orlando. Shortly after launching Orlando, JetBlue will serve Rochester, New York and Burlington, Vermont, two of the highest priced travel destinations in America. By the end of the year, we will have ten brand new aircraft in ten cities and this growth pace will continue for at least four years and forty aircraft.

Importantly, even at this pace, I know that in four years JetBlue will still be a very small regional carrier. This is precisely why certain aspects of the proposed merger, and its potential consequences for the entire industry, are of concern to JetBlue.

From a macro perspective, if this deal is approved, I believe other large carriers will feel the need gain additional market strength in order to keep pace with United. Whether or not such moves are economically justified or in the best interest of their shareholders or customers, I still believe this will occur.

This industry consolidation could conceivably result in three or four major carriers carrying upwards of 85 percent of all US domestic traffic. As an entrepreneur who has started and then sold companies, including an airline, I am not against airline mergers per se nor am I against the concept of this merger. However, industry consolidation such as would occur through this merger, and others, absent protection for smaller carriers trying to compete fairly in the domestic marketplace, can only be seen as harmful to the American consumer.

When there are fewer companies competing in a market, any market, prices tend to rise. Small carriers, whether low fare in nature like JetBlue or otherwise, must be assured a level playing field and the ability to compete. To ensure the consumer's continued access to multiple carriers and low fares as the industry consolidates, small airlines must be afforded access into concentrated airports as well as access to commercially viable facilities such as gates and counter space at these airports. While some carriers claim airspace is the most pressing issue facing the U.S. airline industry, I believe the ability of small carriers to access concentrated airports and obtain adequate facilities is the most critical issue facing new entrant carriers.

Also, as carriers consolidate their systems and pare down overlapping or inconsistent routes, lessening consumer choices, they will be in a far stronger position to utilize their suddenly available excess equipment to the disadvantage of their competitors, especially smaller carriers and new entrants.

As this deal is reviewed, I believe Congress and the Departments of Justice and Transportation should carefully examine these negative ramifications and consider ways for United and US Airways to eliminate these and similar problems. One approach which may prove to be a good starting point would be to strengthen and enact the Department of Transportation's Competition Guidelines while also increasing the use of the its unfair practices enforcement powers. I suspect the need for the Guidelines may prove greater than ever as the industry consolidates.

On a micro perspective, this deal presents several areas that I believe need to be addressed. Included here are specific airport access and facilities issues as well as specific city-pair routings where the only carrier in several large markets will be the new United. Also, in this regard, I believe that the proposed DC Air presents an unworkable attempt to solve the obvious hub domination issue that will exist in the Washington DC-Baltimore metropolitan area.

From the press accounts I have read, DC Air is poised to become Washington DC's new low fare airline; and it is suggested that it will be profitable too. I have a tremendous amount of respect for its potential new CEO, Robert Johnson. He is one of America's premier entrepreneurs with a stellar track record.

Yet the deal itself is not only bad for consumers in the entire Washington metropolitan region, it is bad for consumers throughout the eastern United States who visit Washington on business or leisure travel.

United Airlines is by far the dominant carrier today at Dulles Airport. After the merger, its dominance will increase. After the merger, United will also become the dominant carrier at BWI. And right in the middle, at Reagan National Airport, DC Air will supposedly eliminate that new regional dominance.

DC Air will be flying a fleet of jets, most of which will have 50 or fewer seats. Its costs, as a so-called "virtual airline" that wet-leases the vast majority of its operational assets and personnel from United, will be high, as will its own operating costs given its equipment type and proposed route structure. In fact, with the proposed route system as I have seen it, most of DC Air's markets will have far less capacity than those markets receive today with US Airways.

With a decreased supply, and even a steady demand, prices for consumers in all DC Air's markets will likely increase. Since the deregulation of the domestic airline industry in 1978, passenger traffic at Washington's National Airport has actually decreased by 360,000, a drop of more than five percent. Operations at National have also decreased during this period by more than 10 percent. Under DC Air's proposal, not only will the daily capacity further decrease at National Airport, by 16 percent, but so too will the number of daily operations, by 8 percent. With less supply into slot-controlled National Airport, leisure travelers seeking lower fares will likely find them unavailable and be forced to utilize the two remaining United dominated airports in the region.

I do not believe the DC Air proposal, which will significantly reduce capacity at the already under utilized and artificially slot-controlled National Airport, should be rubber-stamped by the regulatory authorities.

National is a unique airport. New entrants have effectively been barred since 1986 as slots cannot be purchased at any price and lease prices are prohibitive. Even with the new FAA Reauthorization law, there is no end in sight to National Airport's slot regime which has yielded less than a one percent growth rate in passenger traffic over the past twenty-five years while total domestic enplanements have grown by more than 200 percent in this same period. This is clearly not the most efficient utilization of the taxpayer's most scarce aviation resource. Given the new competitive landscape that will be painted by this deal, coupled with National Airport's unique attributes, I believe the Department of Justice should insist that a portion of the slots that DC Air seeks to purchase at a below market price be returned to the government, from whence they came at no cost, and be allocated to qualified new entrant carriers who will legitimately spur competition.

Mr. Chairman, in the end, the post-deregulation domestic airline landscape is littered with many start-up carriers that have failed due to a combination of weak management, an inability to achieve low costs and/or a poor business plan. JetBlue is not, nor will it become, this type of carrier. We have performed our due diligence and have successfully begun to implement our business plan in the largest travel market in the nation. All that we seek from those reviewing this merger is to correct some of its negative aspects and afford us a fair chance to grow our franchise and create further opportunities for customers to enjoy the JetBlue Experience.

In closing, I am reminded of a forward-looking statement recently made by the President of United Airlines. He said that with this deal, for domestic purposes, United would become a "finished network." Possibly speculating on others in the industry, he added that consumers would benefit most from the competition of but three or four national carriers and dozens of smaller regional carriers. Frankly, with but one reservation, I cannot altogether disagree with his prognostication. However, my reservation is simply that these dozens of smaller regional carriers he refers to have a fair opportunity to compete in *every market they so choose*. This is JetBlue's chief concern.

Thank you.

Attachment

STATE	ROUTE	TODAY @ DCA	DC AIR	DULLES
NY	DC–ALB $379 1w	US x 3 jets = 378 seats	3 RJ = 150 seats	6 US Exp* 3 US Exp
	DC–BUF $379 1w	US x 3 jets = 361 seats	3 RJ = 150 seats	8 UA Exp 3 US Exp
	DCA–SYR $386 1w	US x 3 jets = 323 seats	3 RJ = 150 seats	6 UA Exp 3 US Exp
	DCA–ROC $346 1w	US x 3 jets = 362 seats	3 RJ = 150 seats	7 UA Exp*** 4 US Exp
OH	DCA–DAY $393 1w	US x 3 jets = 326 seats	3 RJ = 150 seats	3 UA Exp 3 US Exp
	DCA–CMH $439 1w	US x 3 jets = 320 seats	3 RJ = 150 seats	7 UA Exp* 3 US Exp
VT	DCA–BTV $400 1w	US x 3 prop = 96 seats	2 RJ = 100 seats	4 UA Exp**
SC	DCA–CHS $449 1w	US x 3 mix = 196 seats	3 RJ = 150 seats	5 UA Exp*
TN	DCA–TYS $380 1w	US x 4 mix = 164 seats	3 RJ = 150 seats	3 UA Exp

All fares are full fare, one-way fares as of June 13, 2000
RJ = 50 seat regional jet
Exp = commuter affiliate at IAD utilizing turboprops
* = includes both regional jets and turboprops
** = all flights operated with 50 seat regional jets
*** =all flights operate with turboprop, except one 737

PREPARED STATEMENT OF ED PERKINS, CONSUMER ADVOCATE, THE AMERICAN SOCIETY OF TRAVEL AGENTS, INC.

My name is Ed Perkins, and I currently serve as the Consumer Advocate for the American Society of Travel Agents (ASTA). I am also a nationally syndicated travel columnist and author of several travel buying guides. I was Founding Editor of Consumer Reports Travel Letter, from which I retired in 1998. In addressing you today, I am focused solely on the interests of American consumers, not on those of the travel industry or any of its components.

In my view, we can't view a proposed merger of United Airlines and US Airways in isolation. Instead, we must look at it in the broader context of concentration in the US airline marketplace. And in that context, I submit that the merger of United and US Airways—or any other merger between any of the six giant lines—would be highly inimical to the general public interest and the interests of travel consumers. I base that conclusion on two sets of issues: pricing and labor. Let's look at each.

You've already seen and heard lots of claims about the merger's possible impact on prices. Many of the industry's most celebrated economists have published learned treatises, and they generally seem to agree: fares would either go up, go down, or stay about the same. Not to disparage those economists—I used to be one, myself—but we all know that, depending on how they structure an issue and the assumptions they make, capable economists can come to diametrically opposite conclusions about almost any issue. Certainly this one. More to the point: If we get bogged down in the details of relative costs, overlapping routes, hub consolidations, differential wage rates, and such, we'll quickly lose sight of the basic principles that should really govern the decision.

Instead of looking at all those murky details, we should focus on how one or more mergers would impact the process by which the giant airlines raise and lower prices—specifically, how they would affect the pricing dynamic in a commodity market, which is the way today's airline market behaves.

Price increases happen when one giant airline decides an increase would be a good thing. Immediately, the other giant lines study the increase and determine if they would also like to see higher prices. One by one, those that agree announce their own hikes—sometimes following the originator, sometimes with adjustments. As in the old saying, one airline runs the fare hike up the flagpole, and the others start saluting it.

What's critically important here is that it now only takes one of the six giant lines to reverse the hike. In effect, each of those six lines has veto power over price hikes in the entire national airline marketplace. If any one of them doesn't salute, the hike is quickly run back down the flagpole and returned to the closet.

Clearly, the fewer the number of giant lines, the less chance that any given price hike will be vetoed. And, in a worst-case scenario, a concentration down to only three super-giants would make it far easier for any one of them to make price hikes stick.

The fare-cutting process works the same way. It takes only one of the six giants to kick off a nationwide fare war. And, as you probably know, that's when a lot of ordinary consumers buy their tickets. When it comes to starting a fare war, six chances for a price cut are far better than five, four, or three.

Labor issues, too, militate against further concentration. With the largest U.S. line owning no more than about a 17% share of the domestic market, the nation's economy can survive the complete shutdown of any one giant airline. But only barely: The last American shutdown showed us how much disruption resulted from a loss of just 11% of the domestic lift, as measured in passengers.

If you liked that strike, you'd love a shutdown of a merged United-US Airways system. That would represent just about twice the American share. Even worse, of course, would be a merged American and Delta, with a staggering 28% share of total passengers.

We made it through the American stoppage as well as we did, at least in part, because other five giant airlines—plus the smaller players—managed to absorb most of American's travelers, over an extended period. But could fewer other airlines absorb twice as many displaced passengers without far more serious disruption? Or, in the worst case, could two remaining super-giant lines absorb 28% of the passengers? I don't think so. Instead, the effects of a super-giant strike would be devastating to the economy, and certainly to the travel plans of millions of consumers. As with pricing, for labor reasons alone, we just can't risk more market concentration.

One more point: let's not forget the largely negative effects of an earlier wave of mergers and acquisitions. How such user-friendly lines as Air California, New York Air, PSA, Piedmont, and Republic disappeared in the black hole of mergers? Don't take my word for it; ask someone from Charlotte or Detroit.

"It needs more study" is the classic way of evading a tough-minded decision. Or, in Carleton Green's construct, it's a way of handling a tough question by "dissolving it in a weak solution." I would submit that we don't need any more study on the merger question. We can't afford a weak solution. This is one of those cases that should be decided by basic principles and common sense, not statistical models.

And those basic principles come in with a clear message: No more concentration by merger. No more buying out potential competitors rather than competing with them. We should take merger and acquisition among any of the six giant lines completely off the table, starting now. If any one of those lines is desperate to increase its market share anywhere in the US, let that line do it the old-fashioned way: earn it, with better service and lower fares.

Thanks for your attention.

PREPARED STATEMENT OF AMERICA WEST AIRLINES, INC.

America West Airlines, Inc. offers these comments in conjunction with the Committee's evaluation of the public interest impact on competition of the proposed merger between United Airlines and US Airways and the sale of Washington Reagan National Airport slots to a proposed new airline DC Air. America West is very concerned that already serious competitive barriers, particularly at airports where United and US Airways have dominant or strong positions, will only be exacerbated should the merger be approved in its proposed form.

For America West and other post deregulation carriers, government imposed or sanctioned competitive barriers including the perimeter rules at Reagan National and LaGuardia airports, continuing slot constraints at National, LaGuardia and Kennedy, and the unavailability of economically usable gates at many metropolitan airports including National, LaGuardia, Newark, Logan and O'Hare, make it virtually impossible for new post deregulation carriers to launch meaningful competition at these airports. America West appreciates the positive changes to the slot rules enacted by Air 21. However, the proposed merger highlights the immediate need, before any merger which contributes to these constraints goes forward, for more expansive Congressional action to induce badly needed new competition to key airports in the East and in Chicago.

Background

In 1977, Alfred Kahn, chairman of the Civil Aeronautics Board, noted that "Whenever competition is feasible it is, for all its imperfections, superior to regulation as a means of serving the public interest." The following year, the Airline Deregulation Act was implemented, phasing out government control over fares and service. From that point on, Congress intended that market forces would dictate the price, quantity and quality of domestic air service. In the deregulated environment, consumers would reap the benefits of open competition in a free marketplace.

America West Airlines provides the model for post-deregulation success. It initiated service on Aug. 1, 1983, with three aircraft, 280 employees and a route system consisting of five destinations. As a small start-up carrier competing head-to-head against much larger and better-established airlines, its potential for success would be defined by its ability to effectively distinguish itself from the competition and build a solid base of loyal customers. Today, America West, the nation's ninth largest commercial airline, is the only post deregulation airline to achieve major carrier status. It has established an effective marketing and operational niche as the only major network airline to offer a combination of full-service and low fares. Its customers enjoy the same full range of services provided by larger airlines, including advance seat assignments, First Class cabins in every aircraft, a competitive frequent-flyer program, an airport lounge club, electronic and online booking, onboard audiovisual entertainment systems and inflight meal service. America West's 1999 unit cost of 7.52 cents per available seat mile was, for the sixth consecutive year, the lowest unit cost of all full-service major carriers. These low costs enable America West to deliver upon deregulation's promise of expanding the reach of commercial air service by developing new markets to smaller communities not otherwise served by major earners. America West's East Coast to West Coast "walk up" fares and average fares are substantially below those of the largest incumbent carriers.

America West has achieved this success while weathering the storms of the marketplace. Mergers, bankruptcies, severe increases in the price of fuel, and deep traffic losses caused by war and recession have all been overcome. America West is committed to bringing more East-West competition to key Eastern airports like Logan, LaGuardia, Newark and Reagan National, and to expand at O'Hare. To provide viable competition for business travelers, America West must offer a total of at least five roundtrips a day to its hubs. Slots, perimeter rules and lack of gates prevent the full development of this service and deprive the public of the benefits of competition by America West and other lower cost carriers. These barriers to competition remain as a result of government inaction. Without Congressional action, regardless of the outcome of the pending merger these barriers will remain. Further consolidation of the industry without government action to alleviate these barriers to entry will doom the competitive environment. Congress must act to ensure complete and unfettered access to the marketplace by eliminating archaic slot and perimeter rules while ensuring all competitors have access to gates and associated facilities at federally funded airports.

Slots

Congress recently made some additional new entrant slots available at O'Hare, LaGuardia and Kennedy airports and repealed the High Density Rule (HDR) governing Chicago's O'Hare to be fully effective in 2001 and New York's LaGuardia and

Kennedy airports in 2007. While this action was important, LaGuardia and JFK will remain subject to slot rules for seven more years. At these airports, slots will continue to hinder competitive entry. Moreover Air 21 did very little to stimulate competition at Reagan National Airport where the HDR restricts the number of hourly slots allocated for commercial takeoffs and landings to 37 for jets and 11 for commuter aircraft which total to approximately 760 commercial operations per day. The 24 daily exemption slots provided under Air 21 constitute only a three percent increase in slots. America West hopes to stimulate competition to the West at Reagan National with the slot exemptions it received under Air 21. However, its ability to do so is limited by the fact that it can operate only three daily round trips rather than the five it requested from the Department of Transportation. As a result of slot restrictions, DCA is one of the highest cost airports in the country, with virtually no ability to expand capacity or otherwise improve the competitive environment.

As America West has pointed out over the last decade, DOT/FAA attempts to increase competition at slot-controlled airports in general and at DCA in particular have been woefully inadequate. See Government Accounting Office, *Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets,* Letter 3 (Letter Report, 10.18/96, GAO/RCED–9704) (hereafter, *"GAO Airline Deregulation Report"*). According to the GAO, the trend toward market concentration at slot-controlled airports has continued throughout the past decade:

> Since the early 1990s, a few established carriers have continued to build upon the favorable positions they inherited as a result of grandfathering. By contrast, the share held by the airlines that started after deregulation has remained low.
>
> Because the number of slots is largely fixed and the holding of those slots is concentrated among a few established carriers, a seller's market has emerged, and slots have become very expensive.... Moreover, in order to mount competitive service in a market, an airline generally needs about six slots, with at least three slots falling during the peak periods so that the airline can offer a flight schedule that is attractive to business travelers. As a result, for the airlines that started after deregulation, the cost of purchasing the slots necessary to compete effectively may be prohibitive.
>
> Even if financing can be arranged, buying slots is extremely difficult for newer airlines because the established carriers rarely sell their slots, and when they do, the buyer is usually an airline that already holds a large number of slots at the airport.

GAO Airline Deregulation Report, Letter 3:1. The net result, according to the GAO: "[L]ittle or no entry has occurred at" Reagan National and other slot-controlled airports. *GAO Airline Deregulation Report,* Letter 3. America West urges Congress to advance the date for the termination of slots at LaGuardia and JFK, and to also act to abolish slots at Reagan National.

If the High Density Rule at Reagan National cannot be repealed, then slots must be added. In its 1995 slot study the Department of Transportation reported that DCA could easily handle an additional 7 slots an hour or 126 flights per day. Given the Stage 3 noise requirement, these slots could be added with no significant impact on noise or increase in delays. If Congress added 100 slots (50 additional round trips) for either inside or outside perimeter flights, to post deregulation carriers operating large aircraft, it would generate substantial new competition. Since 50 additional round trips by post deregulation carriers like America West could have a substantial competitive impact in many markets, the competitive concerns associated with the proposed transfer of slots to DC Air would be lessened. However, without a substantial increase in slots, any approval of the proposed merger should require the transfer of the proposed DC Air slots to post deregulation carriers that can maximize competition.

Perimeter Rules

Washington Reagan National

The perimeter rule at Reagan National limits non-stop flights to a distance of 1,250 miles. The perimeter rule never served any safety purpose. It was a tool created to divert traffic to the fledgling Washington Dulles International Airport. However, the primary effect of the rule has been to bolster the ability of the large incumbent carriers to flow East-West traffic through their primary hubs by offering multiple daily connecting flights and preventing new low fare competition. A recent GAO study shows that unrestrained access to Dulles and BWI by low-fare carriers has had little or no impact on fares at Reagan National, primarily because, for reasons of convenience, air travelers in the Baltimore Washington region (particularly business travelers) are unlikely to switch airports. GAO Letter Report, *Reagan Na-*

tional Airport: Capacity to Handle Additional Flights and Impact on Other Area Airports, Letters 1 and 5 (GAO/RCED–99–234, Sept. 1999). This situation would only be exacerbated if the proposed merger were permitted to go forward while the perimeter rule remains in effect.

Moreover, there is no longer any need to protect Dulles, which has established itself as a significant domestic and international destination. The airport's emplacements are already comparable to those at DCA. In addition much of the area's growing high tech enterprises and new residential development are located near Dulles which is the fastest growing airport in the United States as reflected in the recently announced a six year $3.4 billion building plan that includes a new runway. *Dulles to Undergo Major Expansion,* The Washington Post, July 20, 2000 at A–1. The pending transaction demonstrates the importance of Dulles and United's commitment to it. When faced with the perceived need to divest overlapping routes involving the Washington, D.C. area, United and US Airways voluntarily chose to retain Dulles and substantially reduce service to National. Today, the perimeter rule simply distorts the market while conferring no consumer benefits.

New York LaGuardia

The perimeter rule governing LaGuardia was imposed decades ago primarily to control ground congestion at and around the facility and to generate service at the newly developed JFK. Subsequent changes at LGA and JFK as well as aircraft technology over the intervening years makes the rule a superfluous barrier to entry that deprives New York travelers the full range of options that should be available at all three airports serving the New York metropolitan area. The Department of Transportation has found LaGuardia constitutes a unique market apart from these other airports. Barring action by the Port Authority of New York and New Jersey, only Congress is in a position to enact legislation to preempt the locally imposed perimeter rule—a significant barrier to competition at this critically important New York airport. The proposed merger would likely further restricted East-West competition from LaGuardia unless the perimeter rule is abolished.

Gates

Lack of adequate gate access and related facilities has hindered new entrants at many major Airport. Inability to obtain gates has hurt America West's ability to compete at major airports and remains a serious problem at eleven major airports including Newark, LaGuardia Philadelphia, Hartford, Baltimore-Washington, O'Hare, Atlanta and San Francisco. America West believes consumers would reap a high benefit from improved access by America West and other post deregulation carriers if gates at these airports were available. The gate and airport facilities problem will only be exacerbated by regulatory approval and closure of United—U.S. Airways merger, which consolidates gate holdings of United and US Airways at many of these airports. Without reasonable access to adequate gates and related facilities, new entry at key airports is effectively blocked. See Department of Transportation, *FAA/OST Task Force Study, Airport Business Practices and Their Impact on Airline Competition,* October 1999. Congress has responded to the Task Force Study by including in Air 21 a requirement for major airports to prepare a competition plan and requiring the Secretary of Transportation to "ensure that gates and other facilities are made available at costs that are fair and reasonable." America West applauds this action but believes Congress needs to take more aggressive action in this area.

Airport officials at Newark where 84 percent of the gates are subject to exclusive-use leases recently confirmed there are currently no gates available at that airport. At LaGuardia and O'Hare, 83 percent and 85 percent respectively of the gates are the subject of exclusive use agreements. According to the Metropolitan Washington Airports Authority (MWAA), all 42 gates available for jet operations at Reagan National are leased to the incumbent tenant airlines until 2014. *Reagan National Airport: Capacity to Handle Additional Flights and Impact on Other Area Airports* (Letter Report, 09/17/99, GAO/RCED–99–234). Although MWAA officials are committed to addressing gate access, a recent GAO report remains decidedly pessimistic:

> MWAA may make a gate available to another airline when it is not needed to support the tenant airline's scheduled operations. While a tenant airline cannot prevent another airline from using the gate when it does not need it, the only effective opportunity for a new entrant to initiate service at key business times of the day or for an incumbent to expand service is through a contractual arrangement with the tenant airline. To date, this is how new entrants have gained access to the airports.

These arrangements have been generally inadequate for new entrants and today the incumbents are withdrawing gates they have made available in the past. While incumbents may not use some gates and under utilize other gates at these airports, America West has been unable to obtain its own gates and is forced to enter into short term handling agreements with incumbents subject to 30 or 60 day termination clauses to operate at these facilities. For example, at O'Hare America West uses Continental gates under a master handling agreement. However, if as expected, Continental expands its O'Hare service, America West may be forced out of the airport. In this connection, the rapid growth of regional jets will soon put additional pressure on gate availability and post deregulation carriers will likely be squeezed out of many key airports if action to protect access is not taken soon. In addition, at O'Hare where America West has attempted unsuccessfully for over a year to obtain its own gates, it pays an annual fuel surcharge of between $250,000 and $300,000 because it is not a signatory airline. These additional charges place America West at a competitive disadvantage to incumbent carriers. At BWI, America West's short term agreement with Continental was recently terminated forcing America West to relocate to the International terminal, where it is the only domestic airline using international gates for domestic service. Moreover, BWI officials have stated that if it obtains additional international flights America West must give up these gates. If America West cannot locate gates with another incumbent it will be forced out of this important airport. Finally at San Francisco, another United stronghold, America West currently is handled by TWA. America West has requested two own gate from the airport. However, despite the renovation of the airport and Congressional concern that airports be pro-active in providing access for new entrants, America West's request will be considered only if Delta, which as a signatory airline has a preference does not take these gates.

America West's experience confirms the findings of the Department of Transportation and the GAO that exclusive use leases and majority in interest agreements to be barriers to entry. *Task Force Study* at 38. America West believes Congress should direct DOT to take immediate action to compel airports to provide reasonable gate access and other facilities to new entrant carriers where exclusive use or other agreements that are vestiges of the pre-deregulation system block competitive new entry. It is clear from the *Task Force Study* that current federal law—including Section 155 of Air 21, airport grant agreements with the FAA, and DOT's authority to prevent unfair trade practices by airlines—is sufficient to enable DOT to act aggressively to ensure new entrants gain reasonable access to gates. Should the Department of Justice consider approval of the merger, it must require United and US Airways to make available a reasonable number of gates at Reagan National, LaGuardia, Boston Logan, O'Hare and Newark to permit needed competition to be introduced by post deregulation carriers.

DC Air

Like many of the witnesses who testified on the proposed merger at the Committee hearings, America West questions whether DC Air represents a real competitive force at Reagan National. Certainly, DC Air will not be independent of United and this lack of independence means there will not be real competition against the merged carrier. DC Air will wet-lease ten 737–200 aircraft from United for at least two years. United will provide gates to DC Air, which as emphasized above, it is not prepared to do for other new entrants at Reagan National that could compete against it. United will also provide maintenance services and DC Air will participate in United's frequent flyer program. Such dependence, as members of this Committee have pointed out, does not create the true independence required to provide meaningful competition to the combined United/US Airways in any market.

America West and other post deregulation carriers have been essentially excluded from serving Reagan National. In this light, it would be unconscionable to permit United and US Airways to determine that a single start-up airline serving predominately short-haul routes, dependent on United for aircraft and support and linked to United's frequent flyer program and international alliance will solve any competitive concerns at the airport. In essence this would be like allowing American and British Airways to spin off a "new" airline at Heathrow that uses BA aircraft and crews and is a member of their oneworld alliance, to provide new competition at that airport.

Conclusion

Regardless of any conditions the Department of Justice may propose to United and US Airways to find this merger acceptable, America West believes additional Congressional action is necessary to eliminate those vestiges of the pre-1978 regulatory environment that continues to inhibit competition at key airports. Specifically, America West believes Congress should immediately:

- Advance the date for abolishing the slot restrictions at LaGuardia and Kennedy airports.
- Abolish slot restrictions at Reagan National or in the alternative provide 100 additional slots at to be made available to post deregulation earners.
- Abolish the perimeter rules at Reagan National and LaGuardia airports.
- Instruct the Secretary of Transportation to take the necessary steps to ensure that any post deregulation carrier can obtain sufficient gates and related facilities at major airports to operate up to five round trips a day to that carrier's primary hub airports.

By taking these steps, Congress will bring the benefits of deregulation to key airports in the East and Midwest where government policies and the historic dominance of the pre-deregulation carriers has prevented meaningful competition and unfairly tilted the playing field in favor of the major high fare carriers. Congress took an important first step in Air 21 to open up slots, and by permitting a few beyond perimeter flights at Reagan National. Now is the time for Congress to complete the process of deregulation and level the playing field so America West and other low cost highly competitive carriers can serve these important markets that remain subject to restraints that serve no purpose but to protect the largest incumbent airlines.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. MAX CLELAND TO ALBERT A. FOER

Question. Today we are down to about 6 major carriers. If two of the top six—whoever they are—merge, and we see as a result more hubs and higher prices, does this say to you that this direction is something that might not be in the best interest of the consumer?

Answer. I don't think we should necessarily associate more hubs with higher prices. The question is whether these hubs will be dominated by one carrier or be open to a reasonable amount of competition. More hubs that compete with other hubs by offering consumers alternative ways to go from A to B could also benefit consumers. My concerns are that (a) we have not yet established a policy that assures hubs will operate competitively and (b) there is a strong possibility that if two of the top six merge, a tipping effect will be set off, leading to not five airlines but some smaller number. (Recall, in fact, that Northwest and Continental are already in the process of merging, pending a court decision.)

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. SLADE GORTON TO ALBERT A. FOER

Question 1. One of the outcomes of airline deregulation has been the development of hub airports. In some of these cases, the hubs have been described as "fortress" hubs where new carriers have been unable to obtain market entry for a variety of reasons. The possible merger of United and US Airways has created a situation where two large U.S. airlines would have majority market positions at a number of airports. For example, at Philadelphia, where US Airways already has approximately 65 percent of the local market, that share would increase to about 72 percent following the merger. At Charlotte, where US Airways is virtually the only carrier, carrying about 90 percent of total traffic, the combination with United would add only incrementally to that share.

Do the antitrust laws allow for any sort of remedy that would address such market dominance?

Answer. The antitrust laws require the Justice Department to look at the impact of the merger in every individual market that is served by both airlines. Where it concludes that the merger "may" substantially reduce competition, it must take action, either to block the merger or to negotiate conditions that "fix" the anticompetitive problem. Thus, in specific hubs where the merged carrier will have a high market share, it may be necessary to require the carrier to spin off assets, such as gate privileges, in order to permit additional competitors to participate. If the market was already highly concentrated, as in the Charlotte example, prior to the merger, even an incremental addition as a result of the merger can create the basis of illegality.

Question 2. Can gates be made available to new entrants at these dominated airports?

Answer. Gates can be made available to new entrants at these dominated airports, as part of a settlement. It is important that the locations of such gates as well as their prices be reasonable. The Department of Transportation may be able to do more than it has in this area.

Question 3. Even if physical access is made available at an airport, how can the antitrust laws address sales and marketing issues (e.g., corporate discounts, frequent flyer programs, etc.) that would more effectively open those markets to new competition?

Answer. Sales and marketing tactics have been employed by dominant carriers at various hubs, when fighting against new entrants. It must be recognized that such tactics (e.g., reducing fares, increasing the number of seats, giving extra frequent flyer credits) may be effective means for destroying a new entrant. If they are being employed as part of a predatory scheme, they must be declared illegal. The difficulty comes, of course, because these may be also be perfectly legitimate business tactics under conditions where competition is aggressive but non-abusive, and may be useful to a new entrant trying to build market share. While recognizing the difficulty in drawing lines, the situation is currently at square one: trying to deal with several Supreme Court precedents that currently make it extremely difficult to base any case on a theory of predation. The American Airlines litigation might eventually lead to a useful precedent. Otherwise, Congress could consider legislation that would clarify the circumstances under which predation is to be deemed illegal.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. ERNEST F. HOLLINGS TO ALBERT A. FOER

Question 1. Should we require as a condition of any other merger that is likely to be proposed (American, Delta, Continental and Northwest at various times have all been rumored to be talking about several different combinations), that it also be conditioned on a divestiture of significant gates and facilities to enable some other carrier to come in and compete?

Answer. I do not understand why we would want to focus on gates when we should be focusing on the overall structure of the industry. If we have only three major airlines, who will be in a position to take over divested gates and operate on a large and efficient scale? The only realistic answer to that is, foreign airlines—and permitting them to compete will require legislation. Far better would be for the Justice Department to act now to prevent this rush to consolidation. And if Congress is not satisfied with how Justice handles the case, it could institute a moratorium on further growth by merger, much as the Surface Transportation Board has done on a temporary basis with respect to railroads.

Question 2. Can you explain the role of predation at hubs dominated by one carrier?

Answer. There is substantial evidence that hub-dominant air carriers frequently pursue business strategies aimed at keeping low cost entrants from competing at their hubs. The technique has generally been to reduce prices and increase the number of seats available, often accompanied by heavy advertising and even frequent flyer bonus miles, making it impossible for the new entrant to gain a toehold in the market. Once the entrant waves the white flag of surrender, the dominant incumbent reduces the availability of seats and raises prices to prior levels (or higher). Consumers gain from a short-term price war, but ultimately lose as prices go back up. Indeed, now that the dominant carrier has successfully delivered a message about how it deals with low cost entrants, it is less likely that either the same entrant or any other will try again in the future at this hub or any other where the particular carrier operates. This may give the dominant carrier even more flexibility to raise prices than it had at an earlier time when it might have worried about the possibility of a new entrant attacking the market. Thus, despite those neo-classical economists who doubt that predation ever takes place and who argue that it should not be subject to the antitrust laws, predation is a reality that helps maintain market power and high prices at many of our largest airports.

Question 3. Should we demand that DOT issue those guidelines and why hasn't DOT issued them yet?

Answer. DOT has proposed guidelines for dealing with predation at hubs. While not perfect, these guidelines would make it clear that predatory behavior is indeed an antitrust violation and that the government will fight it in order to encourage new entrants. It would be useful if Congress demanded the guidelines be issued, but one could suspect that Congress' apparent previous lack of support may be one reason DOT has delayed. It is also possible that DOT is awaiting the outcome of the DOJ predation case against American Airlines, which will help establish whether the courts will uphold a claim based on predation.

Question 4. If we are left with three mega-carriers, should Congress consider some form of price controls on flights out of hubs?

Answer. Airline deregulation was premised on the idea that competition could protect consumers better than regulation. This assumed that there would be ample competition. (In those days, true believers adhered to the "contestable markets" theory that indicated it would be very easy for carriers to enter a market that was not operating competitively.) Antitrust was to ensure that there would be enough competition. What happened was not entirely consistent with the plan. There was not enough antitrust. Mergers reduced the number of competitors. Alliances reduced the intensity of competition. Predatory practices precluded entry. So, if the bargain that underlay deregulation is not kept, it would be appropriate to ask whether we need to return to some degree of price regulation. Keeping the industry as competitive as possible would be a more desirable option.

Question 5. Should we seek to have the shuttle included in the DC Air agreement, or sold off to another carrier?

Answer. The question is, if we decide to let the merger take place, what conditions will ensure the continuation of the same level of competition in specific markets such as Washington, DC? The incumbent operates a shuttle that is supposed to be very profitable. Can a successor company be equally successful as a competitor without this asset? Indeed, can it be, even with this asset?

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO ALBERT A. FOER

Question 1. Will the Justice Department review of the proposed merger take into account the fact that governmental slot controls and perimeter rules on the east coast will only decrease the likelihood of competition against the combined United-US Airways on the east coast? Don't the Department of Transportation and the Department of Justice have every responsibility to take significant action to mitigate any government-sponsored impediments to competition, such as slot controls and perimeter rules, which will advantage the merging parties?

Answer. I believe that the Justice Department's review of the proposed merger should take into account the fact that governmental slot controls and perimeter rules on the east coast will decrease the likelihood of competition against the combined company, in that this is one element of the analysis that must be made of entry conditions in the industry. It should be a major priority for the Department of Transportation and the Department of Justice to mitigate government-sponsored impediments to competition, such as slot controls and perimeter rules—with or without this merger. Given the current level of concentration in this industry, the government should be working to create possibilities for new entrants.

Question 2. The clear beneficiaries of the proposed merger transaction are the citizens in relatively small communities who have been promised continued service to Reagan National by DC Air. Do you believe it is likely that this preeminent feature of the merger helps guarantee the merger's success with the antitrust regulatory authorities?

Answer. I do not believe that promises to serve small communities by DC Air should help guarantee the merger's success with the antitrust authorities. If the merger is allowed, it must be conditioned on terms (including divestitures) that will guarantee that competition is not diminished. The question with respect to Reagan National is far more complex than simply a promise to continue service. Will DC Air really have the capacity to provide the same level of competition as US Airways? If US Airways was not making a profit on small community routes, then why would we expect DC Air to operate profitably? And if it does not operate profitably, how long will it continue serving unprofitable routes? It seems that US Airways' exit strategy was not to stop service, but to merge into United and get rid of the difficult routes while retaining the most profitable ones.

Question 3. Won't DC Air's transition period, during which time it will maintain a high cost airline at Reagan National, just serve as a multi-year grace period for United and US Airways to resolve their integration problems without any real competition? Is this a factor that the Justice Department is likely to take into account I its review of the merger?

Answer. I think the description in your question makes a lot of sense. Unless DC Air is likely to survive for an indefinite period and provide a comparable level of competition, the Justice Department should not consider it a viable stand-in.

Question 4. I have seen one of the earlier iterations of the Reagan National divestiture plan that I believe accompanied the SEC filings. It indicated that the merger parties considered proposing to divest the carriers' hub-to-hub routes, such as Charlotte to O'Hare, or Philadelphia to Denver. Do you think this condition would be a good one for the Justice Department to impose on the merger? If so, who would operate these routes?

Answer. The question of who would want to operate on a major hub-to-hub route recognizes that the dominant airlines have had outstanding success in killing off challenges by new entrants. Despite the D.O.T.'s proposed guidelines on exclusionary practices, and despite the Justice Department's pending litigation against American for predatory behavior at a hub, it is not clear that the situation for entrants has improved. Before investors will sanction much new entry on hub-to-hub routes, it will have to be a lot clearer that predatory practices will not be permitted. In theory, however, if the merger is to be permitted, any conditions the Justice Department is able to negotiate that will deconcentrate fortress hubs would likely be in the public's interest.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. SLADE GORTON TO NANCY E. MCFADDEN

Question 1. Since the DOT instituted the Buy-Sell rule for slots, how many new entrants have been able to enter National Airport? On what percentage of routes at National Airport have competitive service? On routes where there is more than one carrier, is there price competition? For example, do Delta and American compete on fares between National and DFW? Do American and United compete on fares between National and O'Hare? Do Delta and US Airways compete on fares between National and Atlanta? Do these airlines offer lower fares to Dulles from Atlanta than from National to Atlanta? Why?

Answer. Since DOT instituted the Buy-Sell rule, the following carriers have started service to National: Air Atlanta, Air Canada, Air Wisconsin, America West, AmericanTrans Air, Braniff II, Jet America, Midway/Jet Express, Midwest Express, PanAmerican, Pan American Shuttle, Trump Shuttle, and Western.

Twelve of 70 routes that have nonstop service out of National, or 17 percent, have competitive service. Among the 70 nonstop routes out of National, 56 have nonstop service from Dulles. The factor that primarily affects price is not whether a competitor is present, or whether the service is to DCA or Dulles, but whether or not a low-fare competitor serves the market. For example, although American and Delta both provide nonstop service between Dallas and Washington, average fares are relatively high. But between Atlanta and Washington average fares are relatively low because a low-fare carrier, AirTran provides service between Atlanta and Dulles. Fares to Dulles tend to be lower than fares to DCA, and the principal reason appears to be that more low-fare service is available to Dulles than to DCA.

Question 2. In a May 2, 2000 hearing before the Senate Subcommittee on Antitrust, Business Rights and Competition, Roger Ferguson of Midway Airlines testified that they "have consciously avoided picking fights with the major airlines by flying directly into their hubs." Isn't this alarming? If concentration at major hubs continues to grow, isn't this going to make it more difficult for new entrants to compete? Aren't we likely to see more new entrants avoiding hubs?

Answer. The Department believes that entry by new entrants at major airlines' hubs is very important. Our ongoing review of the fare information that carriers file with the Department shows that major carriers do not tend to enter each other's hubs except to link them to their own, that major carriers are not aggressive price competitors at each other's hubs, but that entry by low-fare airlines tends to result in vigorous price competition. If new entrants were to avoid major carrier hubs the result would be continued high prices for consumers. New entrants have entered major carrier hubs, such as AirTran at Delta's hub in Atlanta, and Sun Country at Northwest's hub at Minneapolis/St. Paul. Other low-fare new entrants compete at major carrier hubs by serving alternate airports, such as Vanguard at Midway Airport in Chicago and Legend at Love Field in Dallas. While some progress has been made, much more entry at major carrier hubs is needed to bring the benefits of price competition to passengers in many city-pair markets.

If concentration at major carrier hubs increases we believe that this will probably make it more difficult for new entrants to enter and successfully compete.

Question 3. Does the Department have legislative authority to withdraw slots at National Airport from incumbent carriers and allocate these slots to new entrants?

Answer. The Department's authority to withdraw and reallocate "slots" (instrument flight rule takeoffs and landings) at a slot-controlled airport such as Washington National is limited by the terms of the High Density Rule (14 CFR 93.221, et seq.).

The High Density Rule (HDR) authorizes air carriers to buy, sell, lease or trade slots, subject to FAA approval. In adopting the "buy-sell rule" in 1986, the Department determined that market forces would lead to the most efficient allocation of slots. The transfer-approval process is generally ministerial in nature but includes a determination by the Secretary that a proposed transfer will not injure the Essential Air Service program (14 CFR 93.221(a)(6)).

Under the High Density Rule (HDR), the FAA retains the right to withdraw slots to "fulfill the Department's operational needs, such as providing slots for international or essential service operations or eliminating slots." The HDR sets forth the process that applies in withdrawing slots for operational need. All slots are assigned, by random lottery, a withdrawal priority number for recall purposes at each airport. This process does not provide for slots to be withdrawn for operational reasons from a specific carrier. Separately, the HDR dictates that the FAA shall withdraw slots from a carrier for failure to meet the minimum slot usage requirement.

Question 4. Under the FAA Regulations, available slots at National Airport are supposed to be periodically allocated through a lottery. When was the last such lottery? Who holds temporary slots and how long have they held them? Why hasn't the Department used its authority to reallocate these slots?

Answer. The last lottery for slots at Reagan National Airport was held in 1986. The Department's authority to withdraw and reallocate slots at a slot-controlled airport is limited by the terms of the High Density Rule, as revised in 1986.

In 1992, in order to increase slot efficiency, the FAA increased the required utilization rates to 80 percent under the use-it-or-lose provisions of the High Density Rule. This resulted in the periodic return of a few slots in the late evening slot period. The FAA has made these available for redistribution on a temporary basis to interested air carriers. Until recently, the number of these available late evening temporary slots has exceeded demand and therefore a lottery has not been necessary, and this category of slots has been distributed on an "as requested" basis. American, Delta, Midwest Express, Midway, Northwest, and United currently hold slots in this temporary, late evening category. The table below shows the dates of allocation. Although there are not any requests from new entrant air carriers indicating how they would actually schedule these late evening slot times, interest in these temporary slots has recently increased, and the Department may consider conducting a lottery in the future for carriers that have a serious interest in operating these slots at the available times.

The Department has addressed the issue of a future slot lottery recently in orders Order 99–11–4 and Order 2000–2–26. In the first order we noted, "Pursuant to 14 CFR § 93.225, the FAA reserves the right to determine when a sufficient pool of slots is available for lottery." In the latter order we found that FAA's decision not to hold a lottery at that time (February 2000) was well-supported. We also noted, however, that we would be closely monitoring DCA slot availability and, when a sufficient number of DCA slots became available, we would consider holding a DCA slot lottery (as currently requested by some low-fare airlines).

Table I—DCA LATE EVENING (2100) SLOTS

Holder	Allocated
American	1/4/93
Northwest	5/1/93 (originally NWA slot-returned to FAA 11/1/92)
Northwest	4/7/96 (originally NWA slot-returned to FAA 11/1/92)
Delta	7/15/96
United	4/5/97
Midway	6/15/95
Midwest Express	2/1/2000 (moved by "slide" to earlier hour)
Midwest Express	2/1/2000 (moved by "slide" to earlier hour)

Question 5. At an American Bar Association Forum on Air and Space Law in 1998, the Secretary stated, "Our responsibility at the Department of Transportation is to ensure that every airline—large or small, new or established—has the opportunity to compete freely. That is what deregulation is supposed to be about—a fair chance to compete."

What steps has the Department taken to provide access to new entrants at National?

Answer. Before the passage and enactment of the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR 21) on April 5, 2000, the Department was explicitly prohibited under 49 U.S.C. 41714(c)(1) from granting slot exemption relief to new entrants at Reagan National. The Department was able to grant slot exemption relief to new entrants at the other slot controlled airports, and under our pre-AIR 21 statutory authority, we granted 30 slot exemptions at LaGuardia, 60 slot exemptions at O'Hare, and 75 slot exemptions at JFK to new entrant or limited incumbent carriers.

On July 5, 2000, as required by AIR 21 the Department awarded a total of 24 slot exemptions (for 12 round trip flights) for new air services at Reagan National Airport. The Department issued two separate orders, the first granting 12 slot exemptions for service outside the 1,250 mile perimeter established for civil aircraft operations at Reagan National and the second granting 12 slot exemptions for services inside the perimeter.

Outside the perimeter carrier awardees included America West Airlines at Phoenix (four slot exemptions or two roundtrips) and Las Vegas (two slot exemptions or one roundtrip); National Airlines at Las Vegas (two slot exemptions or one roundtrip); Frontier Airlines at Denver (two slot exemptions or one roundtrip) and Trans World Airlines at Los Angeles (two slot exemptions or one roundtrip). The Department received applications from nine air carriers requesting 44 slot exemptions for outside perimeter service. National and Frontier were true new entrants at Reagan National with no prior operations, and America West and TWA had only a limited presence at Reagan National prior to the awards. This shows that the Department gave substantial weight to an applicant's presence at Reagan National in making its selection decisions.

Inside the perimeter carrier awardees included American Trans Air at Chicago-Midway (four slot exemptions or two roundtrips); Midway Airlines at Raleigh/Durham (two slot exemptions or one roundtrip); Midwest Express Airlines at Des Moines (two slot exemptions or one roundtrip); and Spirit Airlines at Melbourne, FL or Myrtle Beach, SC (two slot exemptions or one roundtrip) and another community in Florida or South Carolina proposed by Spirit (two slot exemptions or one roundtrip). For inside perimeter service, the Department received applications from 11 air carriers requesting 60 slot exemptions. All of the above carriers also have had only a limited presence at Reagan National.

Under the very specific and restricted conditions of 49 U.S.C. § 41714(d), in a few instances, the Department has also allowed new entrant air carriers to retime flights (or "slide slots") to and from Reagan National in order to improve their service offerings.

Question 6. Over two years ago, the Department issued its proposed anti-competitive guidelines. What is the status of these guidelines? Doesn't the proposed merger make the playing field more uneven? Some of the carriers looking to merge are being examined by the Department for engaging in anti-competitive behavior. If these carriers merge, wouldn't the threat of anti-competitive behavior increase?

Answer. The Secretary determined that the Department should publish its proposed competition policy in order to obtain public comment, since he wished to begin a debate on the issues and be in a position to adopt the best possible policy. We have received over 5,000 comments on the proposed policy. In addition, as directed by Congress, the Transportation Research Board of the National Research Council issued a report on airline competition that included an assessment of the Department's proposed policy. We continue to work on our proposed policy statement. We felt it necessary to proceed deliberately on this important and contentious issue. We plan to make a final decision soon on our proposed policy.

We are fully aware that, if any consolidation occurs between the major airlines, preventing anticompetitive conduct by incumbent airlines will become even more important.

Question 7. Where do you stand on your investigations of anti-competitive behavior? How many anti-competitive complaints does DOT have? How long have these investigations been going on? What formal actions have you taken?

Answer. The Department has undertaken a preliminary review of each of the informal complaints alleging that a major airline has engaged in anti-competitive conduct. In most cases the Department has asked the airline to explain the rationale for its conduct and to provide additional information on its competitive practices. In the case of Orbitz, which has been the subject of several informal complaints, the Department has asked Orbitz to provide information and documents relevant to the questions concerning its organization and operational plans.

The Department has been reviewing the information submitted in Response to its requests involving informal complaints and Orbitz to see whether further action should be taken. We have not as yet taken formal action on any complaint.

Low-fare airlines have told the Department that its past actions in pursuing the informal complaints and in stating the seriousness of the issue presented by those complaints, together with the Justice Department's suit against American, have caused major airlines to respond to entry in ways that are less unfairly aggressive than in earlier years. The Department intends to build on that success by continuing to investigate the complaints to see whether the incumbent airline seems to have engaged in unfair methods of competition.

There are six informal complaints currently under active investigation by the Department (counting all complaints filed against one airline or firm based on common facts as a single complaint). These complaints were all filed within the past fifteen months, including some within the last several months.

In addition, travel agency groups have filed formal enforcement complaints against major airlines based on claims that the airlines' changes in distribution practices, such as their reduced commission rates, constitute unfair methods of competition and unfair and deceptive practices that violate 49 U.S.C. 41712, formerly section 411 of the Federal Aviation Act. The enforcement office is determining whether formal enforcement proceedings should be begun in any of these cases.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN MCCAIN TO NANCY E. MCFADDEN

Question 1. I have a recent letter from United Chairman Jim Goodwin disputing that a hub fare premium exists. As I recall, the Department of Transportation and the General Accounting Office studied and concluded that indeed there is a hub fare premium. Am I right and, if so, would you please elaborate?

Answer. As the Transportation Research Board pointed out in its report last year, most studies of hub fares have found that fares in hub markets are significantly higher than fares in non-hub markets. We agree with this assessment, and would note that fares at O'Hare are not typical of those in most hub markets for several reasons—O'Hare has had slot controls, it has two hubbing airlines, and the substantial amount of low-fare airline service offered at nearby Midway causes O'Hare fares to be lower than they would otherwise be. We find that fares in hub markets with low-fare airline service are much lower than fares in other hub markets.

Question 2. I understand that DC Air, in terms of the number of its operations it plans to conduct on day one, is the biggest airline that the Department of Transportation or the FAA has ever certified. How long will it take for the Office of Secretary and the FAA to certify DC Air from an economic fitness and a safety standpoint?

Answer. It is difficult to say until the Department actually receives DC Air's application and can determine precisely how its operations and organization will be structured, and what issues this presents from a regulatory standpoint. It typically takes 3 to 9 months to process an "economic fitness" application of a company "starting from scratch", depending on the completeness of the application and the complexity of issues presented. The FAA process usually takes about the same amount of time, but can take longer, again depending on how prepared the applicant is. Representatives of DC Air recently met with the Department's staff to discuss its plans.

Question 3. The Justice Department could impose a condition on the merger that would require the parties to divest the carriers' hub-to-hub routes, such as San Francisco to Charlotte, or Philadelphia to O'Hare. If that happened, from a practical standpoint, what carrier would operate these routes?

Answer. When the Justice Department determines that a merger or acquisition should be challenged because it may substantially reduce competition, the Justice Department may agree not to challenge the transaction if the parties can remedy the competitive problems that would otherwise be created by the transaction. One possible remedy is a divestiture of part of the combined businesses. If a transaction's problems are to remedied by a divestiture, the Justice Department will insist that the assets being divested are sufficient to enable the purchaser to be an effective competitor over the long term. Usually the parties to the merger or acquisition suggest a purchaser. The Justice Department will review the purchaser to ensure that the purchaser's operation of the assets will remedy the transaction's competitive problems. The Justice Department will also wish to be certain that the purchaser will be independent.

At this point we do not know whether the Justice Department will conclude that United's merger with US Airways is likely to reduce competition in any market and which, if any, markets will be likely in the Justice Department's opinion to lose competition as result of the merger. It is therefore premature to predict what assets should be divested and which firm might acquire the assets.

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