U.S. Senate Committee on Commerce, Science, & Transportation Hearing

State of the Airline Industry: the Potential Impact of Airline Mergers and Industry Consolidation
Wednesday, January 24, 2007
10:00 AM

TESTIMONY OF GERALD GRINSTEIN

CHIEF EXECUTIVE OFFICER

DELTA AIR LINES

Mr. Chairman and members of the Commerce Committee, we appreciate the opportunity to testify today about the potential impact of airline mergers and consolidation. Obviously, the immediate issue of the US Airways hostile takeover attempt is of serious concern to Delta and 104,000 active and retired Delta people – all of whom have participated in this company's remarkable financial turnaround and care deeply about its future. Clearly, if this transaction occurs, the impact on the industry will extend well beyond our airline. We are grateful to the committee for its vigilance and willingness to examine this proposed take over more closely.

A primary reason for Congress to examine the competitive impact of this deal is that it will trigger broad industry consolidation. Almost every day brings a new media report on potential mergers in the airline industry, most of which are stated openly as direct reactions to US Airways' bid. And if this anti-competitive proposed merger gains approval despite its substantial adverse impacts on competition, consumers, communities, and employees, virtually any other airline merger would likely pass regulatory muster. In our view, the likely outcome of follow-on consolidation would be to leave the combined Delta and US Airways as the weakest carrier, with little West Coast and Asian presence and a staggering debt load.

We believe US Airways' unsolicited and anticompetitive proposal does not meet antitrust standards, and would harm employees, consumers and communities. It would create a much weaker combined carrier that would threaten the future stability of our nation's air transportation industry. It would reverse the remarkable progress Delta has made. Let me be clear – this is a hostile takeover bid; not a consensual merger.

1. Delta is poised to emerge from bankruptcy as a strong airline.

Delta has made enormous progress over the past 16 months in transforming the airline into a strong, healthy, and vibrant competitor. In September 2005, faced with unrelenting competitive and economic pressures and a staggering $17 billion debt load, Delta filed for Chapter 11 protection. While many companies use the bankruptcy process simply to shore up their balance sheet and reduce debt, our company undertook a top-to-bottom re-engineering that touched every aspect of how we do business. We are using the bankruptcy process appropriately: to improve and strengthen our airline.

As they have throughout this company's 76-year history, Delta people stepped up to these challenges. In every area of our airline, at every level, they participated fully in the long, demanding restructuring process. The result has been a remarkable turnaround with accomplishments that include:

- **Reduced costs and improved unit revenue**, positioning the airline to emerge from Chapter 11 with the lowest unit costs of any network carrier.

Delta has improved productivity and eliminated approximately $2 billion in annual costs.

- **A stronger, more balanced network** as a result of rapid expansion of international routes with the highest profit potential. In the past year Delta has undertaken the largest international expansion in its history, and we are now #1 in the transatlantic market.
- **Significantly reduced net debt** from $17 billion to an anticipated $7.5 billion by the end of 2007.
- **Improved liquidity position and profitability**, totaling $2.7 billion in cash, cash equivalents and short-term investments as of November 30, 2006. Delta will emerge with the strongest balance sheet among network airlines.
- **An expected consolidated equity value on exiting Chapter 11 estimated between $9.4 billion and $12 billion** – compared to essentially zero equity value only 16 months ago. US Airways' unsolicited offer clearly recognizes the value Delta people have helped create.

Importantly, customer service standards and operational performance were not sacrificed to achieve these gains. Passenger ratings instead increased, with the prestigious J.D. Power and Associates customer satisfaction survey for 2006 ranking Delta as one of the top two domestic network airlines.

Last month, Delta filed its Plan of Reorganization with the bankruptcy court. We are now poised to exit bankruptcy this spring as one of the best positioned airlines in the country based on financial strength, profit potential, and a cost structure among the lowest of any traditional network carrier. Our global network provides access to more than 300 U.S. destinations and 52 foreign countries. The stage is set for Delta to emerge as a powerful, competitive force to be reckoned with – unless US Airways' takeover bid is allowed to derail our momentum and jeopardize our hard-won gains.

Given Delta's restored financial and competitive strength, this deal is not at all comparable to America West's acquisition of US Airways out of bankruptcy. That purchase was a rescue mission of a failing carrier that was struggling to avoid liquidation.

Compared to our standalone plan for reorganization then, the US Airways bid produces inferior value for Delta's stakeholders. US Airways' offer is structurally flawed and raises overwhelming regulatory and labor issues that would weaken Delta going forward. Among the many example is fleet efficiency. Before filing for bankruptcy, Delta had 14 fleet types. Today, we have eight, all manufactured by Boeing. [Exhibit A]

Although US Airways recently raised its bid, which Delta's Board plans to review shortly, management's preliminary reaction is that the revised proposal does not address the serious flaws our analysis identified in the original bid.

So, Delta remains focused on emerging from Chapter 11 this spring. A successful emergence requires a complex and highly coordinated series of events and resources. Timing is crucial, especially since many essential elements such as financing arrangements are outside Delta's control. If US Airways' proposal is not stopped now, the regulatory and bankruptcy review process could take as much as a year, even if it is rejected eventually based on antitrust and anticompetitive grounds. Leaving Delta in bankruptcy limbo creates risks for all stakeholders, including creditors, customers, employees, and vendors – a situation that is simply unnecessary.

Of course, we take seriously our fiduciary duty to maximize the value of our company for our creditors. Some of our work in this area has generated rumors and speculation. One such rumor is that Delta is negotiating a merger or similar deal with Northwest. One point we want to make very clear: We are not negotiating any such deal with Northwest. However, in the face of US Airways' hostile takeover bid, our Official Creditors Committee asked us to help us gather information about potential strategic alternatives from other airlines, including Northwest. To that end, we recently retained an investment banker to obtain that information, a far cry from negotiating for a merger. We are compiling this information, but there has not been any negotiation regarding a merger or similar deal with Northwest or any other airline.

2. Delta people deserve to determine their own destiny.

When Delta entered Chapter 11, the people of this airline came together and determined to do whatever was necessary to save their company. They worked hard, long hours through months that included first terrible hurricanes in Florida and then the devastation of Katrina. For many at Delta, those crises affected not only their jobs, but also their families, homes and friends. They implemented the transformation of our airline, from restructuring hubs to the largest international expansion in our history. They watched as co-workers and friends left as part of regrettable but necessary job reductions. When the cleaning of aircraft interiors didn't meet their standards, they volunteered their own time on overnight shifts where people from throughout the company showed up to scrape gum off seat bottoms and sweep the jetways. They sacrificed financially, too, from pay cuts to reductions in benefits, from health insurance to vacation time, to the loss of any equity value their years with Delta had earned them.

They tirelessly developed, implemented, and refined the changes required to rebuild the airline's financial position, brand, and customer service – believing all the while they were restoring not only Delta's future, but their own. And by all rights, it should be. The exit from bankruptcy our company is poised to make is what Delta employees have worked and sacrificed together to achieve. This is the moment they deserve. And this is the moment US Airways' merger proposal would unfairly take away from them. From the lost opportunity to share in the benefits of the equity value their blood, sweat and tears have created to the likely loss of an estimated 10,000 Delta jobs, Delta people are understandably and deeply concerned.

As soon as US Airways' hostile takeover bid was made public, Delta employees and retirees erupted in an overwhelming grassroots demonstration of opposition to the proposed merger, followed by an outpouring of support for Delta's plan of reorganization. The Delta Board Council, a group representing Delta employees in various workgroups, quickly produced tens of thousands of buttons, wristbands and T-shirts bearing a "Keep Delta My Delta" message. The result has been a nationwide campaign with a website that has so far collected over 100,000 signatures on petitions opposing the proposed merger, and generated more than 155,000 letters to Capitol Hill.

The Delta unit of the Air Line Pilots Association, which represents our airline's pilots, also has voiced its strenuous opposition. They have stated clearly and publicly that the foundation of the US Airways proposal – including the 10% capacity reduction and related job losses – cannot be accomplished consistent with the requirements of the Delta-ALPA collective bargaining agreement. Delta pilot leadership has openly stated its commitment to do everything possible to stop this deal, allocating $15 million towards that effort.

Delta people are united in their strong opposition to US Airways' proposal, representing as it does the worst possible combination with the most negative impact on virtually all constituencies.

3. US Airways' proposal fails absolutely to meet antitrust standards and would reduce competition and harm consumers.

US Airways' principle goal in its hostile takeover attempt is to eliminate its key competitor. Delta is the airline with which US Airways' network overlaps most, with the highest number of overlapping markets and hubs. No merger in the history of this industry has ever been approved by the Department of Justice with anywhere near this degree of network redundancy. That's why US Airways believes this will create cost synergies. This merger is being proposed to cut service, shrink hubs and increase prices.

US Airways' proposal to merge with Delta will harm competition. In a pro-competitive merger, the two airlines' routes do not overlap excessively; they are complementary. Joining complementary networks can enhance competition and create consumer benefits that result in lower prices and increased service options. Such mergers can provide benefits to consumers, communities and employees, as well as creditors, shareholders, and other stakeholders.

By contrast, US Airways' proposed takeover of Delta is the poster child of an anticompetitive merger. Delta and US Airways are each other's most direct and pervasive competitors. The combined networks almost totally overlap. If a picture is worth a thousand words, the full story is shown in the map marked Exhibit B.

The Delta-Western merger in 1987 illustrates a pro-competitive merger, combining two complementary networks with very few overlaps. Delta's network strength in the south and east, joined with Western's network strength in the west, did not reduce competition. Instead, an expanded network of services provided a platform for growth and significant additional value for customers, communities and stockholders.

The America West-US Airways merger in 2005 arguably could be considered another example of a complementary merger. Combining the two geographically distinct route systems added network strength and scope without reducing competition – an important distinction.

Mr. Chairman, time will tell whether the US Airways-America West merger will be successful or not; it is not yet complete. US Airways has made numerous promises and commitments on jobs, fares, and services, based on their experience in the America West-US Airways combination. But one thing is clear: in terms of size, scope, overlap and competitive redundancy, it is totally absurd to compare that merger to the proposed merger between Delta and US Airways.

Impact on consumers and communities

US Airways and Delta compete directly in thousands of markets up and down the Eastern Seaboard and in many transcontinental markets from Western States, to the east, south and southeast. That's because all of our hubs are in close geographic proximity to US Airways' hubs, as illustrated in Exhibit C.

- Delta's Atlanta hub competes against US Airways' nearby Charlotte hub.
- Delta's Cincinnati hub competes against US Airways' Pittsburgh hub.
- Delta's JFK hub competes against US Airways' Philadelphia hub.
- Delta's Salt Lake City hub competes against US Airways' hubs at Phoenix and Las Vegas.

Each of these hubs draws traffic from smaller cities, gathering enough passengers to make connecting service to other smaller markets – or to other big markets or even international destinations – sufficiently profitable to continue operating. For example, a customer traveling today between Tallahassee, Florida and Boston can choose a connection through Atlanta on Delta or through Charlotte on US Airways. If a merger were to occur, the merged carrier would significantly down-size service at one or more of the competing hubs – with Charlotte almost certainly losing out in this example.

While US Airways has said no city would be dropped from the combined carrier's network, they also have admitted that the claimed cost synergies of the deal require at least a 10% cut in capacity. While we believe this number is understated, even a 10% capacity reduction requires elimination of flights and jobs equivalent to about 200 airplanes. Where would those cuts occur? At hubs, most likely leaving only one of the current two or three operating as a major hub, and in communities served by those hubs.

Cuts in competition are expected to:

- Create a near monopoly – more than 90% passenger share – in more that 1,500 markets affecting 8.5 million passengers annually.
- Reduce competition on 31 overlapping nonstop markets, impacting more than 11 million annual passengers and creating 12 monopoly markets.
- Significantly reduce the number of competitors in almost 4,000 markets, affecting approximately 33 million customers each year.

US Airways contends that concerns about increased fares and service reductions are unfounded. Their rationale is that so-called low-cost carriers, or LCCs, such as Southwest or AirTran and other airlines will fill any service or competition gaps their proposed merger might create -- a speculative claim at best.

The primary loss of competition and service will be in the city pairs currently connected by one-stop service operating over the two airlines' competing, overlapping hubs, as noted earlier. But LCCs are highly unlikely to replace the loss of a competing hub at Charlotte, Pittsburgh, Cincinnati, or Salt Lake City, for two primary reasons.

First, unlike traditional network carriers such as Delta and US Airways, the LCC business model is different from the hub-and-spoke system of gathering travelers from small markets into hubs where they connect to their destination. Instead, these carriers have typically cherry-picked markets with enough passengers to fly non-stop, without connecting through a hub. Since 2000, they have expanded primarily into larger markets with over 7 million annual passengers.

Second, the rapid LCC expansion of recent years has slowed considerably in the face of an airline industry which, in order to survive, has become far more efficient and competitive. As recent reports from Jet Blue, Air Tran, and others indicate, profits are slowing – and along with them, so are orders for the new jets required to fuel their previous level of growth.

After American acquired TWA in 2001, TWA's major hub at St. Louis, which competed directly with American's hubs at Chicago-O'Hare and Dallas-Ft. Worth, was closed. In the interim years, even during the period when LCCs still were expanding rapidly, no carrier has stepped in to replace the lost hub service.

Small communities will suffer significant loss of service and economic benefits.

The major loser in this proposed takeover is small communities[1]. US Airways' plan is to cut capacity in connecting markets to achieve cost efficiencies. This will be devastating to dozens of small cities because both Delta's and US Airways' networks serve a greater portion of these markets than the other legacy or network carrier. For example, Delta serves 144 small cities.

These two carriers are often the only competitors in these markets, so competition will suffer and consumers will have fewer choices as a result. For example, the combined carrier would operate:

- More than 90% of all service at Greenbrier/Lewisburg, Huntington/Ashland, and Charleston, West Virginia;
- 60% of all seats at Portland and Bangor, Maine, including more than 90% control in 10 markets served from those cities;

[1] "Small communities" as defined by the FAA are small or non-hub airports.

- More than 90% of flights at Florence and Hilton Head and 60% to 70% at Myrtle Beach, Charleston, Colombia; and Greensville/Spartanburg – including more than a 90% monopoly in 30 to 40 markets.

A merger between Delta and US Airways would make the combined carrier the largest in 127 small markets, as defined by the Federal Aviation Administration. [Exhibit D]

Once again, US Airways' claim that LCCs will fill the void belie the facts. Of the 127 small cities where a combined US Airways-Delta carrier would dominate, only 14 currently are served by LCCs. [Exhibit E] Business travelers typically weigh the price differential between their time and higher fares and decide not drive to airports where LCCs operate when local service is offered.

Fares are unlikely to fall as competition is reduced.

US Airways also has said that as a "price maverick" and a "price leader," consumers should not be concerned that it would increase fares even if the merger were allowed, despite a new-found domination in thousands of markets. The carrier actually claims to have r<u>educed</u> fares since the US Airways-America West merger in 2005.

The facts paint a different picture. US Airways <u>is</u> a price leader, but in an upward, not downward direction. In reality, the airline has increased the average price paid by consumers in four times as many markets as it has decreased them. US Airways claims that it has reduced fares in 1000 cities, but there are nearly 6,600 cities where consumers are paying higher fares than they were before US Airways merger with America West. [Exhibit F] These increases were attained through a combination of actual fare increases as well as restrictions placed on the availability of lower fares. Again, it is important to remember that the America West merger, unlike the proposed US Airways-Delta merger, was not about eliminating your primary competitor.

Also, US Airways has given few specifics about how it might reduce capacity by 10% while maintaining, much less increasing, current revenues – unless, of course, the combined carrier raises fares. All indications – and all past evidence – point to price increases for consumers should this merger go forward.

4. US Airways' proposed takeover of Delta would have major adverse impact Washington-Reagan National and New York's LaGuardia Airports.

The potential anticompetitive impact of US Airways' takeover attempt also would extend to Washington National and New York-LaGuardia airports. The combined carrier would overwhelming dominate at these unique airports with restricted entry due to slot controls imposed by the Federal Aviation Administration and limited gates. [Exhibit G] For example:

- At Washington National, a merged US Airways-Delta would operate nearly four times more slots as its next largest competitor, even after divesting one of the Shuttles. Contrary to US Airways claims, divestiture of one of the Shuttles won't solve the problem.

- At New York-LaGuardia, the combined carrier would operate almost twice as many slots as the next largest competitor, even after divestiture of one of the Shuttles.
- The two carriers also would control 38% of the gates at LaGuardia and 46% of the gates at Reagan Washington National.
- Delta and US Airways are currently the only carriers with enough slots to serve small communities from LaGuardia and Washington National. Those services would be reduced, if not eliminated entirely, should US Airways' proposal be allowed to occur because additional slots and gates would have to be divested to meet DOJ approval (if it could be met at all), and the new carriers would not be able to serve those small communities with their smaller portfolios of divestiture obtained slots at those airports. [Exhibit H]

5. The proposed merger would make Delta a weaker and less competitive carrier.

Despite Delta's massive restructuring and incredible progress since September 2005, our airline will end up as a weaker, less competitive company if US Airways is allowed to proceed with its take-over.

The combined company would have a **staggering debt burden of $24 billion** – even higher than Delta's debt when it entered Chapter 11 – and far higher than the $7.5 billion projected for an independent, standalone Delta, following our exit from bankruptcy this spring. The size of debt does matter in the airline industry. A mountainous debt load like that proposed by US Airways would place the merged US Airways-Delta one crisis away from financial collapse.

The combined carrier would have no significant presence in Asia and the West Coast. It would be competing against carriers with far more extensive global networks. It would be the weakest and least efficient of the major carriers when, not if, follow-on mergers occurred.

A combined carrier would face significant employee integration problems. US Airways is far from completing the labor integration made necessary by its merger with America West. To add more then 45,000 Delta professionals to the mix, all of whom are vehemently opposed to this merger, is a recipe for disaster. The Delta pilots have publicly stated that US Airways' plans for reducing capacity would violate their contract. Dissatisfied Delta people likely will see their hard-earned gains disappear. The traveling public will likely see service and operational performance declines. All of this will disrupt Delta people's lives as well as the service received by the traveling public.

Employee integration would be further complicated by pension issues. Delta and Delta people joined together to minimize cuts to their health programs, and also, with the help of Congress, to preserve the already-earned pension benefits of 91,000 Delta employees and retirees. US Airways, on the other hand, turned all of its employees' pension plans over to the Pension Benefit Guaranty Corporation, or PBGC, with a liability of $4.8 billion.

Yet another concern in a service industry where employee engagement is crucial would be the pending **reduction of an estimated 10,000 jobs**, though US Airways denies that such job reductions would occur. In reality, the number of employees employed by US Airways/America West at the time of the merger was 43,000 – that number has fallen by 8,000 to the current figure of 35,000. The simple fact is that the combined US Airways and Delta will not be able to sustain as many jobs as the two companies do now. Regardless of how the process is defined, eliminating 10% capacity across the system, consolidating operations at airport facilities, and consolidating administrative and management staff will lead to significant job reductions, despite US Airways' assertions to the contrary.

Summary

The central question for this Committee to consider is which is better for consumers, the hundreds of communities served by Delta, and the employees whose blood, sweat and tears have earned them the right to participate in Delta's success, as well as Delta's creditors and other stakeholders?

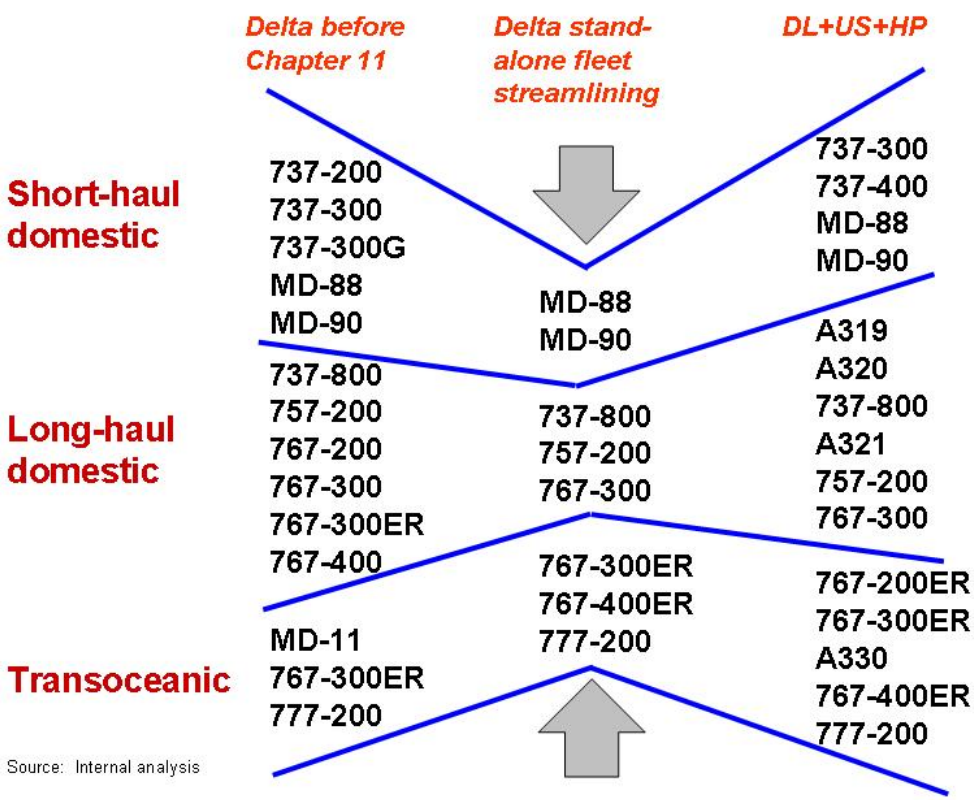
- To have Delta emerge as a strong, stand-alone competitive force?
- Or to allow US Airways to merge with Delta, by far its largest competitive rival, thus reducing competition in thousands of markets; eliminating service, especially to smaller communities; eliminating 10,000 jobs; and creating an airline with a precariously high debt load?

And also ask, is this what the people of Delta Air Lines deserve for all their hard work?

Clearly, Delta would be much weaker financially and competitively if this takeover bid were to succeed. All Delta stakeholders and the public will benefit from a stand alone, independent Delta.

Again, our company sincerely appreciates the opportunity to submit this testimony to the Committee and we will be happy to answer any questions you might have.

Merger Combines Two Mismatched Fleets



Source: Internal analysis

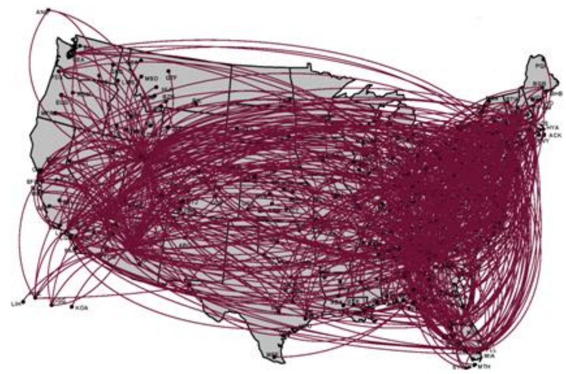
Exhibit A

US Airways and Delta Have Dramatically Overlapping Networks

US Airways' domestic network

Delta's domestic network

US Airways/Delta's domestic network



Source: US Airways merger proposal

Exhibit B

In Contrast, the US Airways and Delta Hubs Completely Overlap

Merger of These Networks Would Result in Loss of Competition and Reduced Service

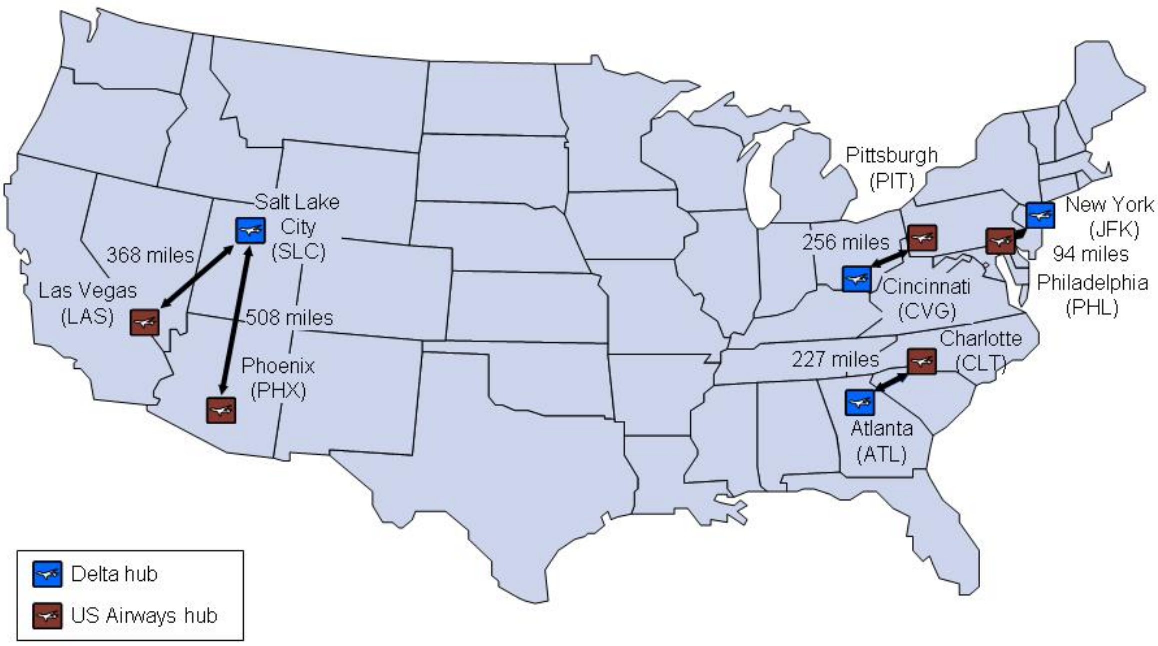
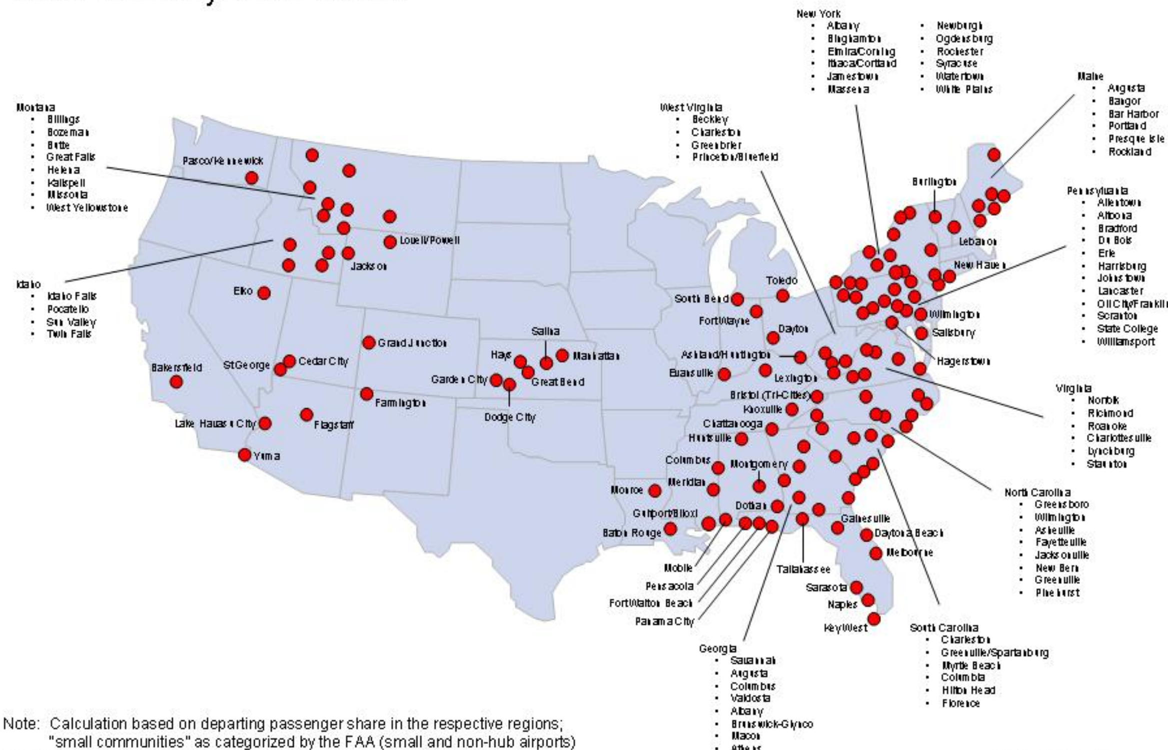


Exhibit C

US Airways/Delta Would Be the Largest Carrier in 127 Small Communities

More than Any Other Carrier



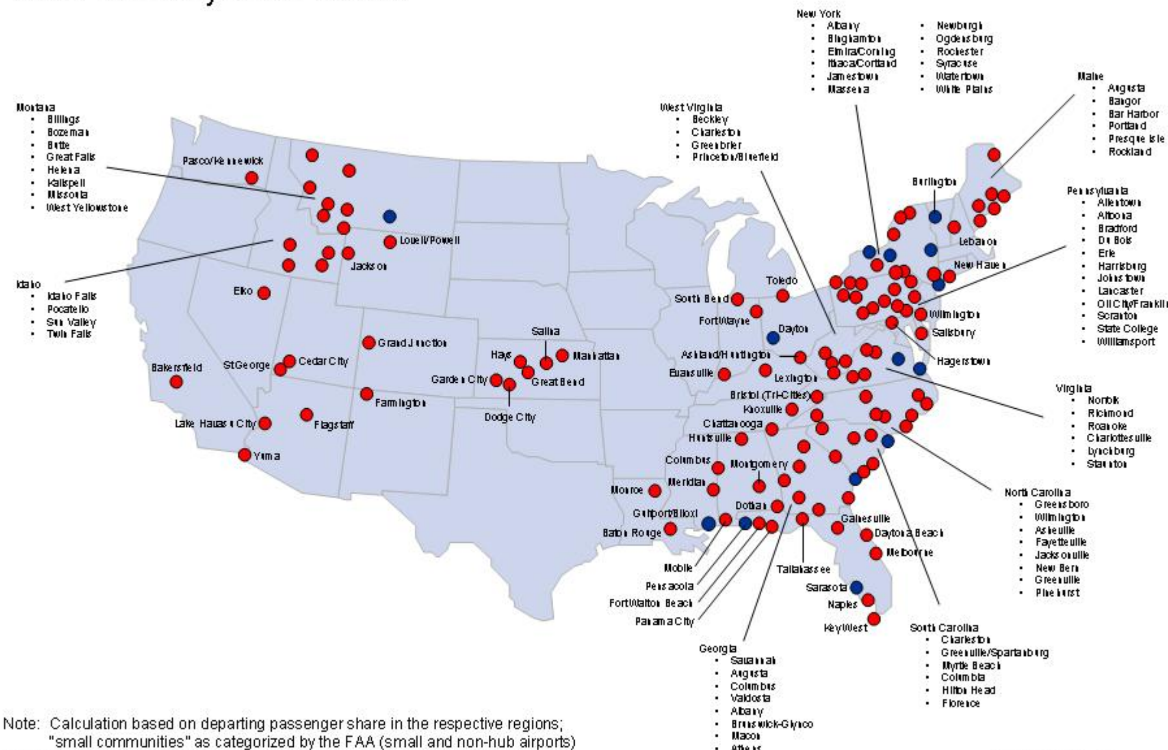
Note: Calculation based on departing passenger share in the respective regions; "small communities" as categorized by the FAA (small and non-hub airports)

Source: DB1B data - YE 2Q 2006

Exhibit D

US Airways/Delta would be the Largest Carrier in 127 Small Communities, only 14 of which have low-cost carrier service

More than Any Other Carrier



Note: Calculation based on departing passenger share in the respective regions; "small communities" as categorized by the FAA (small and non-hub airports)
Source: DB1B data - YE 2Q 2006

Exhibit E

Since its Merger with America West, US Airways has Raised Fares More than its Competitors

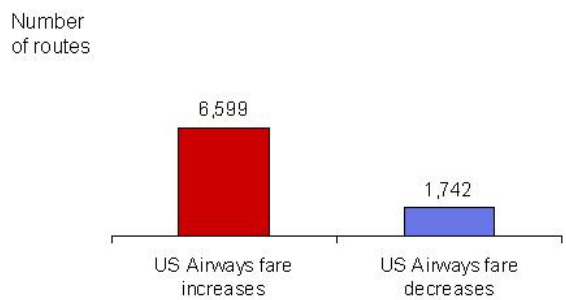
US Airways' claim

"Merger synergies will enable the new Delta to continue offering consumer-friendly fares"

The facts

US Airways has increased average fares in almost 4 times as many markets as it has lowered them

(2Q 05 vs. 2Q 06)



Source: DB1B data - 2Q 2005 and 2Q 2006; US Airways 8k filing, November 17, 2006

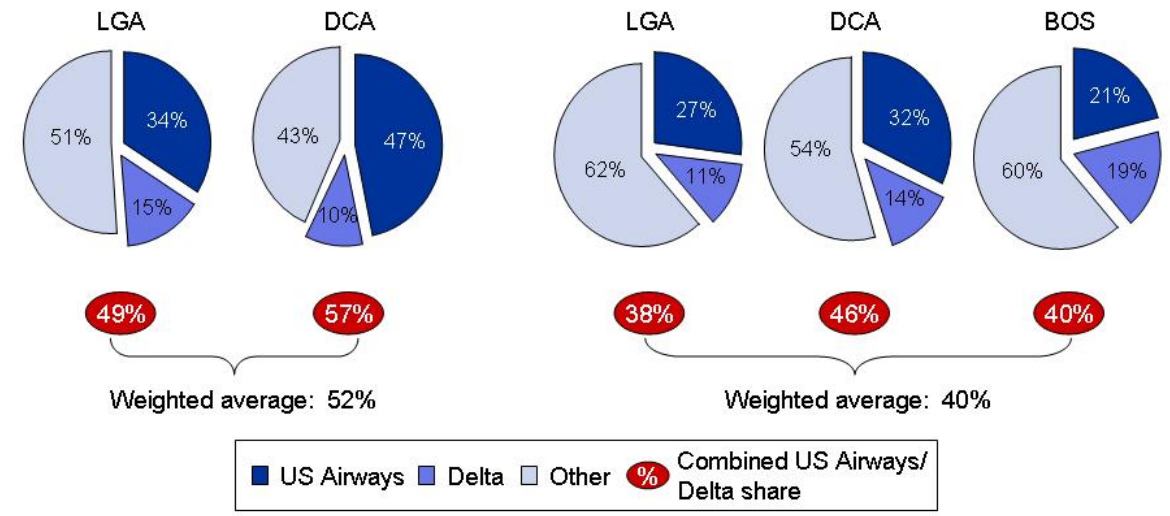
Exhibit F

US Airways and Delta Would Operate 52% of Slots and 40% of Gates at Major East Coast Airports

Even After Shuttle Divestiture

US Airways/Delta would operate over half of the slots at LGA and DCA(1)

US Airways/Delta would have 40% of the gates at LGA, DCA and BOS(2), (3)

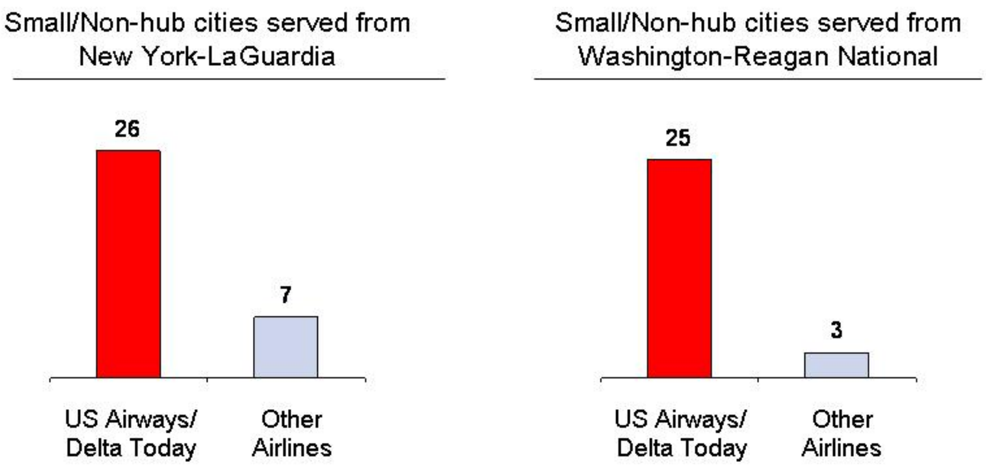


(1) Analysis shows slots operated (and not slots owned) after shuttle divestiture (assuming all divestitures will come out of Delta's current slots)
(2) New York-LaGuardia includes Marine Air Terminal; gate counts for mainline gates; off-gate Regional Jet parking positions excluded
(3) Assuming all divestitures will come out of Delta's current gates (4 gates at LGA, 2 gates at DCA, and 2 gates at BOS)
Note: One slot refers to one arrival or one departure
Source: OAG November 2006; snapshot of operating performance, November 17, 2006; FAA

Exhibit G

Delta and US Airways are the Only Significant Providers of Small City Service From LGA and DCA

Divestiture of US Airways/Delta Slots Would Reduce Service to Small Communities



New York-LaGuardia and Washington-Reagan National airports are likely to lose service to small communities

Source: OAG November 2006; snapshot of operating performance, November 17, 2006; FAA

Exhibit H