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before the

**COMMITTEE ON COMMERCE, SCIENCE, & TRANSPORTATION  
SUBCOMMITTEE ON AVIATION OPERATIONS, SAFETY, AND SECURITY  
U.S. SENATE**

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Chairman Cantwell, Ranking Member Ayotte, and Members of the Committee:

**Introduction**

I appreciate the opportunity to appear before you to discuss the state of the airline industry and the role of the Department of Transportation (DOT) in the review of the proposed American Airlines / US Airways merger.

**State of the Airline Industry**

Let me begin by providing a broader historical context for this transaction. In the more than 30 years since airline deregulation, consumers have reaped enormous benefits, as market forces have determined airline fares and services. During this period, air transportation was transformed from a luxury that few could afford, to an affordable and indispensable service that connects families and businesses across America and the globe. The new entrant carriers brought innovative business models and substantial price competition to a marketplace dominated by the incumbent, high-cost legacy carrier business model, just as the architects of deregulation had predicted.

While deregulation brought enormous benefits for consumers, the results were not as positive for the airline industry, particularly the legacy carriers. The legacy airline industry has been characterized by highly cyclical periods of profits and losses and, when profits were made, they were at extremely thin margins. Even as most low-cost carriers continued to profitably grow through most of the challenges of the last decade, the legacy carriers suffered significant losses and have restructured their businesses through the bankruptcy process. Following several consecutive years of losses from 2001 to 2005, the industry returned to modest profitability in 2006 and 2007, only to confront rapidly increasing fuel costs and then a global recession. 2008 and 2009 were some of the most challenging years in the history of U.S. aviation, primarily due to the global recession. Analysts began to question the financial sustainability of an industry that chased market share rather than profits and consistently failed to earn its cost of capital. Airlines began aggressively taking corrective action by reducing capacity and moving toward more fuel-efficient aircraft and operations.

In the years since the steep rise in oil prices during the summer of 2008 and the global economic recession that followed, the U.S. airline industry took steps to operate more successfully in a seemingly permanent high-cost environment. Airline managements, at legacy, hybrid, and low-fare carriers, have prioritized financial performance over gains in market share by cutting capacity, executing several mergers, and unbundling certain products and services for sale resulting in billions of dollars in ancillary revenue. They also focused on significantly reducing non-fuel related expenses in a number of ways and began to manage their networks more efficiently. As a result of these structural changes in the industry, the balance sheets and bottom lines for many airlines are showing significant improvement. Airline managements credit mergers as having played a key role in the industry's climb to financial sustainability.

As recently as five years ago, there were six major U.S. network carriers. Since then, Delta has acquired Northwest, and Continental merged with United. US Airways, having joined forces with America West in 2005, is now seeking to merge with American. Consolidation has also taken place in the low-fare carrier segment of the industry as a result of the combination of Southwest and AirTran. Mergers are, however, very difficult for the companies, their employees, and the customers they serve as varying fleets, systems, corporate cultures, and route networks are blended and rationalized into viable business plans. These changes take years to accomplish, especially on the network side and occur while the marketplace continues to evolve.

Given the importance of the airline industry to the economy and economic growth, consumers benefit from having a financially healthy industry. However, the consolidation and capacity cuts that are part of the industry's restructuring efforts raise questions about their effect on consumers both in the short- and long-term. They put upward pressure on airfares, as load factors continue to surge past historical highs. While inflation-adjusted fares remain low relative to recent decades, they have increased 16% since 2009. The economic effects of the current transformation of the industry have been further reinforced by persistently high and volatile fuel costs and have been exacerbated by the restructuring of the regional airline industry as well.

In a deregulated industry, airlines are free to determine the routes they will serve and the prices they will charge, disciplined by competition. Mergers often produce shifts in management focus, changes in relationships with regional airlines, and significant network restructuring that can have an impact on cities used to a particular level of air service. As some airline managements have argued, larger airline networks will sustain service to more communities, especially small- and medium-sized communities. While some of the recently merged carriers have maintained or added service to these types of communities, others have substantially cut service, choosing instead to concentrate on larger markets. As a result, various stakeholders and analysts have expressed concern that mergers can lead to troubling cuts to small communities.

Airlines seek financial sustainability and good returns for their shareholders; consumers seek lower fares and better service. While these interests are not necessarily diametrically opposed as airlines benefit when more people travel and consumers benefit from the product and service options of larger global carriers, it is competition that determines the appropriate balance between firm and consumer interests in a deregulated market. As the industry continues its transformation and adapts to a dynamically changing economy, the Department is committed to doing what it can to foster an economically viable air transportation industry -- including entry into air

transportation markets by new and existing air carriers -- and to prevent unfair and deceptive practices in the airline industry.

### **DOT's Authority to Review Merger Transactions**

While I am sure you can understand that I am not able to discuss the specifics of the proposed American / US Airways merger, or any proposed transaction that is before us for review, I will briefly describe DOT's role in this process.

The Department of Justice (DOJ) has the lead role in reviewing proposed airline mergers, given its statutory authority to enforce the antitrust laws. This practice is consistent with Congress' determination that the deregulated airline industry should generally be subject to the same application of the antitrust laws as other unregulated industries. DOT does have a role, however. Utilizing its special aviation expertise, DOT typically confers with the Antitrust Division. Each transaction we review is considered on a case-by-case basis consistent with antitrust principles and practice.

Both the antitrust laws and the transportation statutes governing DOT strive to ensure that consumers receive the benefits of competition. This is the prism through which the Department analyzes airline mergers. I can therefore assure you that the Department is committed to fostering an environment that embraces competition and provides consumers of all types with the price and service benefits that competition brings.

We also recognize that the airline industry is dynamic. Cyclical economic conditions, the competitive environment, infrastructure access and capacity, and industry innovation all need to be taken into account to allow the industry to adapt to rapidly changing economic conditions.

Should DOJ decide not to challenge a particular transaction on antitrust grounds, DOT would then address follow-on issues that fall within its jurisdiction, including international route transfers, economic fitness, code-sharing, and possible unfair or deceptive practices.

As to international routes, the carriers must apply to DOT for approval to consolidate the international routes they individually hold under one certificate, which is part of the merger process. By statute (49 U.S.C. 41105), DOT may approve a transfer of such routes only if we find that it is consistent with the public interest. As part of that analysis we must examine the transfer's impact on the viability of each airline party to the transaction, competition in the domestic airline industry, and the trade position of the United States in the international air transportation market.

We would only decide an international route transfer case after we had established a formal record and given all interested persons the opportunity to comment. If DOT determines that the transfer would be contrary to the public interest on competitive grounds or for another reason, DOT could disapprove the transfer in whole or in part.

DOT may also review any code-share arrangements concluded between the merging carriers. In DOT's experience, code-share arrangements would likely be necessary during the early phases of integration after the transaction is closed.

Finally, at DOT, we take our responsibility for consumer protection seriously. For example, if carriers in pursuing or implementing a merger were to engage in unfair or deceptive practices, we have ample authority to protect affected consumers based on our unfair and deceptive practices statute (49 U.S.C. 41712).

## **Conclusion**

Civil aviation plays a critical role in the U.S. economy amounting to \$1.2 trillion in 2009 and generating more than 10 million jobs, with earnings of almost \$394.4 billion. Airlines connect national and global communities – linking friends and family, suppliers and producers, retailers and manufacturers, facilitating business partnerships, and fostering educational and cultural exchanges of all types. Every American has both a personal and an economic interest in access to safe and affordable air travel. It is therefore easy to understand why so many people take an interest in airline mergers.

Our consideration of aviation economic policy focuses on what is best for a healthy and a competitive industry, for its workers, and for the communities and consumers that it serves. Our goal must be to strike what is often a very difficult balance in the face of a complex and dynamically changing industry. Importantly, in doing so we must also consider the longer term, collective impact on all stakeholders, most importantly America's traveling public.

Chairman Cantwell, this concludes my testimony. I would be happy to answer any questions you may have.