TESTIMONY BEFORE THE UNITED STATES SENATE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION

REGARDING CHALLENGES FACING HAWAII'S AIR SERVICE MARKET

April 10, 2008

Mr. Chairman, Vice Chairman, Members:

Good afternoon and aloha!

This is a very sad time for Aloha Airlines and indeed the entire airline industry.

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

How things have changed in our industry!

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

about 40 years ago, i was on the front lines as a ticket agent. Thanks to

TWA, I learned a lot about customer service from the ground up, writing tickets by hand, and handling baggage.

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

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

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

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

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

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

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

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

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

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

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

(fuel costs)

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

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

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

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

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

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

(Bankruptcy)

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

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

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

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

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

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

(Mesa Air Group)

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

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

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

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

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

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

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

Why was go! charging $39, $29, $19 or $1 for a seat that cost them as much as $70 to fly?

Why would any manufacturer or provider of services offer their product for less than what it cost to produce it, for almost two years?

Now everyone loves a bargain, particularly in air fares, but even so, Mesa’s strategy of below-cost pricing raised some eyebrows. Even bargain-lovers began to ask, “Why doesn’t somebody do something about it?”

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

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

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

(Lawsuits)

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

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

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

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

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

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

(Second bankruptcy)

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

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

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

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

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

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

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

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

(Impact on Hawaii)

What impact does our situation have on Hawaii?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

((**roll video))**

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

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

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

Thank you for your kind attention.