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Bankruptcy is becoming normal for America's **airlines**

OVER the past four years, America's **airlines** have lost \$32 billion, hit by the effects of terrorist attacks, the collapse of the dotcom bubble, the war in Iraq, the SARS epidemic in Asia and fiercer competition from new low-cost carriers. This devastated landscape is now being visited by a sixth horseman of the apocalypse: oil prices. On September 14th Delta **Air Lines** and Northwest **Airlines**, America's third and fourth-largest **airlines**, filed for bankruptcy. With United and US Airways already operating under **Chapter 11** bankruptcy regulations, at least half of America's **airline** industry has now been declared bankrupt. These firms will keep flying on empty, thanks to court protection from their creditors. But a once-proud industry is officially on its knees.

The impact of higher oil prices on the industry was outlined this week by Giovanni Bisignani, the director-general of the International Air Transport Association. He forecast that this year American carriers' losses would be around \$8 billion, some \$2 billion more than he had forecast as recently as May, when the price of oil, at \$47 a barrel, was already twice that of four years ago. Today the oil price stands at \$64. Facing fierce competition from relative newcomers like Southwest and JetBlue, which are still profitable, the older, "legacy" **airlines**, with their much bigger fixed costs, are unable simply to pass the higher oil prices onto their customers.

Yet earlier this summer there were some signs of light in the skies. **Airline** passenger numbers were up. Planes were on average 79% full, which was a small improvement. Revenues per seat ("yields") were still falling (1.8% down on the same period in 2004), but that is part of a long-term trend. Thanks to fierce cost-cutting, and with the co-operation of worried unions, there were flickers of hope on the horizon. In the April-June quarter, American **Airlines**, the biggest, made \$58m, its first net profit (excluding special factors) in five years. Continental **Airlines** did even better, with revenues up 12% and a net profit of \$100m. Even United **Airlines**, stripping out huge exceptional charges related to its plans to emerge from bankruptcy, reduced its quarterly loss to \$26m, from \$247m in the same period a year earlier.

But the good cheer did not last. The knock-on effect of the rise in the oil price in the past year is making the desperate plight of **airlines** critical once again. "Oil is robbing the industry of a return to profitability," Mr Bisignani said in Washington this week. Delta has gone bankrupt despite a big refinancing last September, several efforts to shrink its network and lay-offs of over 7,000 employees-a tenth of its workforce. Northwest has been further damaged by a strike of maintenance workers since late August, forcing it to seek court protection from creditors through **Chapter 11** bankruptcy.

Chapter 11 is a form of interim bankruptcy that allows companies to keep operating as a business while shedding some liabilities such as debts and financial obligations to a corporate pension fund. The value to shareholders is also wiped out, and new financial support is sought. The benefits of **Chapter 11** are supposed to be avoiding the unnecessary liquidation of businesses, and the job destruction and total loss to creditors this can involve. But in the **airline** industry this emergency ward for stricken companies has turned into long-term intensive care, inadvertently wreaking further damage on rivals. In mid-October tougher new rules for **Chapter 11** will come into force, so troubled **airlines** have an incentive to go bankrupt soon, to benefit from today's more benign regime.

Despite its signs of recovery in the second quarter, United had to announce six weeks ago that it was yet again postponing its planned emergence from bankruptcy. This is now scheduled for February. By then the **airline** will have spent 38 months under court protection from its creditors. And even this new deadline may not be met: a year ago United's boss Glenn Tilton was forecasting exit from **Chapter 11** in March 2005. The more likely candidate for an early exit from bankruptcy is US Airways, which is in **Chapter 11** for the second time in four years.

Under normal circumstances, consolidation in the **airline** business would be part of the process of recovery. But none of the stronger carriers, such as American or Continental, has the stomach to swallow a rival for fear of being landed with its problems. American bought the remnants of TWA more than four years ago, before the 9/11 attacks, and more or less closed it down afterwards. With the exception of America West, which was anxious to widen its geographical footprint and so agreed a merger with US Airways on September 13th, low-cost **airlines** have little appetite for less-efficient legacy carriers.

Oil prices are a problem for **airlines** worldwide. But in America, with its refineries stretched to capacity even before Hurricane Katrina knocked some of them out, the problem is even more acute. The shortage of refinery capacity means that jet fuel is competing with petrol and heating oil for space in the plants. This bottleneck has sent refinery margins soaring. So the price of oil translates into a price of \$87 a barrel, once refining costs are taken into account.

Crushed by such added costs and with the looming change for the worse in their treatment under the new bankruptcy rules, it is little wonder there is a rush for the protection of the courts. Predictably, the American carriers are also asking for more government help. They received a \$2.5 billion hand-out after the 9/11 attacks grounded them and some, such as US Airways, qualified for subsidised loans. But now they want the government to waive federal taxes on fuel surcharges to air fares, arguing that federal taxes on aviation are now 26 cents in the dollar, compared with only seven cents in 1972.

There is no sign of an end to the legacy **airlines'** agonies, since the fuel-price effect will corrode their earnings next year, and there is little prospect of oil prices sliding back much below \$60. So the legacy **airlines** are trapped in a downward spiral. Every move they make to cut costs by removing trimmings from their cabin service or charging for meals and refreshments just brings them down to the level of service associated with low-cost carriers. The low-cost merchants, meanwhile, helped by their youthful, enthusiastic staff and their simpler, point-to-point routes, offer a standard of service that frequently outshines the networks, not least in terms of punctuality. As the number of routes offered by no-frills **airlines** increases, the legacy carriers are forced to retreat even further, making their residual networks less attractive because they offer fewer destinations.

The only bright spot for American carriers is international routes, where yields are rising steadily. But as they add capacity across the Atlantic, the bosses of European **airlines** such as British Airways are getting angry. They regard America's **Chapter 11** bankruptcy as a form of subsidised, unfair competition. It looks as though the woes of America could spill over on to the international market.

