A Painful Less

The Air Transportation Stabilization Board helped only a few airlines, yet it still turned a $300 million profit for the U.S. government.

By Brendan Smith, Contributor

In the fearful and tumultuous days following Sept. 11, 2001, the U.S. Congress acted quickly to stabilize the airline industry, which suffered the most immediate impact of America's darkest day of terrorism and the unprecedented 3-day shutdown of the nation's skies to air travel.

However, even the best of intentions can be waylaid, as the actions of the Air Transportation Stabilization Board (ATSB) reveal. In an act approved just 11 days after 9/11, Congress created the ATSB to authorize and administer as much as $10 billion in federal loan guarantees to help keep struggling airlines flying despite the drastic downturn in passenger traffic caused by 9/11.

By now, more than 4 years later, the Board has approved only $1.6 billion in loan guarantees, or 16 percent of the available funds, rejecting more than half of the applications that airlines submitted, including that of United Airlines, which filed for bankruptcy after its initial request was denied. ALPA's president, Capt. Duane Woerth, attributes the small payout to "pure politics" and the Bush administration's opposition to any aid for the airlines after 9/11. The Bush administration set the criteria for approving federal loan guarantees and appointed the ATSB's three voting members.

"We are a high-wage, highly unionized industry. That was their problem," Capt. Woerth says. "The ATSB seemed more interested in labor-cost restructuring. Congress intended to stabilize the industry. The goal of Congress seemed to be completely different from the goal of the administration."

One day before 9/11, Capt. Woerth returned from his honeymoon in Germany to Washington, D.C. He would not return to his home in Florida for almost 6 weeks as he and ALPA staff worked long hours to lobby Congress on behalf of pilots and the airline industry. "On Sept. 12, 2001, I started fighting for money," Capt. Woerth says. "Thank God, my office has a shower, because I had to use it almost every day."

The failure of the ATSB to approve the full $10 billion in loan guarantees helped trigger a harmful domino effect, with airline managements "doing stupid things with revenue" because of the need for short-term cash to fend off creditors, Capt. Woerth says. The dominoes included bankruptcies, ter-

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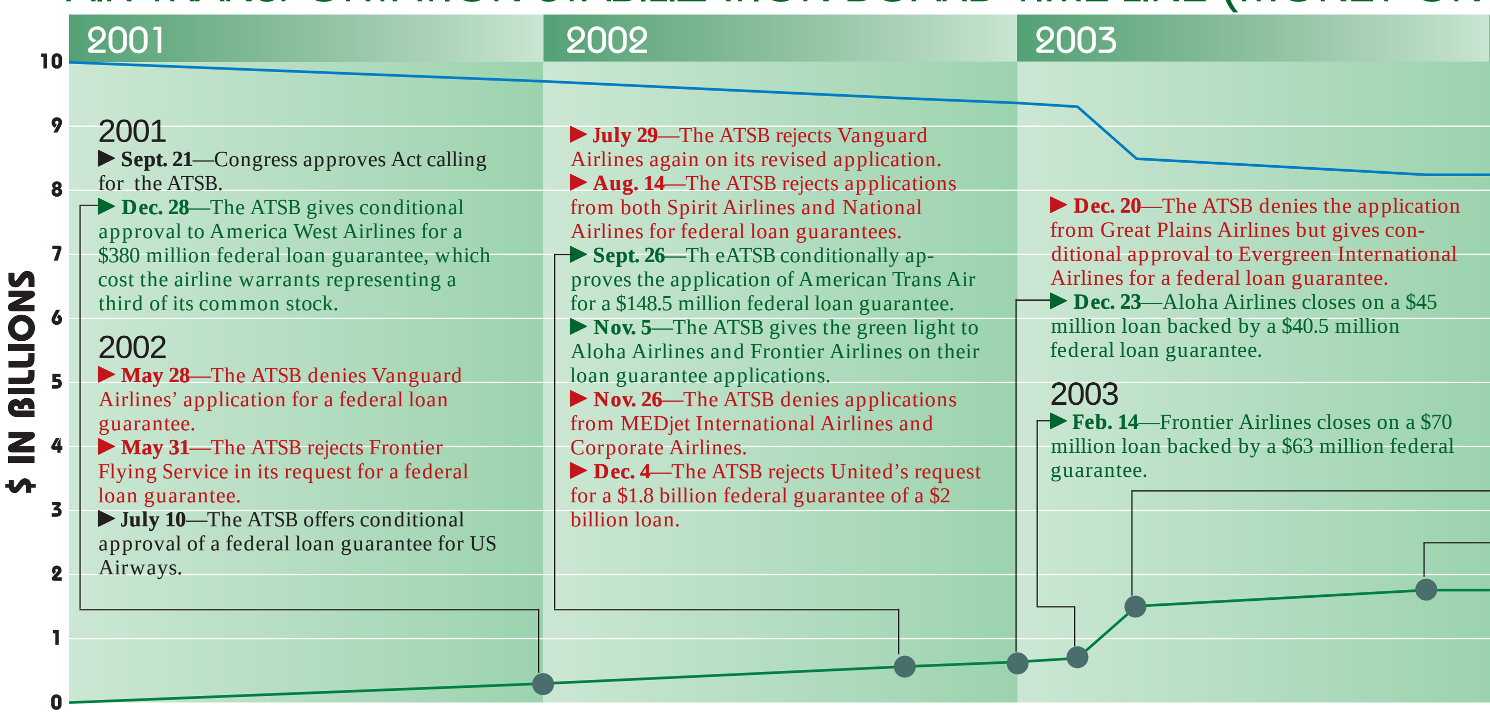
AIR TRANSPORTATION STABILIZATION BOARD TIME LINE (MONEY ON



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mination of collective bargaining agreements, defaults on defined-benefit pension plans, costly fare wars, and the misguided sale of tickets below cost to Internet wholesalers. "The cost of not getting those guarantees has just been enormous," Capt. Woerth says. "An awful lot of the havoc that occurred after 9/11 could have been avoided."

The ATSB lists dozens of press releases on its website, but it has chosen not to mention a stunning bit of news from this year. When the Board concludes its business, it is set to have earned more than $300 million in profits from the $1.6 billion in approved loan guarantees, including equity sales for warrants and other collateral that airlines provided and fees charged above loan repayments. The money will return to the U.S. Treasury, says ATSB Executive Director Mark Dayton, who justified the profits. "There is a risk component. Taxpayers are bearing risk that as it turns out we didn't have to make good on," Dayton says. "As it turned out, a lot of airlines decided they didn't need to seek a loan guarantee."

American, Continental, Delta, and Northwest did not seek loan guarantees even though they all suffered financially after 9/11. The reason some major airlines didn't seek help can be traced to the handwriting on the wall from the first loan guarantee the ATSB approved for America West Airlines in December 2001. In the ATSB's conditional approval of a $380 million federal loan guarantee, the Board demanded that America West increase its offer of warrants to the federal government from 5.3 percent of America West common stock to a staggering 33 percent. Warrants provide the right to buy a company's shares at a set price until a deadline is reached. The ATSB stipulated the warrants would not carry voting rights, but the federal government would profit greatly if America West's stock price increased.

Dayton, who became executive director of the ATSB in August 2004, says the Board was simply following its congressional mandate by requiring compensation to the federal government for the sizable risk of approving loan guarantees. He says that ATSB members did not debate labor-cost restructuring during their deliberations. "People have this impression that there were these ulterior motives, but there were none. We're not going to approve loans that are too risky," Dayton says. "The Board never once told any of our borrowers how to put together a business plan. We said, 'Give us a business plan that works.' We never once told anyone to cut labor rates or lease rates or how to create their business plan."

That claim rings hollow in the case of America West Airlines. In addition to requiring warrants representing a third of the company's common stock, the ATSB wanted proof of $600 million in concessions from America West's suppliers and creditors, along

THE TABLE)

2004 | **2005** | **2006**

LOAN GUARANTEES AVAILABLE

$8.4 BILLION AVAILABLE

▶ **March 31**—US Airways closes on a $1 billion loan supported by a $900 million federal guarantee.
▶ **April 23**—Th eATSB conditionally approves World Airways for a federal loan guarantee.
▶ **June 2**—The ATSB turns down Gemini Air Cargo for a federal loan guarantee.
▶ **Dec. 23**—Frontier Airlines fully repays the balance on its $70 million loan.

▶ **Dec. 30**—World Airways closes on a $30 million loan supported by a $27 million federal guarantee.

2004
▶ **June 17**—The ATSB rejects United for a second time in its request for a $1.6 billion federal loan guarantee.

2005
▶ **April 4**—Aloha Airlines fully repays the balance on its $45 million loan.
▶ **July 22**—The ATSB consents to the America West/US Airways merger.

2006
▶ The ATSB is set to earn more than $300 million in profits before concluding its business later this year.

$1.6 BILLION APPROVED

LOAN GUARANTEES APPROVED

with one final provision. "Finally, the Board notes that AWA's business plan and prospects are heavily dependent on labor costs," stated the Board's letter to America West President Doug Parker. "Accordingly, the Board's approval is conditioned on receipt from AWA of a commitment, satisfactory to the Board, to control growth in labor costs that could prevent AWA from achieving the goals of the business plan and, thereby, cause AWA to fail to repay the loan to be guaranteed."

The ATSB approved a $900 million federal loan guarantee for US Airways as part of the exit financing for the airline's emergence in 2003 from its first bankruptcy. In exchange for continuing the $708 million US Airways ATSB loan guarantee in 2005, when US Airways exited its second bankruptcy, the ATSB received warrants that represented 10 percent of the combined airline's reorganized equity.

After America West and US Airways merged in September 2005, America West President Parker also became president and CEO of US Airways Group. The ATSB, which gave its consent to the approval of the merger, made a killing on the deal. A month after the merger, the ATSB sold its warrants for both America West and US Airways and remarketed the guaranteed loans to private investors without the federal guarantee, earning the Board $112 million of its more than $300 million total expected profits.

Despite the high cost of doing business with the ATSB, United Airlines had nowhere else to turn when it sought $1.8 billion in federal loan guarantees in 2002 to stave off bankruptcy. Despite several amendments to its business plan, the ATSB rejected United's application on a 2–1 vote and refused to allow the airline a one-week extension to submit more information. The ATSB decided that United's business plan was "not financially sound" and that its revenue projections were "unreasonably optimistic." The decision outraged some members of Congress, notably Sen. Jay Rockefeller (D-W.Va.), who at the time was chairman of the Aviation Subcommittee. "I'm deeply troubled by the actions of the ATSB. The Board was created to get the industry back on its feet, and it has failed to meet its responsibility," Sen. Rockefeller said in December 2002. "And now the ATSB has failed to provide United Airlines with the essential backing it needs."

After 38 months and two bruising rounds of contract revisions, United emerged from the longest and largest bankruptcy restructuring in industry history on Feb. 1, 2006. In the end, United pilots' pay was cut more than 40 percent, their work hours increased more than 20 percent, and their pension plan was dismembered.

Capt. Mark Bathurst, chairman of the United Master Executive Council, notes the "enormous sacrifices" made by all United employees, including its 6,600 active pilots. "At every critical step of this journey," he says, " to save the airline, the pilots shouldered the greatest cuts. The indisputable fact is that the resolve of the employees of United Airlines is the major reason the airline exited bankruptcy."

During bankruptcy, United tried again for a $1.6 billion federal loan guarantee but lost on another 2–1 ATSB vote in June 2004. This time, the Board decided a federal loan guarantee to the second largest U.S. airline wasn't "a necessary part of maintaining a safe, efficient, and viable commercial aviation system in the United States," part of the Board's mandate from Congress.

Adam Pilarski, senior vice-president of AVITAS, an aviation consulting firm in Washington, D.C., blames airline management for the poor financial condition of many airlines. "Airlines have been mismanaged for a very long time," he says. "United management was clearly more incompetent than many other airlines." United management also spent too much time seeking government money instead of focusing on a viable way to emerge from bankruptcy, says Pilarski, who admits as an economist he is biased against federal loan guarantees, which interfere with a free market.

The ATSB suffered internal inconsistencies that illustrate the contrasting goals of Congress and the Bush administration. Under the congressional act, the ATSB was supposed to provide loan guarantees to airlines "for which credit is not reasonably available" and that the loans were "prudently incurred" by the airline. No mention is made of labor rates. However, the Bush administration set the regulations for the ATSB through the Office of Management and Budget, which added a second layer of criteria and required that the ATSB give preference to certain airlines, including those that obtained "concessions by creditors, [airline] employees, or others that will strengthen the financial condition of the company." In other words, airlines that squeezed their own employees first received preferential treatment for receiving a federal loan guarantee.

For ATSB members, their congressional mandate of "maintaining a safe, efficient, and viable commercial aviation system in the United States" became nothing more than "an academic exercise in pure economic principles," Capt. Woerth says. For airline employees, the ATSB offered a painful lesson in politics.

ATSB: The Nuts and Bolts

The Air Transportation Safety and System Stabilization Act, approved by Congress just 11 days after Sept. 11, 2001, created the Air Transportation Stabilization Board to authorize and administer as much as $10 billion in federal loan guarantees to help struggling U.S. airlines.

The Act also included aviation insurance, victim compensation, and $5 billion in direct aid to airlines.

The ATSB's membership has changed several times. The ATSB is now chaired by Donald Kohn of the Federal Reserve System's Board of Governors, with voting members Randal Quarles, Treasury Department undersecretary for domestic finance, and Jeffrey Shane, Transportation Department undersecretary for policy.

Comptroller General David Walker is a non-voting ATSB member.