Airlines for America™
We Connect the World

Nicholas E. Calio
President and CEO

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The Honorable Bill Nelson
Ranking Member, Committee on
Commerce, Science & Transportation
United States Senate
716 Senate Hart Office Building
Washington, DC 20510

Dear Ranking Member Nelson:

I am writing to address issues raised by the recently released report by the Commerce Committee minority staff about optional airline services. I appreciate your leadership on issues affecting the airline industry, and your goal of enabling the industry to serve customers in the most safe, efficient, and cost-effective manner possible. I was disappointed with your statements that suggest that the airline business model of unbundling – in which passengers pay only for the services they use – is somehow anti-consumer. On behalf of Airlines for America, I offer a broader perspective on these issues, which should be considered as the Senate Commerce Committee deliberates its approach to the FAA Reauthorization bill.

As you are well aware, the ability of airlines to provide service to their customers and communities, create jobs and contribute to the nation's economic growth is tied not only to their ability to cover their costs, but to earn a return over the long run. This fundamental and accepted economic objective is critical to the success of any business, but historically was not achieved by U.S. airlines. Consequently, following deregulation many airlines failed, industry employment shrank, capital flow shriveled and airline investment in products diminished. It has only been in the past several years that airlines have regained the financial ability to reinvest in our customers, product and employees.

Optional services priced like other products – that is, based on demand – provide airlines with new sources of revenue that help them achieve sustainable earnings that they failed to achieve previously. By creating new optional services and unbundling existing services, airlines are able to offer lower base fares because only customers who value these additional services pay for them. The modern airline business model is very transparent and no different than the customer experience at a ballpark, theater or hotel, where price/product differentiation is the norm.

1301 Pennsylvania Ave, NW, Suite 1100, Washington, DC 20004-1707 T: 202.626.4226 F: 202.626.4166 E: ncalio@airlines.org W: airlines.org

Optional Services are a Positive Development for Consumers and Airlines

The minority staff report paints an incomplete picture regarding the role of ancillary fees and how that role has changed in recent years. Consideration of these issues must be taken within the context of the industry's substantial losses in the preceding decade and a continuing need to earn a return on invested capital throughout the business cycles.

From 2001 through 2014, U.S. passenger airlines reported cumulative losses of $43 billion, or more than $4 a passenger. Given the long climb to financial stability in the last 15 years and the hard work remaining to ensure our global competitiveness through financial stability, the minority staff's recommendation that fees be tied to cost ignores competition's benefits to the consumer and the stagnancy that price regulation created in our industry. After nearly a decade of losses from 2001 through 2009, the industry's net profit margin just last quarter finally reached the "average" U.S. corporate profitability, as represented by the Standard & Poor's (S&P) 500 and continues to trail companies like Apple, Chipotle, Coca-Cola, CSX, McDonald's, Starbucks, Verizon and Walt Disney.

The losses incurred from a decade of two recessions, record fuel prices, global conflict, natural disasters and pandemics forced U.S. carriers to scale back investment in new aircraft and equipment, reduce service to communities and shed 142,000 airline jobs – nearly one-third of the industry's total workforce. In an effort to mitigate these losses and cover a 55 percent increase in total operating costs from 2000 to 2014, including a 201 percent increase in annual jet fuel expense, some airlines began to unbundle and charge fees for certain optional products and services. For example, to address certain customers' desire for better seating, a few carriers invested heavily in outfitting their aircraft with a section of extra room seats in the economy cabin, while other carriers did not. Airlines develop products and services that they believe may appeal to customers. All of this experimentation and innovation is a hallmark of competition and is good for consumers.

Lower Fares

Today, optional services ensure that passengers only pay for the services they use, e.g., why bundle the cost of a checked bag into the base price of the ticket when many customers do not check a bag? The additional revenue they generate allows airlines to enhance service quality and investment. And, while fuel prices have thankfully abated, fares also have come down: year over year in June, fares are down 5.5 percent.

Airfare remains a bargain, and costs on average considerably less than it did when the government last dictated pricing, something the minority staff report recommends despite the fact that deregulation has been an unquestionable boon for consumers. The good news for consumers is that airfares have not kept pace with overall U.S. inflation: adjusted for inflation, the average domestic airfare, per the U.S. Department of Transportation (DOT), fell 13 percent, or 8 percent including ancillary revenue, from 2000 to 2014. Very few consumer goods (including those under the jurisdiction of the Committee) provide such consistent value to customers. What's more, customers have greater levels and choices of service than they did when airfare was regulated by the government.

Airlines Reinvesting in the Customer Experience

Improving finances are enabling significant reinvestment in the customer experience. This year, U.S. passenger airlines are spending over $1.4 billion per month on capital spending, including

new or refurbished aircraft (our members are taking delivery of on average a new plane every day this year), more fuel efficient engines, premium seating, improved in-flight entertainment options, advanced baggage systems, and airport facilities and kiosks.

Improving Finances Benefit Employees, Create New Jobs and Increase Service

As a result of painful restructurings within the industry, and despite entering 2014 with $72 billion in debt, the airlines are now more stable financially. However, only two airlines, Southwest and Alaska, have investment-grade credit, something all our carriers need to achieve. As inherently cyclical businesses, airlines are working hard to improve their corporate creditworthiness by paying down debt and prepare for the next economic downturn. In the past 5.5 years, U.S. airlines have retired $50 billion in debt, or an average of $9 billion a year.

Gradually strengthening finances have benefited airline employees through rising wages and benefits, profit sharing, accelerated contributions to employee retirement accounts, and enhanced job growth and security. In fact, the industry just recorded its 18th consecutive month of year-over-year employment gains.

As airlines generate normal return on capital, customers are seeing more service. In fact, domestic seats are at their highest point in seven years, while international seat supply is at an all-time high. Published schedules show that airlines have been adding capacity for 10 consecutive quarters. Improving finances have enabled this return to growth, which in turn fosters economic growth in trade and tourism – key industries for the state of Florida.

Airlines Have an Incentive to Transparently Market Optional Services to Consumers

The minority staff report raises a concern about whether airlines are sufficiently transparent about fees for optional services. Optional services are important potential sources of revenues for carriers. However, these services will not produce revenue if they are not sold to customers. Carriers have made significant investments in these services, like extra-room seats, so it makes no sense that they would not want to be transparent about selling them. Even with checked bag charges, it makes no sense for an airline to try to hide them from passengers. Having existed on most airlines for more than five years, customers understand baggage policies, and airlines are fully transparent about potential charges. Airlines are fiercely competing for passengers, and are counting on repeat customers – there is nothing to be gained by surprising them with hidden charges.

Existing DOT Rules Assure Ample Disclosure of Ancillary Services and Fees

Some in the Global Distribution System (GDS) community advance the argument that consumers are surprised by ancillary services and fees. This is a spurious argument GDSs and third-party travel sellers make to support their effort to have DOT require airlines to distribute optional services through third parties (and GDSs) instead of obtaining that right through arms-length commercial negotiations with airlines. Customers do have the wherewithal and experience to determine not only airline fares but also optional service fees. This is the basic characteristic of the e-commerce marketplace today: the customer can quickly determine and compare the availability and costs of services offered in the marketplace. This is where the minority report gets it very wrong. Customers have immediate access to pricing and service options. And knowledge is power and a stimulus to competition: it guides customers' purchase decisions and those decisions shape what airlines offer and the prices of those offerings. It may

be that some customers dislike paying for some of the optional services, but that is not the same as not knowing about them. Baggage charges, for example, have been widespread in the industry for many years.

Passengers always know what they are paying for before it is charged to their credit card.

Charges for optional services are disclosed on carriers' websites and can easily be obtained from reservations agents. Because services offered on a complimentary basis may depend on the particular customer's loyalty status or credit card, the best resource for a customer to determine what fees might apply is to go to the carrier website and review the terms and conditions for services. The minority staff's recommendation about disclosure is overly complex and would likely cause confusion rather than add clarity. To the extent that staff have concerns that some carriers were not making charges for optional services sufficiently accessible, they have already been addressed by the Department's Consumer Rule 2, which requires carriers to post them within one click from the home page.

Information on Ancillary Services and Fees Is Available for Comparison Shopping

The minority staff report also raises the issue of consumers needing to comparison shop. In addition to airline websites, third party sites, such as SmarterTravel.com show that consumers have more than adequate knowledge and insight into charges for optional services.[1] In short, the marketplace provides multiple one-stop comparison shopping options and regulation is not needed.

While we believe that information enabling comparison shopping is clearly available, we would also note that no industry is subject to any requirement to distribute their product in a manner enabling comparison shopping. In fact, the same distribution channels that sell airline tickets also sell other travel products, such as hotel rooms and rental cars. Notably, there is no proposed government mandate (nor should there be) that would require hotels, for example, to disclose at the time of booking the myriad optional fees (Wi-Fi, parking, cancellation charges, to name but a few) that a guest may encounter while staying at a hotel.

The Airport and Airway Trust Fund (AATF) Contains a $6 Billion Surplus from Excessive Taxes on Airline Passengers

The minority committee staff report not only sounds an alarmist theme about optional service fees, but indicates that the Trust Fund is losing money because some optional fees are not taxed. Given the excessive $20 billion special commercial aviation tax burden that falls primarily on passengers, we strongly oppose any attempt to increase the tax burden of the traveling public, especially given the current $6 billion in unobligated cash currently sitting in the Trust Fund. The current tax system for funding the nation's air traffic control system is irrational since revenues are not related to the costs of the system, an issue which could be addressed in the larger context of governance and funding changes to the air traffic control system.

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[1] SmarterTravel.com's "Ultimate Guide to Airline Fees" (last updated July 24, 2015) is found at: http://i.slimg.com/sc/sl/photo/a/ai/airline_fees_chart.pdf.

FAA Reauthorization and the Importance of Commercial Aviation

These issues are of vital importance as the Senate Commerce Committee begins consideration of an FAA Reauthorization bill. Congress enacted the Airline Deregulation Act believing that an airline industry driven by market forces and competition would benefit the public by delivering a variety of affordable service options and prices across the demand spectrum, and allow the industry to prosper and grow. Congress' belief in fundamental market forces – supply and demand, competition and price transparency – clearly has benefited the public, as discussed above. Now is not the time to turn back the clock toward reregulation.

A sustainably profitable and healthy airline industry is critical to the nation and the State of Florida, whose economic engine is driven by travel and tourism. Commercial aviation creates the following impact on Florida's economy:

- 807,083 high-paying jobs
- $54 billion or 7 percent of state GDP
- $28.5 billion in earnings (wages, sales, other labor income that can be attributed to commercial aviation)

Senator Nelson, airlines share your view that the consumer experience must be in the forefront of our responsibilities The fact that more people than ever are traveling this summer is a testament to the fact that customers are embracing our product. Indeed, with reinvestment in new equipment and products and with satisfied employees providing the service, the experience is better than ever for the traveling public and will continue to improve. The airline industry has evolved into one in which customers have a range of different business models from which to plan their travel. These airlines compete vigorously for customers, driving greater industry investment in innovations, new services, and jobs.

I greatly appreciate your consideration of our views, and would be happy to discuss these issues with you and your staff.

Sincerely,

Nicholas E. Calio