

STATEMENT OF PATRICK V. MURPHY, JR.
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DEPARTMENT OF TRANSPORTATION
BEFORE
THE HOUSE SUBCOMMITTEE ON AVIATION
REGARDING EASTERN AIR LINES

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Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to discuss the Department of Transportation's activities in connection with Eastern's bankruptcy proceeding.

With me from the Federal Aviation Administration is Mr. John S. Kern, Deputy Associate Administrator for Regulation and Certification. Mr. Kern is available to address the safety and readiness-to-operate issues involving Eastern.

The Department has been monitoring closely the activities of Eastern Air Lines for some time. In April 1988, then Secretary of Transportation Jim Burnley announced a preliminary investigation of Eastern, its sister company, Continental Air Lines, and its parent, Texas Air Corp. This investigation was launched to determine whether there was substantial cause to question the carriers' continuing fitness and whether they were disposed to comply with the safety and economic rules applicable to air carriers. As part of this investigation, the FAA commenced a special thirty-day inspection of Eastern that was subsequently broadened to include Continental and its commuter subsidiaries.

On June 2, 1988, a final report was issued and the investigation was concluded. The results of the investigation showed that both Eastern and Continental continued to meet the Department's fitness standards with respect to management, finances, and compliance disposition. With respect to financial fitness, the investigation found that, despite significant financial losses at both Continental and Eastern, each carrier had sufficient assets and access to capital to operate safely and without undue risk to the public, and there did not appear to be any significant question about their financial viability for the near term.

The investigation did find that, while Eastern and Continental had satisfactory compliance dispositions, the labor-management tension at Eastern raised concerns about that carrier's ability to comply in a full and satisfactory way with our safety requirements over the long term. As a result, Secretary Burnley asked former Secretary of Labor William Brock to work with Eastern's management and employees to build the lines of communication and cooperation within the company that are necessary to maintain the highest level of safety. In addition, the FAA announced that it would increase its surveillance of Eastern to ensure that the carrier's operations were being conducted in full compliance with all safety requirements. On July 6, 1988, Secretary Brock announced that his efforts had resulted in the successful negotiation of an agreement between Eastern's management and its independent employees and unions to establish procedures that would open lines of

communication within the company and would address the safety issues identified in the investigation. Unfortunately, during the late fall of last year, the procedures established by that agreement broke down.

Labor-management relations problems at Eastern culminated in a strike against the carrier by its Machinists union on March 4, 1989. Machinist picket lines have been honored by the majority of Eastern's pilots and flight attendants. As a result of the strike, Eastern curtailed substantially its service, initially being able to operate only about 10 percent of its flights. On March 9, Eastern sought protection from its creditors in the bankruptcy court under Chapter 11 of the U.S. Bankruptcy Code. Eastern is now under the protection of that court until the bankruptcy proceeding before the court is terminated.

Various factors served to moderate the initial impact of Eastern's service reductions on consumers. The potential strike had been well-publicized in advance, coming at the end of a 30-day National Mediation Board cooling off period. Many travel agents and passengers had already made alternate travel arrangements. A number of carriers accepted Eastern's tickets when the strike began, and several continued to accept them even after the bankruptcy filing. Major cruise lines arranged transportation on other airlines at no additional charge for package cruise customers with Eastern tickets.

The Department's Consumer Affairs Office responded to telephone inquiries from affected travellers and issued a fact sheet immediately following the bankruptcy advising Eastern customers of alternatives available to them. That office has continued to track consumer problems at the carrier. Compared to the sudden bankruptcy of Braniff in 1982, the effects of the Eastern bankruptcy on consumers were limited. Following Braniff's bankruptcy, the Civil Aeronautics Board received 170 inquiries per hour from consumers, whereas following Eastern's bankruptcy, we received only 170 inquiries for the entire month of March. Since the first month of the strike, the number of complaints about Eastern reported to our consumer office has been very small. As a matter of fact, the number of complaints actually decreased sharply -- from 131 in March to 44 in April, 34 in May, and 18 through the first three weeks of June. Refund problems accounted for one-half of those complaints, but in absolute numbers, the volume of complaints has been quite low.

Let me describe briefly for you the most important aspects of Eastern's refund practices.

Passengers holding Eastern tickets have several options. Under federal credit law, most people who bought Eastern tickets with a credit card are entitled to a refund from their credit card company. Eastern recently estimated that about 60 percent of its outstanding pre-bankruptcy tickets were credit card sales.

Eastern has created the Ticket Holder Assistance Program, under which passengers can apply their tickets as partial credit toward new Eastern flights. Continental Air Lines also initiated a program to offer full credit toward Continental tickets for Eastern tickets that were purchased from a travel agency.

We understand that Eastern is not providing refunds for tickets purchased on or before the March 9, 1989, bankruptcy filing, because such refunds would be contrary to the requirements of the bankruptcy code.

Based on the consumer complaints filed with the Department, it does not appear that passengers are having difficulty in finding alternatives to the cancelled Eastern flights. This probably reflects the very competitive nature of Eastern's system.

Although several proposals to purchase Eastern from its current owners have been made, to date none of these attempts have been successful. At the present time, there is no formal restructuring program before the bankruptcy court.

On April 24, Eastern announced informally a plan for the restructuring of the airline. Under the plan, Eastern would sell about \$1.8 billion in assets, including 98 of its 255 aircraft, 117 of its 281 gates, 28 of its 204 takeoff and landing slots (in addition to the 92 slots used in the shuttle operation), and certain unspecified international routes. Included in the plan

was the sale of the Washington-New York-Boston shuttle operation to Donald Trump for \$365 million, which has since occurred. Eastern proposes to rebuild a smaller airline, operating to 77 cities, compared to 102 before the strike, with 157 aircraft and 17,000 employees. The carrier indicated that it would concentrate on rebuilding its Atlanta hub and on adding flights on routes from the Northeast to Florida and the Caribbean, and that it could have 30 percent of its proposed service in place by July, 50 percent by August, and 100 percent by the end of the year. Proceeds from the asset sales would be used to pay off \$914 million in debt. The remainder would be for working capital. Under Eastern's plan, fares would be discounted heavily during the rebuilding phase to lure back passengers.

Eastern apparently has reached agreements to sell almost \$900 million in assets. This is about half of its goal of \$1.8 billion. Included in these asset sales are the shuttle to Donald Trump; various assets, international routes, and facilities at Philadelphia to Midway Airlines; and certain aircraft.

The Department is not a direct party to the bankruptcy proceeding, but, like other Government agencies having an interest in the proceeding, such as the IRS and GSA, is represented in the case through the U.S. Attorney's office in New York. We have been monitoring closely the issues raised and the decisions made by the

Judge, particularly those that may affect airline fitness or competition. Our General Counsel's office has been receiving and reviewing the various documents filed and issued in the bankruptcy proceeding. We have been carefully reviewing individual transactions resulting from the bankruptcy case and from Eastern's proposed restructuring plan. To this end, we did not object to the sale of the shuttle operation to Donald Trump, since his airline had already been found fit by the Department and issued an operating certificate by the FAA. However, when Eastern was proposing to sell certain gates at Philadelphia and two Canadian routes from that city to USAir, Secretary Skinner sent a letter to the Attorney General raising serious concerns about this sale on antitrust grounds, finding that the transaction would create significant competitive and international transportation policy problems. Subsequently, the Justice Department threatened that it would sue Eastern if the carrier proceeded with this sale. Eastern then withdrew its agreement with USAir and has now agreed to sell those assets, as well as some aircraft, to Midway Airlines. This is expected to result in a major new hub in Philadelphia bringing new, competitive service to the Northeast. The Department also welcomes the emergence of The Trump Shuttle with its plans to renew and revitalize the Eastern Shuttle operation.

Further, on June 13, 1989, Secretary Skinner sent a letter to the Chief Executive Officers of 28 air carriers reminding them of the

provisions of section 401(h) of the Act, under which international route transfers are subject to prior Department approval. In that letter, the Secretary indicated that he viewed with concern the prospect that carriers might endeavor to sell these routes and that such sale might "undercut the important public benefits that the Department sought to achieve by awarding the route in the first place." Recent press reports indicate that Eastern may be negotiating with American Airlines for the sale of certain of Eastern's Latin American routes. Any such sale, if actually proposed, will be subject to DOT review.

Eastern now operates 79 flights a day to 27 destinations. By July 2, it hopes to fly 226 flights a day to 49 cities, and by August 1 it will add another 165 flights and 21 cities, bringing its service to 70 cities and 391 flights a day systemwide. Eastern has 6,000 employees now and by August 1 plans to add another 6,500 employees. By early 1990, the carrier hopes to have 17,000 employees on its payroll. Whether Eastern is able to succeed with its plans depends to a large extent on whether it is able to attract and hire new employees to conduct its operations, and whether its product will be attractive to consumers.

Prior to the strike and the bankruptcy filing, the Department established a Strike Impact Center, staffed by DOT personnel, to collect and provide to the Secretary information on the economic effects of the strike by the IAM on Eastern as well as on the operations of other major airlines and railroads, including

commuter rail. The FAA simultaneously established a separate center for monitoring the safety-related aspects of the strike. At least daily contacts with each of the major air and rail carriers, as well as with Eastern's unions, were maintained to determine whether secondary boycotts at other carriers had occurred, as well as whether any displaced passengers from Eastern flights were not being accommodated. Close monitoring of the strike situation was maintained through this Center for 12 to 14 hours a day for almost three weeks. FAA monitoring was on a 24-hour basis during this same period. When it appeared that major disruptions in the transportation system were not likely to occur, the daily contacts, other than with Eastern and its unions, were discontinued.

In concluding my remarks, I want you to know that the Department continues to monitor the Eastern bankruptcy and strike situation, providing periodic reports to the Secretary on major developments. The Department has continued to maintain regular contacts with the labor unions in order to keep in touch with the progress of the strike and bankruptcy from their point of view. The FAA is also continuing to scrutinize closely Eastern's operations from the safety standpoint. My colleague, John Kern, will be able to speak to FAA's role.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions the Subcommittee may have on this matter.