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**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

Chief of Staff

400 Seventh St., S.W.
Washington, D.C. 20590

FAX TRANSMISSION COVER

Date: 12 / 18 / 92

TO: Bob Zoellick

FAX: 456-1121

FROM: **Michael P. Jackson**
(202) 366-1103
(202) 366-3956 (fax)

Number of pages to follow: 2

Comments:

As discussed - let me know
if you have questions or need
changes.

mf

U.S.-U.K. LIBERALIZATION TALKS

I. KEY ELEMENTS OF AN "OPEN SKIES" AGREEMENT (JULY 1992 PROPOSAL)

Major elements:

- o No limit on the number of airlines that may serve the bilateral market, or any city-pair (e.g., Baltimore to London) within the market.
- o No limit on the number of cities in each party's territory that may be served by the airlines of each side (international services only -- not cabotage).
- o The airlines of one party may carry passengers and cargo between the territory of the other party and third countries without limitation (fifth freedom).
- o No regulation of the number of flights per week operated by the airlines of both sides or of aircraft type.
- o No regulation of the fares or rates charged by the airlines of both sides.
- o Charter flights may be operated between the territories of the parties under the most liberal rules of either party, subject only to compliance with consumer protection requirements.
- o No barriers to the normal conduct of ancillary activities (e.g., installation, operation, and marketing of computer reservation systems, "self-handling" of passenger check-in, baggage, and cargo, maintenance and provisioning of aircraft, etc.).

II. U.K. OBJECTIVES

The U.K. seeks DOT approval of British Airways' investment in, and integration with, USAir. In return, they are prepared to enter into an agreement that liberalizes the bilateral regime for air services. In the formal negotiations, however, the U.K. has taken the position that essential elements of that more liberal regime must be:

- o (a fast-track dispute resolution mechanism to address anticompetitive airline behavior (which the U.K. believes will be rampant absent strict government controls);
- o (the unfettered ability of U.K. nationals to own and control U.S. airlines; and
- o (the ability of U.K. airlines to operate within the U.S. domestic market (cabotage).

- 2 -

III. IS SUCCESS POSSIBLE?

The essential requirements for a meaningful breakthrough at this point are that the U.K. (1) drop the demand for a change in U.S. law (ownership and cabotage) as part of the package; and (2) agree to complete and unconditional implementation of an "open skies" agreement including all of the elements listed in Section I of this paper. The U.S. proposal tabled in July 1992 contained all of those elements, with the intention that they come into effect immediately upon reaching agreement.

Secretary Card has said both in Washington and London that he needs "immediate open skies" as a basis for ruling favorably on the BA/USAir transaction. The essential requirement is that we have a fixed and irrevocable schedule for liberalization leading to full open skies in the very near term. (In October 1992, the U.S. proposed a two-year phase-in of the July package, but the proposal was vehemently opposed by most of the U.S. airline industry. In addition, restating their view that U.S. statutory changes are needed, the British did not seriously engage in a discussion of our October proposal.)

If the Prime Minister drops the requirement for statutory changes as elements of the package, there might well be a basis for agreement. That possibility will vanish, however, if it is necessary to spend time negotiating a complicated formula for phasing in benefits. Any such negotiation will divide the U.S. airline industry against itself and against the Administration, will have to cover a parallel phase-in of the BA/USAir transaction as well, and will have only the dimmest prospects for success.

It is still possible to approve the BA/USAir transaction and bring the decision to closure prior to January 20, but time has almost run out. Given the level of control vested in BA by the proposed agreement, approval would require a deliberate departure from a long-standing interpretation of the Federal Aviation Act -- a departure based on our willingness to adopt a more flexible policy in the context of a truly liberalized aviation market. To be defensible in court, the decision would have to be preceded by notice and a reasonable opportunity (a few weeks, at least) for public comment.

All of this makes very clear that, at this point, we will have to have an open skies agreement that can be negotiated virtually overnight. A simple, straightforward opening of the market in keeping with the elements listed in Section I would be such an agreement. (Our open skies agreement with the Netherlands was concluded in three days.) Experience with the U.K. in aviation teaches that any undertaking to negotiate a more calibrated regime will involve much more time than is available to us.



**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

Chief of Staff

400 Seventh St., S.W.
Washington, D.C. 20590

October 19, 1992

MEMORANDUM FOR ROBERT ZOELICK

FROM: MICHAEL JACKSON *MJ*

SUBJECT: Request for a Telephone Call by Mr. Baker to
Douglas Hurd

As discussed, it would be helpful if Mr. Baker could make a call to Foreign Secretary Douglas Hurd to reinforce the President's cable to the Prime Minister. Attached are several documents:

- o The President's cable. *(classified)*
- o Draft talking points.
- o Background on the BA/USAir investment, Secretary Card's conversations with the British and our negotiations this week in London.

Of course we understand if Mr. Baker is unable to make the call. We are therefore grateful for the offer you made to touch base with the British if Mr. Baker is unable to do so. Thanks for your help.

JAB:

- 1) I think this would be a good call to make if you have a moment
- 2) you only need to look at POTUS's letter & the talking points
- 3) Please let me know if you don't call, b/c I'll try to do something more in that case

~~CONFIDENTIAL ATTACHMENT~~

RBZ

UNCLASSIFIED UPON
REMOVAL OF CLASSIFIED
ATTACHMENTS
14 08/07/23

~~CONFIDENTIAL~~NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

October 19, 1992

MEMORANDUM FOR THE HONORABLE ANDREW CARD
The Secretary of Transportation

SUBJECT: Message to Prime Minister John Major

The attached cable was sent to Prime Minister John Major in response to your memo to General Scowcroft dated October 15, 1992.

William F. Sittmann
Executive Secretary

DECLASSIFIED

White House Guidelines

E.O. 13526, SEC 3.4 (b), September 11, 2006

By MB NARA, Date 5/22/17~~CONFIDENTIAL~~

Declassify on: OADR

~~CONFIDENTIAL~~~~CONFIDENTIAL~~

Dear John:

Andy Card, my Secretary of Transportation, met recently with John MacGregor to review aviation issues. As Andy indicated, we would like to find a way to approve the proposed investment by British Air in USAir. However, as BA's proposal would change dramatically the structure of international aviation, it would be very difficult to approve without a true liberalization of our bilateral aviation market.

Tomorrow our officials resume negotiations on our air services agreement. My officials are prepared to discuss a detailed "Open Skies" proposal. They are prepared also to negotiate for a rapid conclusion of a new agreement. I believe we have the opportunity now to secure a truly liberal regime that would benefit our two countries and set a standard for other countries as well.

With the proper political will on both sides, we should be able to conclude two precedent setting cases shortly: an "open skies" agreement between our two countries and BA's investment in USAir.

Because of the importance I attach to these issues, I have asked Andy Card to meet with John MacGregor this week in London. I would be grateful for your personal review of these issues.

Sincerely,

George Bush

DECLASSIFIED

PER DOS WAIVER, November 6, 2015

By 14 NARA, Date 08/01/23

~~CONFIDENTIAL~~

Declassify on: OADR

~~CONFIDENTIAL~~

DRAFT TALKING POINTS
Telephone Call With Foreign Secretary Hurd

- o The President has just sent a message to Prime Minister Major about the very important aviation bilateral negotiations that are underway between our two countries.
- o According to the reports I receive, these talks show signs of dragging on for a considerable time.
- o I think something dramatic is possible in this negotiation -- a new and truly liberal aviation agreement. It would be a good thing for both of our countries, and create precisely the kind of model you have tried to persuade the EC to embrace.
- o Of course the backdrop for these negotiations is our review of the proposed investment by British Airways in USAir.
- o We truly would like to find a way to approve the BA deal. We are committed to improving the climate for foreign investment.
- o Unfortunately, Secretary Card simply cannot approve the deal without a true liberalization. We ought to be able to make both work.
- o If both things are to happen, we will need to close a deal in the very near future -- this week if at all possible. For this reason, the President has Secretary Card to travel to London to meet with John MacGregor on Wednesday.
- o I'd be grateful for your personal review of this matter.

#

• As you may have heard, Ross Perot slammed the President last night in the last debate for considering this deal. So we're fighting for what's right, at some risk.

10/19/92

- Can't you take the same approach? We both know open transatlantic competition + open investment are the right results, but we won't get there if the UK doesn't show its serious on liberalization.

BACKGROUND ON PROPOSED BRITISH AIRWAYS-USAIR INVESTMENT
October 19, 1992

The Deal: British Airways ("BA") has proposed to invest \$750 million in USAir. In return, BA would exercise a degree of oversight of USAir's management that would be unprecedented for a foreign airline. Ultimately, the two airlines would operate as one. The proposal, which requires DOT approval, is extremely controversial; DOT has received more than 100,000 letters on the subject on all sides of the issue.

The investment clearly would be a good thing for USAir, a carrier that, like so many others, has experienced a serious erosion of profits during the past few years. Communities in which USAir is a major employer, together with their Congressional delegations, strongly favor early approval of the BA/USAir transaction.

Most other U.S. airlines, however, including all of the "majors," say that the investment should not be approved until the U.K. agrees to liberalize access to its international aviation market (not the U.K. domestic market, in which our airlines have little interest). They say that BA, already the strongest airline in the bilateral market by a substantial measure, will satisfy its remaining aspirations for service to the U.S. through its new partnership, and that we then will have lost whatever leverage we might have had to negotiate a more open market for U.S. airline services to Britain. The Administration, the airlines say, should insist on liberalization as a prerequisite to approval of the deal.

They make a powerful argument. Although we have long attempted to persuade the U.K. to relax its regulation of trans-Atlantic flights, the U.S.-U.K. aviation agreement ("Bermuda 2") remains one of the most protectionist that we have. The U.K. insists on a highly regulatory regime that limits the number of U.S. and U.K. cities that can be served with nonstop flights, limits the number of airlines that can serve each city pair, limits the schedules of the airlines that do serve, and requires governmental approval of every fare. Bermuda 2 prohibits any additional U.S. airline service to London and other U.K. cities, even from U.S. communities that do not currently enjoy any direct service at all. A number of cities that seek new or additional air service to the U.K. have joined the airlines in opposing the BA investment.

Update on DOT Negotiations: Secretary Card met with the U.K. Secretary of State for Transport, John MacGregor, on September 23. They agreed to an accelerated schedule of negotiations on a new bilateral aviation agreement. The first round of negotiations took place two weeks ago. Although some modest improvements in the approach of the British team were evident,

the results were far short of the meaningful steps toward liberalization that we advocate.

Last week, after consulting with Larry Eagleburger, Secretary Card spoke by telephone to MacGregor and conveyed his disappointment that the first round had not made more progress. MacGregor persisted in saying that the British are interested in liberalization.

Our team is meeting for the second round in London this week. We expect to table a very detailed "Open Skies" proposal that provides for: (1) a clear agreement on the end result -- truly open markets; and (2) a fixed and predictable schedule of steps over three years that will allow us to get to Open Skies.

While there has been no overt linkage in our discussions with the British government between the bilateral agreement and the proposed British Airways investment in USAir, that deal has, of course, been looming large in the background of these discussions.

Secretary Card has publicly stated on a number of occasions that our aviation relationship is a very significant variable in the "environment" of issues affecting review of the BA/USAir deal. He has met privately with all the airline CEOs and spoken to numerous others. We have received over 100,000 letters on this subject representing all sides of the issue.

Secretary Card told MacGregor in private on September 23 that he did not see how he could justify approval of the BA deal unless there were a true liberalization of our aviation bilateral.



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3J

My ref:

Your ref:

Andrew H Card Jr.
Secretary of Transportation
400 Seventh Street, SW
Washington, DC 20590

- Know remain cool
- Letter signals ~~something~~ diff tone
- But NOT skeptical
- Invited to come for 14th ^{start}
- Feel staying
- Signal
- Set up for Mini -- seems

Dear Secretary Card,

I am very much looking forward to meeting you during my visit to Washington on 22 and 23 September, when I am scheduled to address the British-American Business Association and International Aviation Club on aviation issues.

I felt you might like to know in advance something about what I am currently intending to say in that speech, especially given the possibility of developments on the USAir/BA deal before then.

I shall be setting the scene by describing the efforts we have been making to liberalise arrangements both in Europe and elsewhere and our satisfaction with the results. I shall be laying particular emphasis on our belief in a highly competitive multi-airline industry and the benefits we have seen from the privatisation of BA. I shall also mention the battle we are continuing to fight in Europe against state subsidy in the airline industry, a battle which I am pleased to say has already been won so far as the UK/US market is concerned.

However, I am planning that one of the key points of my speech should be on my commitment to pursue efforts to move away from the current arcane air services agreement and replace it with a modern, more liberal agreement designed to foster the same type of vigorous, competitive market we have been trying to encourage in the UK.

I know that some people in the US have been arguing that if the proposed BA/USAir deal were to go through we would lose interest in liberalisation. This is wrong. We want to press ahead with liberalisation because we believe that, provided we get it right, it should benefit both the consumer and the industry. Nothing in the proposed deal changes that. The UK airlines have been understandably cautious about abandoning the safeguards the existing agreement offers largely because of the greater power and greater access to the US domestic market enjoyed by the US majors. To the extent that the proposed deal improves BA's access to the US market,

~~Resisting~~ *change* ~~and~~ *change* ~~and~~ it is likely to reduce their grounds for ~~resisting~~ *change* and increase their appetite for new opportunities not available under the existing agreement.

There will also be an immediate spin off in terms of extra services. Because BA will be taking on USAir's existing routes to the UK, traffic rights on three routes will be freed for distribution among the other US carriers. Two of those could be to cities with no service at all at present.

I know that there have also been suggestions that I might take a more restrictive attitude to a proposal by a US carrier wishing to make a comparable investment in a UK carrier. This is not borne out by precedent: the UK has in the past welcomed foreign investment. There are substantial foreign shareholdings in several UK carriers and of course BA itself is 25% owned by Americans. My people have already been in touch with yours about the assurances we might give both in terms of UK and EC rules on this point and, if it would help remove obstacles in the way of the USAir proposal I would be happy to say in my speech that I would be disposed to approve a minority American investment in a UK airline in comparable circumstances.

The proposed deal represents a substantial capital injection freely negotiated between two independent private sector entities which should improve the viability of USAir and so enhance competition and service to the consumer. It would bring immediate benefits in terms of opening up new routes and give new impetus to our efforts to promote liberalisation.

If, on the other hand, the proposal were to be blocked, there would be understandable feeling that the US was interested in new opportunities and extra competition only where this would reinforce the supremacy of the largest US carriers. In those circumstances it would be far more difficult for me to press ahead towards the liberalisation both of us would like to see.

I am asking the Embassy to pass this message on to acting Secretary Eagleburger and to Secretary Brady.

Yours sincerely,

John Macgregor

JOHN MACGREGOR
(Approved by the Secretary of State
and signed in his absence)



British Embassy
Washington

3100 Massachusetts Ave N.W.
Washington D.C. 20008-3600

Telephone: (202) 898 4250
Telex: RCA 211427 or 216760-WUI 64224
Facsimile: (202) 898-4255

2 September 1992

Mr Robert B Zoellick
Deputy Chief of Staff
White House
Washington DC 20500

Dear Bob,

At the meeting with Mrs Hogg on 27 August we spoke about the proposed USAir/British Airways deal, and you and I have since spoken further about this on the telephone. I now enclose a copy of a letter which the Secretary of State for Transport, John MacGregor, has today sent to Secretary of Transportation, Andrew Card on this subject. This, of course, follows the discussion which Larry Eagleburger had with Douglas Hurd in London on 26 August.

Sincerely,

Christopher

C J R Meyer
Chargé d'Affaires



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

My ref:

Your ref:

Andrew H Card Jr
Secretary of Transportation
400 Seventh Street, SW
Washington, DC 20590

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I am asking the Embassy to pass this message on to acting Secretary Eagleburger and to Secretary Brady.

Yours sincerely,

John Macgregor

PP JOHN MACGREGOR
(Approved by the Secretary of State
and signed in his absence)

RBZ -

8/20

ON THE BRIEFING MEMO FOR LSE FOR
DELTA (TODAY), WE URGED LSE TO PROBE
DELTA ON WHAT RECIPROCAL MARKET
OPENINGS THEY WOULD HAVE US SEEK IN
THE UK. ALLEN'S RESPONSES (pg 2) ARE
INSTRUCTIVE -

WE STILL MUST TRY TO GET A GOOD
DEPT, FOR COVER W/ CONGRESS. BUT IT
CONFIRMS OUR SUSPICIONS ON TRUE MOTIVES.
MBB.

PS - I ASKED FOR THIS MEMO BECAUSE I
THOUGHT YOU'D BE INTERESTED. I DID NOT
SAY YOU'D ASKED.

Document Originally
Attached to
Following Page



United States Department of State

Washington, D.C. 20520

August 20, 1992

NOTE TO BOB ZOELLICK

FROM: DICK HECKLINGER *DH*

You asked for a summary of the key points from the Acting Secretary's meetings with the Chairmen of the four U.S. airlines primarily concerned with the BA/USAir deal. All were fairly brief meetings, over the course of the last two weeks.

United (Aug. 6)

- Wolf:
- o This is a very significant, watershed event; not just a regulatory issue for DOT; has broader implications; needs cabinet-level attention; other foreigners will follow quickly.
 - o Not saying don't approve, but get the appropriate price in return; if it does get approval -- in modified form -- we must get the EC market; tell BA to work on EC politically to get access to US, and then we do phased deal where each side gets equal benefits at each step; can't settle for anything less than EC.
 - o US aviation industry is a great success story for this country and we don't get credit.
- LSE:
- o understand your position, although your industry makes it hard on me by never agreeing among yourselves.
 - o agree aviation is a success story; I should do a speech.
 - o plan to call Card and tell him State has views; the regulatory issues are his to decide, however.
 - o This issue has foreign policy implication; if it is not on Scowcroft's agenda, it should be.

American (JULY 29)

Crandall made essentially the same points as Wolf, including:

- o not necessarily opposed, but US must get significant access in return.
- o UK is not enough; must get EC access as well; understand UK may not be able to deliver.
- o USAir is not in the extreme financial difficulties it claims.

LSE questioned and commented along the line of the Wolf meeting.

Delta (Aug. 20)

LSE posed several general questions that led to the following Delta views:

- Allen:
- o we are opposed to this deal; it's not a matter of what concessions we get.
 - o deal is an illegal takeover of the control of a major US carrier by a foreign interest -- in direct violation of US law.
 - o BA would get access to entire US market while UK denies us equivalent access.
 - o if deal goes ahead, no incentive for UK to liberalize.
 - o USG approval would make it impossible for US carriers to compete on an equal basis on the North Atlantic.
 - o this is a significant policy question; should not be decided on a case-by-case basis; requires a new, coherent US aviation policy that provides equal competitive opportunities.
- LSE:
- o We don't have the answers yet; understand the importance of the issue to you and the industry.

NOTE: SCOWCROFT MTC, WAS AUG. 13.
mgb.

USAir (Aug 19)

Schofield: o USAir is in trouble; its survival is unclear; financial problems become severe in the early part of next year -- have to have this capital infusion.

- o The deal is not control in the sense BA would run the day-to-day operations; BA can veto major decisions to protect its \$750 million investment from being misused.
- o There is a question of international competition that's not getting much attention; Big Three will survive under any scenario; if USAir (and Northwest) fail internationally, there will be only three carriers, an oligopoly with its disadvantages.

- LSE: o understand the high stake this represents for USAir.
- o our concerns are international competition and foreign policy consideration.
 - o matter of "control" is Card's issue.
 - o We don't have answers at this point.



U.S. Department of
Transportation

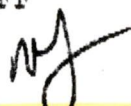
Office of the Secretary
of Transportation

Chief of Staff

400 Seventh St., S.W.
Washington, D.C. 20590

September 21, 1992

MEMORANDUM FOR ROBERT ZOELICK
ASSISTANT TO THE PRESIDENT AND
DEPUTY CHIEF OF STAFF

FROM: MICHAEL P. JACKSON 

SUBJECT: **British Airways-USAir Talking Points**

For 9/21 Mon 4 PM mtg w/British Amb Renwick

As discussed last week, attached are a few talking points for your meeting with the British Ambassador today.

The last talking point is an approach that would not insist on delivery of an open skies agreement in one stroke, but seeks a commitment by the British to achieving open skies on a fixed schedule. Andy will privately raise this approach with his counterpart Wednesday. It is your call as to whether you mention this approach.

We would recommend against your suggesting the particulars of what might constitute an initial package of liberalization, such as specific new flights that might be allowed.

Also attached is an excellent editorial, which I suspect you saw in today's Wall Street Journal.

Attachments

TALKING POINTS
British Airways-USAir

- o Bermuda 2 may be the most restrictive bilateral aviation agreement that we have with any of our major partners.
- o MacGreggor is said to be coming to Washington with the offer of some small concessions to the U.S. as an expression of U.K. seriousness about the liberalization process (e.g., new routes to Manchester, Birmingham, etc.).
- o It is essential, however, that the Card-MacGreggor meeting create greater visible momentum for liberalization -- real progress not just prospects. Our hope is to be able to sit down with a U.K. delegation authorized to negotiate meaningful reforms quickly -- by early October.
- o In short, what the U.S. is seeking is an "open skies" agreement such as that recently signed with the Dutch. (Note: that agreement took only three days to negotiate.)
- o Our proposal for liberalization has been laid on the table by U.S. negotiators since early this summer. The terms of an open skies agreement would include changes such as:
 - an end to limits on gateway cities that may be served in each country;
 - an end to restrictions on entry;
 - an end to price and capacity regulations;
 - elimination of restrictions on charter operations;
 - enhanced U.S. airline opportunities to carry locally boarded traffic beyond the United Kingdom (fifth freedom rights).
- o We recognize that implementation of a liberalized regime may not be possible in one stroke. What we seek is a signed agreement that sets forth a mutual vision of open skies and a fixed, accelerated timetable for achieving it.

- Progress, not big bang
- BA not bluffing (If gets much beyond Nov 3, they might disengage)
- Virtuous Circle or not: ~~Good~~ Hard to liberalize if no deal
- Any progress won't satisfy other US airlines
- Don't want to be awkward

THE WALL STREET JOURNAL MONDAY, SEPTEMBER 21, 1992

REVIEW & OUTLOOK

Her Majesty's Sky

We hope John Major's phone will ring one day soon. And that George Bush is on the other end, inviting the British prime minister to join him in giving the global village a quantum boost. The President will ask Mr. Major if he wants to join in opening the world's air routes to free and productive use, or whether he wants to continue to preside over one of the world's most insular and protectionist airline regimes.

Getting down to details, Mr. Bush will order his Transportation Secretary to let British Airways take effective control of USAir, as it now wants to do, if Mr. Major will open Britain's skies and airports to all U.S. carriers. The dawn of free air trade will then begin.

The British carrier's proposal to invest \$750 million in USAir has been hanging fire since midsummer, while Washington tries to figure out what to do. Fifty percent of the world's passenger boardings take place here. By plugging USAir's domestic system into its international routes, BA creates a global network that — as the world is now set up — no U.S. competitor could hope to match.

That's because landing rights in the global economy are ruled by a suffocating blanket of treaties, the main purpose of which is to nix competition and keep a lot of superfluous national airlines flying around (the Thatcher government privatized British Airways). The Department of Transportation's Jeff Shane says most of these people "know they can't compete with the guys coming out of the jungle of the deregulated U.S. market."

In aviation, the British are as cold-bloodedly mercantilistic as they come. They shot down FDR's plan for universal open skies in 1944, and together we've set the tone for the world ever since. (The U.S. stiff-armed a Canadian request for open skies at the outset of negotiating the recent Free Trade Agreement.) With Britain open, much of the world would follow.

Given what's going on in the free market of acquisitions, open skies can't come too soon. Lufthansa has been pow-wowing with Marvin Davis about buying bankrupt Continental Airlines. As with the BA-USAir deal, Lufthansa smells a way into the U.S. domestic market without having to open up at home. Once inside the world's richest market, they lose all incentive to negotiate for open skies.

That's why Dan Kasper, an avia-

true watershed. He's right. The burden here is on John Major's government either to pitch aviation toward truly destructive protectionism, or open up to the real world.

We're glad that Transportation Secretary Andrew Card is finally taking notice of the opportunity that comes his way. Britain's Secretary of State for Transportation John MacGregor will stop by this week to pitch support for the BA takeover. Washington should show some backbone, because it has shown that it has the right strategy. KLM Royal Dutch Airlines applied recently to mesh its schedules and marketing with those of Northwest Airlines (KLM owns 20% of Northwest), and the White House beamed approvingly — but only because The Hague had just inked an open-skies pact with the U.S. What's good enough for the Dutch is good enough for the British.

With a little push from Uncle Sam, the edifice of aviation protectionism might well disappear — poof — as quickly as the Warsaw Pact did. Tellingly, the Dutch open-skies agreement seems to have lit a match under the European Community, which now contemplates trading airline access with the U.S. as a bloc.

Under the lash of deregulation, the U.S. megacarriers have come up with clever new ways to run their businesses and deserve a chance to test their mettle abroad. American Airlines, United and Delta have trimmed their costs to about 9.5 cents per passenger per mile. By European standards, British Airways does well at 14.5 cents. Lufthansa and Air France bleed at 20 cents.

Europe's white elephants with wings tremble at the prospect of American intruders. But overpriced, inconvenient air service keeps a flood of tourists and investors at home. When Toyota or IBM is looking for somewhere to stick factories and labs, it prefers a place with top-notch access to the airline grid.

About now George Bush's finger should be getting itchy. Heaven knows, the British aren't shy about dialing for aviation favors. Mrs. Thatcher didn't hesitate to ask Ronald Reagan to kill the antitrust investigation into the demise of Laker Airways, smoothing the way for British Airways' privatization.

Last week in Detroit, President Bush promised to "seize every oppor-

8/25

A. Card

- Sept 24 : US Air Labor K. Costly OFF Period expen.
- Finan Situation not great, but ~~the~~ not terrible
- Don't think US Air can afford impression ~~staying~~ of slippage: hunt stock value
- Don't expect layoffs/warnings of
US AIR
- Workforce favors the deal; ALPA doesn't favor
- ~~Don't~~ AC wants to turn down, say no on Mon, b/c not pressure
- Can survive for at least a yr; might be able to restore. Do need K.
- Are important for US competition; but Wall Street sees too much capacity

- Also have problem of access to UK air system.

Other U.S. airlines concerned

- Will have to allow all others in; UK Air agreement is the most restrictive
- Jeff Shane went to London; rained; shifted
- Fears of delay, have to say yes
- Airlines against; ~~Birmingham~~ ALPA → Delta.
- ~~Can't~~ Further party can take walk by Sept 19; Dec 24 - ~~the~~ on
- US Air Hubs: NC, Mo, Penn

If turn down, do soon:

1. US Air get altun
2. BA may offer a better deal (100% slightly on control; 30% face saved on access)
3. Lessen not pressure to approve
4. May have alternative (KLM)

If say yes, will never get EC access

22,000 Ecs

An Issue of National Policy, Competition and Fairness

The Case Against the British Airways Takeover of USAir

August 20, 1992

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OVERVIEW

The move by British Airways to acquire control of USAir represents a most serious threat to the entire U.S. airline industry for the following reasons:

- ▶ It is an illegal takeover of control of a major U.S. carrier by a foreign interest, in direct violation of U.S. law.
- ▶ It would give British Airways access to the entire U.S. air transportation market while the British government denies U.S. airlines equivalent access to the British market.
- ▶ If the U.S. government allows the transaction to go forward in the face of the steadfast refusal by the British government to open the British market, the British will not have any incentive to open their market to U.S. carriers.
- ▶ If other governments see that they can achieve access to the U.S. market by purchasing control of a U.S. carrier, they will no longer have any incentive to enter into agreements with the U.S. government to open their markets to U.S. carriers.
- ▶ Thus, approval of the British Airways takeover of USAir would make it impossible for U.S. airlines to compete on an equal basis in the transatlantic market and undermine the ability of the United States to negotiate free aviation markets around the world.
- ▶ If this is allowed to occur, the U.S. airline industry will either be sold off to foreign interests, lose its ability to compete effectively in international markets, or both. Jobs in the already threatened U.S. airline industry will be seriously jeopardized.

For the above reasons, the U.S. government must not approve this transaction. Any such transaction would require major changes in U.S. law and policy. Such significant policy questions should not be decided on a case-by-case basis, but through the development of a comprehensive, coherent international aviation policy that fosters new competitive opportunities for all airlines and does not sell out U.S. interests.

STATEMENT OF POSITION

The British Airways/USAir transaction is nothing less than the takeover by a foreign competitor -- British Airways -- of a major U.S. airline in direct violation of U.S. law. It is plainly illegal and must not be allowed to go forward. Moreover, British Airways seeks to obtain a U.S. and global franchise while remaining protected from competition in its own markets. Such a result would substantially impair U.S. airlines' ability to compete in the global marketplace and would threaten U.S. jobs.

For more than 50 years, U.S. law and precedent have prohibited foreign interests from owning or controlling U.S. airlines. This illegal acquisition would give British Airways direct control of USAir, making USAir, in effect, the U.S. division of British Airways. Apart from being a U.S. carrier's largest single equity holder, British Airways would have the right to dictate every important aspect of USAir's business including, for example, who it can hire to run the company, what markets it can serve, what airplanes it may acquire, and what prices it should charge.

A transaction of this type and magnitude would require a fundamental change in law and U.S. trade policy and any such change should not and cannot be made on a piecemeal basis, in the context of a single transaction, especially in circumstances where there are no reciprocal opportunities. The Legislative and Executive branches must jointly develop any such major change in U.S. aviation law and policy, governing all future transactions involving U.S. air carrier ownership, control and international competitive posture, on a fair and uniform basis. Until that change in law and policy is accomplished, this transaction cannot be allowed.

Moreover, even if the illegal control aspects of the transaction were to be addressed, no transaction between British Airways and a U.S. carrier should be allowed unless U.S. airlines can enjoy reciprocal access to U.S.-U.K. and U.S.-European markets. The current highly restrictive U.S.-U.K. bilateral agreement bars U.S. carriers from such access. It would be a monumental mistake for the U.S. government to allow a foreign carrier to gain unprecedented access to U.S. air transport markets, when U.S. airlines are foreclosed from comparable access to foreign markets. A policy of unilateral economic disarmament would cripple the U.S. government's ability to liberalize aviation markets not only with the U.K., but throughout Europe and the rest of the world.

Allowing the proposed British Airways takeover to proceed would have far reaching adverse impacts on U.S. trade policy, competition and jobs. This is not simply an issue of foreign investment, but of foreign control of the U.S. airline industry. Hundreds of thousands of U.S. jobs and U.S. competition in international markets would be placed in substantial jeopardy, unless U.S. airlines can compete in all the markets to which British Airways would gain access from the transaction.

THE ISSUES

I. AS A MATTER OF LAW, THE DEAL MUST BE DISAPPROVED.

- ▶ This is not a mere "alliance," but *an illegal takeover* of a U.S. carrier by foreign interests, in clear violation of U.S. law.
- ▶ The law is clear: U.S. carriers must be under the control of American citizens. The terms of the investment agreement would give British Airways substantial and effective control over virtually all business aspects of USAir.
 - ▶ British Airways would become the largest shareholder. At \$750 million, this is no passive investment, but one that would give British Airways a major and undeniable source of influence and leverage over the business affairs of USAir.
 - ▶ Under terms of the British Airways/USAir agreement, all critical business decisions affecting the business affairs of USAir would require agreement of at least 80 percent of its Board of Directors. However, British Airways would control 25 percent of that Board, giving it veto power over matters ranging from the composition and compensation of USAir senior management to the acquisition of routes, the purchase of equipment, operating budgets, commercial or marketing agreements and any merger or consolidation.
- ▶ The Department of Transportation (DOT) and Civil Aeronautics Board (CAB) have consistently held that the exercise of veto power over corporate decisions constitutes control. That is exactly what British Airways would wield over all critical business decisions and operations of USAir, in clear violation of the Federal Aviation Act, which requires that a U.S. carrier not only be majority owned by U.S. citizens, but "in fact, must be controlled by U.S. citizens."
- ▶ In their investment agreement, British Airways and USAir list as a "central purpose" of the transaction their intent to create "a unified airline system." USAir goes from being an internationally competitive U.S. carrier to being the North American division of British Airways, with every significant aspect of its operation controlled by British Airways. That is clearly a transfer of control to a non-U.S. citizen, in violation of U.S. law.
- ▶ Additionally, the planned integration of marketing and operational functions would produce a single "airline system" controlled by British Airways and operating under one "management structure." The British Airways system would thereby extend into and throughout the United States, in clear violation of the specific prohibition of U.S. law against cabotage -- foreign carriers operating within the United States.

II. AS A MATTER OF POLICY, THE DEAL MUST BE DISAPPROVED.

- ▶ This is nothing more than a backdoor attempt by British Airways to achieve what it could not get on a bilateral, reciprocal basis: broad operating rights within the United States unlike any rights U.S. carriers enjoy in Britain or any other country.
- ▶ The well-established policy of the U.S. government is to permit *limited* ownership flexibility only in cases where the United States has a liberalized aviation relationship with the country of the foreign investor.
- ▶ Britain has consistently denied wider market access in Britain to U.S. carriers.
- ▶ The closed British aviation system, one of the most restrictive in the world, precludes the U.S. government from granting British Airways such a large stake in USAir.
- ▶ Thus, even if the issue of illegal control was mitigated by changes in the deal, the absence of an open aviation relationship between the United States and Britain compels the U.S. government to disapprove the transaction.
- ▶ If the U.S. government approves this transaction without first achieving truly open access to the British market for U.S. carriers, Britain will have no incentive to open its market.
- ▶ It would be unilateral economic disarmament to grant such unfettered access to a foreign carrier without complete liberalization of the U.S.-U.K. aviation accord.
- ▶ A giveaway such as this would cripple the ability of the United States to negotiate liberalized aviation relationships with other major trading partners. Other countries would conclude that they could refuse to bargain with the United States, thus protecting their own carriers from competition, while gaining access to the U.S. markets by purchasing control of U.S. carriers.
- ▶ Foreign carriers must not be awarded freedoms that U.S. carriers are denied. The United States must not permit them to violate U.S. law or buy access into the world's largest market without obtaining reciprocal and comparable rights for all U.S. carriers.
- ▶ This is not analogous to the KLM/Northwest case. KLM was not given the opportunity to exercise control over Northwest. Moreover, the United States has a liberal aviation relationship with the Netherlands, which was the basis for approving that transaction. It has no such agreement with Britain.

III. AS A THREAT TO COMPETITION, THE DEAL MUST BE DISAPPROVED.

- ▶ If British Airways is granted virtually unlimited access to the world's largest single market while remaining protected by the British government from U.S. competition in the British market, the ability of U.S. carriers to compete on a global basis will be undermined. Neither the British government *nor any other government* will have any incentive to negotiate agreements enabling U.S. carriers to compete openly in their markets.
- ▶ British Airways would acquire a base of operations in the United States unlike any U.S. carriers could ever expect to achieve abroad. Its ability to gather traffic in the vast U.S. market and funnel it to Britain and beyond might never be matched by any U.S. carrier because of restrictions imposed by Britain and other governments.

IV. THIS IS A DIRECT ASSAULT ON THE U.S. AIRLINE INDUSTRY.

- ▶ This is not a question of British Airways acquiring a "toehold" in the lucrative U.S. market, but a potential "stranglehold" over access to 55 million USAir passengers and 200 million FTKs of air cargo a year.
- ▶ British Airways is seeking a U.S. and global franchise while remaining protected from competition in its own home market.
- ▶ If this transaction is allowed, it is clear that other foreign carriers would pursue similar deals. Thus, this transaction would set a dangerous precedent. With this kind of penetration of the U.S. market — something U.S. carriers are denied abroad — the ability of U.S. carriers to compete and survive would be threatened.
- ▶ Taken over by British Airways, USAir would cease to exist as an international carrier. "Passengers won't know if their pilot is British or American," British Airways director of Corporate Strategy Roger Maynard told *Business Week*.
- ▶ In the integration of British Airways and USAir operations, American jobs would be threatened. The health of the U.S. airline industry would be placed at risk.
- ▶ Unfair competition could send the U.S. airline industry the way of the U.S. steel and auto industries. Jobs and dollars could well go overseas.

V. AMERICAN CARRIERS ARE NOT AFRAID OF COMPETITION.

- ▶ The fare wars of recent months provide ample evidence that U.S. carriers are intensely competitive.
- ▶ U.S. carriers are not attempting to avoid competition, but to preserve their ability to compete on a level playing field in a global market that is anything but free.

VI. THIS IS A WATERSHED FOR U.S. AVIATION POLICY.

- ▶ This is the most monumental policy decision since domestic deregulation.
- ▶ Because of the effect on other countries, the outcome of this transaction will determine the future ability of the U.S. airline industry to compete on an equal footing in all global markets.
- ▶ This is not a fight between British Airways and its U.S. competitors, but a pivotal test of the principles that will govern the relationship between the United States and its major trading partners in the area of commercial air transportation.
- ▶ Never before has the U.S. government been presented with a situation that would surrender so many rights to a foreign carrier.
- ▶ If the policy of the last 50 years is to be changed, it should be done through careful consideration of the issues and as part of a global liberalization of the industry that proves fair to all carriers. It must not be made piecemeal or on the basis of a single transaction.
- ▶ The Department of Transportation should not and must not make such a radical departure from longstanding policy without careful consultation with Congress. Any revisions of current law must provide for a sound and fair international foundation that ensures that foreign investments in U.S. carriers do not result in the unfair treatment of U.S. carriers in world aviation markets.

MYTH VS. REALITY

MYTH: This is an investment within the limits of the law.

REALITY: It is an illegal takeover -- in clear violation of U.S. law.

The issue is not ownership, but control. The percentages of equity and voting stock may be within the numerical limits on foreign investment in U.S. carriers, but the size of the investment -- \$750 million -- and terms of the agreement would grant British Airways control over every significant aspect of USAir's business.

The Federal Aviation Act dictates that U.S. airlines remain not only under the majority *ownership* of U.S. citizens, but also under the effective *control* of U.S. citizens. This proposed takeover fails that crucial legal test.

British Airways would have at least 25 percent of the 16 seats on the USAir Board of Directors, giving it veto power over decisions requiring an 80 percent "super-majority" of the Board. That would include all decisions on:

- ▶ Annual capital and operating budgets
- ▶ Capital expenditures and investments in excess of \$10 million a year, which would include all aircraft purchases
- ▶ The incurrence of debt or certain other liabilities, including leases, in excess of \$25 million a year
- ▶ The acquisition, sale, transfer or relinquishment of any route authorities or operating rights
- ▶ The appointment, compensation and dismissal of senior executives
- ▶ Commercial, marketing or joint venture agreements
- ▶ Mergers or consolidations involving the sale of \$25 million or more in assets

The Department of Transportation has said that its standard for measuring control is whether the foreign investor "will have a substantial ability to influence the [U.S.] carrier's activities." That standard is clearly met in this case. As such, the transaction must be blocked.

MYTH: There is precedent for foreign investment of this kind.
REALITY: Fifty years of DOT and CAB precedent clearly prohibit this transaction.

There is no precedent for approval of a foreign investment of this size and scope.

The law is clear. A takeover of this kind is illegal. The influence British Airways would be able to wield under terms of its agreement with USAir violates the absolute prohibition against foreign control of a U.S. carrier.

As a matter of policy, DOT has allowed limited ownership flexibility only in cases where the United States has a liberalized aviation relationship with the country of the foreign investor. The British market, in contrast, remains one of the most restrictive in the world for U.S. carriers.

MYTH: This is no different from KLM obtaining a sizable stake in Northwest.
REALITY: In the KLM/Northwest case, "effective control" was not an issue.

Under the pressure of DOT concerns about its potential control over Northwest, KLM was forced to scale back its investment in order to win approval.

The KLM/Northwest agreement was subjected to formal, public scrutiny to ensure that control of Northwest would remain in American hands. Even a cursory review of the British Airways/USAir deal makes clear that USAir would cease to be a U.S. citizen, contrary to U.S. law and consistent interpretations by DOT. To quote Salomon Brothers analyst Julius Maldutis: "It is clear that British Airways is demanding effective control of a U.S. company."

As British Airways Chief Executive Sir Colin Marshall told *Newsweek*: "For \$750 million I think you would expect to have some influence!"

MYTH: Investment in USAir by British Airways will strengthen competition.
REALITY: This takeover will lessen competition in the transatlantic marketplace.

A failure by the U.S. government to require reciprocal market opportunities in the U.K. and elsewhere will eliminate any prospect for replacing the restrictive U.S.-U.K. aviation agreement with an "open skies" arrangement.

By admission, British Airways seeks to create "a unified airline system." USAir would become the North American division of British Airways, giving British Airways access to the U.S. market that far outweighs any benefit U.S. carriers might expect from a more open British market.

U.S. carriers have consistently been denied wider market access in Britain. This proposed takeover is nothing more than a backdoor attempt by British Airways to achieve what it could not otherwise achieve on a bilateral, reciprocal basis.

MYTH: American carriers are opposing this out of fear of competition.

REALITY: This deal must be stopped to keep competition alive.

No one can question the highly competitive nature of the U.S. airline industry. However, by allowing British Airways virtually unlimited access to the world's largest aviation market while it is protected from free and open competition from U.S. carriers in the U.S.-U.K. and U.S.-European markets, this transaction imperils the base from which U.S. airlines attempt to compete in a global market. If approved, there would be no incentive for Britain or other trading partners to negotiate "open skies" agreements. Their carriers would remain shielded from competition from U.S. airlines.

MYTH: U.S. carriers see this only as a bargaining chip for a better aviation pact with Britain.

REALITY: U.S. carriers are opposing this as a matter of law, principle and policy.

Let there be no mistake: this is a deal that violates the law, runs counter to established national policy and threatens the future livelihood of U.S. airlines in a highly competitive, highly regulated global market.

The issue here is not fear of British Airways, but legitimate concern that a change of this magnitude in U.S. aviation policy take place only in a truly liberalized international environment. The goal of a global "open skies" environment of fair competition and free markets is endangered by this proposed takeover.

The United States needs a consistent, coherent aviation policy that not only sets acceptable levels for foreign investments, but creates the conditions for free, fair competition. U.S. carriers are not seeking to keep British Airways out of the U.S. market, but to ensure that a monumental change in U.S. policy -- with a marked impact on the future of the U.S. airline industry -- does not rest on a single administrative decision by DOT.

Concessions by the British could not begin to adequately compensate U.S. carriers for what British Airways stands to gain from its deal with USAir: virtually unlimited entry to the world's largest aviation market and unprecedented access to the 40 percent of all foreign-bound U.S. travelers who begin their trips in cities other than regular gateways.

There is no comparison between the U.S. and British markets. If it takes over USAir, British Airways has instant access to a market of 400 million boardings a year. Even full access to the British market would offer U.S. carriers a potential of only 11 million boardings a year.

MYTH: Without this investment, USAir will not survive.
REALITY: USAir is poised for long-term survival on its own.

At the time of the announcement, USAir Chairman Seth Schofield denied this was a rescue of USAir. Even without the British Airways investment, he said, "We still had strong liquidity and we would have been a survivor."

USAir remains a viable carrier on its own. Its balance sheet reflects some of the pressures other U.S. carriers have experienced, but its survival is not in question.

With cash and marketable securities of \$320 million, a reasonable debt-to-equity ratio and an available \$875 million cushion against future losses, USAir has the financial wherewithal to ride out any short-term adverse market conditions and has the ingredients for long-term survival.

With a restructured route system and concessions from its unions, USAir is poised for a turnaround. If it had been in serious financial difficulty, it would not have spent \$1.78 billion on equipment, routes and slots in two years.

If there are jobs at risk, as has been suggested, they are not so much USAir jobs, but the jobs now held at other U.S. carriers and U.S. airline vendors. These jobs could disappear or be transferred abroad in the event foreign carriers are allowed to violate U.S. law, buy their way into the U.S. market and place U.S. international carriers at a serious competitive disadvantage.

If USAir jobs are at risk, they are more at risk from a takeover by British Airways. Economic logic dictates that an integration of operations with larger British Airways will lead to consolidations resulting in a loss of USAir jobs.

MYTH: This is a mere "business arrangement and not a political matter."
REALITY: The health and composition of the airline industry have long been matters of national concern -- to the United States and to other governments.

This transaction is inexorably linked to U.S.-British aviation relations and to the complex web of agreements governing international competition in the airline industry.

It is no simple business arrangement, but an unprecedented transaction with profound policy implications. It would give British Airways a degree of market access that Britain and other European governments have long denied to U.S. carriers.

In 1989, British Airways Chairman Lord King demanded cabotage -- the right to fly domestic routes -- and the right of unlimited investment in the United States. The U.S. government scoffed. Now, British Airways wants to buy from USAir a right that has been at the heart of government-to-government negotiations.

MYTH: This is a logical step in the global integration of the airline industry.

REALITY: This is a direct assault on the U.S. airline industry.

Make no mistake: where British Airways seeks to tread, other foreign carriers are waiting to follow. This would open the door not only to foreign investment, but a sell-off of the U.S. market to foreign carriers.

This transaction would set a dangerous precedent. With this kind of unprecedented access to the U.S. market -- unlike anything U.S. carriers enjoy abroad -- the ability of U.S. airlines to compete and even survive is threatened.

This is the most monumental decision to be made about U.S. aviation policy since deregulation. The outcome will determine whether U.S. carriers have the opportunity to compete on an equal basis with other carriers in global markets.

Never before has the U.S. government been presented with a situation that would surrender so many rights to a foreign carrier. And if the policy of the last 50 years is to be changed, it should be done through careful consideration of the issues and as part of a global liberalization of the industry. It must not be made piecemeal or on the basis of a single transaction.

To allow this takeover would cripple the ability of the United States to negotiate liberalized aviation relationships with other countries. A vital source of leverage would be lost. The United States should not place the "for sale" sign on the U.S. airline industry. Globally, this is still a tightly regulated industry, not a free market.

The Department of Transportation should not embark on so risky a course without first giving Congress and the domestic airline industry a chance to consider revisions in the law and ensuring that a sound and fair international foundation for such changes has been established.



U.S. Department of
Transportation
Office of the Secretary
of Transportation

Memorandum

Close Hold

Subject: **INFORMATION:** USAir's Financial Condition
as of June 30, 1992, and its Projected
Capital Requirements through June 1993

Date: **AUG 21 1992**

From: Jeffrey N. Shane *JS*
Assistant Secretary for Policy and
International Aviation

Reply to: Regis P. Milan
Attn. of: Timothy Carmody
P-55, X62348

To: The Secretary
Thru: The Deputy Secretary

My staff has prepared a comprehensive financial analysis of USAir as it exists today, along with a 12-month forecast of the carrier's capital requirements. A copy the report is attached.

USAir has told the Department informally that it (a) is not now in serious financial distress, (b) will not file Chapter 11 bankruptcy, and (3) will not furlough employees or otherwise change the fundamental character of the airline should the Department disallow the investment agreement with British Airways.

The staff analysis confirms USAir's representations that in the short term the carrier is not in financial extremis and will remain a strong, viable competitor. USAir, however, could have a potential cash flow problem in the future if the economy does not improve.

The fundamental financial question is whether USAir can survive in the long term without a major capital infusion. On the one hand, if the general economy, air traffic, and carrier yields improve, USAir could continue to be a strong competitor on the east coast. On the other hand, if the economy, traffic, and yields do not improve, at least moderately, over the next 12 months, USAir and several other airlines could be financially strained. Some airlines could be forced out altogether, and USAir could be forced to further curtail its operations. However, should this pessimistic scenario prevail, causing some carriers to fail, the remaining carriers would benefit. We note that USAir has a very dominant position in the northeast, which puts it in a better position than perhaps any other carrier to successfully "shrink" to a relatively solid core system, should that be necessitated by a continuing sluggish economy. When the economy does recover and traffic growth resumes, USAir's position in the northeast should allow it to return to profitability, albeit as a smaller airline.

Attachments

FOR OFFICIAL USE ONLY

USAIR'S FINANCIAL CONDITION AS OF JUNE 30, 1992
AND
ITS PROJECTED CAPITAL REQUIREMENTS THROUGH JUNE 1993
PREPARED BY THE
PUBLIC PROCEEDINGS DIVISION
OFFICE OF AVIATION ANALYSIS

SUMMARY

This report is an analysis of USAir's current financial position and a forecast of its capital needs for the 12 months ending June 1993. Our analysis focuses on the USAir's projected financial condition through June 30, 1993, under two scenarios, a most-likely scenario estimate and a pessimistic estimate.

First, our most-likely estimate is that given a basically status quo situation in which there is modest economic recovery (2 to 3 percent growth rate in Gross Domestic Product), some traffic growth, a slight increase in fares, and inflation-related cost increases -- USAir could develop adequate cash flows to permit it to continue operations, in a weakened state, without the infusion of additional investment capital at the level proposed by British Airways. Under this scenario, USAir would incur net losses in three quarters, averaging \$105 million per quarter, followed by a profitable second quarter of 1993.¹

In our pessimistic scenario there would be (a) no traffic growth (with changes in traffic reflecting normal seasonal patterns only), (b) no increase in fares and yields, and (c) costs moving at the inflation rate, USAir would incur four quarters of net losses averaging \$116.5 million. Under this scenario, the airline by June 1993 would have substantially depleted its cash reserves and consequently would have a critical cash flow problem. The airline could not continue to sustain unprofitable operations, beyond several months, without significant additional funding. However, under this grim scenario the three major carriers now in bankruptcy (America West, Continental, and TWA) probably would cease operations and the "Big Three" carriers would also be in serious financial distress.

INVESTMENT AGREEMENT

On Tuesday July 21, 1992, British Airways PLC (BA) and USAir Group, Inc. announced an investment agreement whereby BA would acquire 21 percent of the voting stock and a 44 percent equity in USAir Group Inc., the parent of USAir, Inc., for \$750 million. Under the proposal, BA would pay USAir \$520 million for 7 percent Series C Cumulative Preferred Stock, and \$230 million for newly issued 7 percent Series E Cumulative

¹We did not do a "most optimistic" estimate under which USAir would, of course, be more viable.

Preferred Stock that will be convertible to common voting stock. BA will be able to convert either stock series at a price of \$20.50 a share. None of the stock is convertible for four years following final approval of the pact. The airlines have pledged to complete the agreement by December 24, 1992, subject to the Department's approval.

USAir's management has said informally that if the sale is approved, it would use the proceeds of the sale to retire debt and might use the remaining proceeds to acquire the assets of another carrier, most likely TWA. Furthermore, USAir wants to gain "mass" through an international strategic alliance. BA wants to penetrate the U.S. domestic market and gain feed to its international flights from the U.S. and become a global airline.

The Department must consider several aspects of the transaction, including whether it is in the public interest to revise the foreign control standard. Moreover, the Department must take into account the current financial position of USAir and the effect any decision could have on the continued financial viability of the airline. The airline's management says it has the financial resources to continue to operate at least through the second quarter 1993.

BACKGROUND

USAir (and its parent, USAir Group Inc.), is based in Arlington, Virginia. It is the sixth largest U.S. airline as measured by revenue-passenger miles (RPMs). USAir has major domestic hubs at Pittsburgh, Philadelphia, Charlotte, and Baltimore, and is also either the dominant carrier or a close number two at Boston, LaGuardia, and Washington National. USAir serves many smaller cities through its commuter affiliate, USAir Express.

USAir operates to destinations in Europe, Canada, the Bahamas, and Mexico. Its international routes include Pittsburgh-Frankfurt, Charlotte-Frankfurt, Charlotte-London, and Philadelphia-Paris. In March 1992 (Order 92-4-49), the Department approved the sale of TWA's Baltimore-London and Philadelphia-London routes to USAir for \$50 million.

USAir's international traffic grew 27 percent between 1990 and 1991. However, international operations represent only 4 percent of its total RPMs. USAir has approximately 46,500 employees. It operates a fleet of 492 aircraft consisting of 737s, 757s, 767s, MD-80s, F-28s, and Fokker 100s. Its average fleet age is 9.65 years. USAir owns approximately 239 aircraft, or approximately one half of its total fleet.

USAir, once a local service carrier in the northeast, grew rapidly in the late 1980s. In 1987 USAir acquired Pacific Southwest Airlines (PSA) for \$460 million and Piedmont Airlines for \$1.6 billion.

On March 27, 1992, USAir entered into an agreement to operate the Trump Shuttle for ten years, with an option to buy after four and a half years. USAir began its Shuttle service on April 12, 1992.

USAIR'S FINANCIAL CONDITION

Prior to 1989, USAir had earned annual operating and net profits for 13 consecutive years. Between January 1980 and June 1989, USAir earned \$901.8 million. Since that time, however, the carrier has accumulated operating losses of \$1.36 billion and net losses of \$979 million. See Table 1, *USAir's Total Operating Revenues, Expenses, and Operating and Net Profits, 1980-1992*.

USAir's losses can be attributed to at least seven interrelated factors.

1. Impact of Economy: Since early 1989, there has been a decline in the general economy as reflected by the turndown in the rate of growth of the Gross Domestic Product (GDP). The demand for air transportation is notoriously sensitive to general economic conditions, particularly to Disposable Personal Income (DPI) which is tied to the growth in GDP. The GDP rose at an annual rate of only 5 percent in 1990, 2.9 percent in 1991, 2.9 percent first quarter 1992, and 1.4 percent in second quarter 1992. Lawrence Lindsey of the Federal Reserve Board projected GDP to grow 2 to 2.5 percent for the second half of 1992 after averaging 2 percent in the first half.

USAir's primary markets are situated in the northeast region of the country, which has been particularly hard hit by the prolonged economic recession. Passenger traffic as measured by the growth in RPMs has been constrained and sporadic. See Chart 2, *USAir's System RPMs December 1991 - June 1992*, and Chart 3, *Airline Revenue Passenger-Miles For First Six Months of 1991 and 1992*. As an emerging international airline, USAir has realized significant growth in its international traffic. International operations, however, constitute only 4 percent of USAir's system RPMs. As consequence, the airline has been unable to take advantage of cross-subsidy from international service, where yields have remained relatively high.

2. Acquisitions: Recent mergers and international route and slot acquisitions have contributed to USAir's financial losses in two ways: (1) expanded debt has increased debt service expenses, and (2) increased debt has a negative lever

effect on losses during unprofitable periods. In 1987 USAir's debt increased by \$460 million with the acquisition of Pacific Southwest Airlines and by \$1.6 billion with the acquisition of Piedmont Airlines. In 1991 it purchased 114 Continental slots at LaGuardia and Washington National for \$61 million.

See Chart 4, *USAir's Long-Term Debt and New Stockholders Equity 1980-1992*, and Chart 5, *USAir's Interest on Long-Term Debt and Capital Leases 1980-1992*. The rise in reported debt since third quarter 1989 and the rapid rise in net stockholders equity resulted from the acquisition of Piedmont and its reporting of the combined financial statements in DOT Form 41. As a consequence of added debt burden, USAir's times interest earned declined drastically in 1989, but has since steadily improved and is now positive. See Chart 6, *USAir's Times Interest Earned 1985-1991*. The times interest earned ratio measures the extent to which a firm's earnings can decline before it is potentially unable to meet annual interest expenses.

3. Operating Costs: USAir incurs high operating costs stemming from a number of factors: it has a short-haul route structure situated in the congested northeast, a greater percentage of its fleet operating time is required for takeoffs and landings, its fleet spends greater block time on the ground, and its fleet experiences more aircraft cycles.

Its diverse aircraft fleet mix (6 different types) adds to training and maintenance costs. The low seat configuration of USAir's aircraft -- an average of 126 seats per aircraft compared to the average of 168 for the other majors -- inflates seat-mile costs and limits revenues the airline can derive.

While USAir's 1991 cost per available seat-mile (ASM) was 10.4 cents, the industry average was 9.2 cents. On average, USAir's costs are 13 percent higher than the industry average. See Chart 7, *USAir Yield/RPM and Operating Cost/ASM 1985-1993 2nd Quarter*.

USAir's ability to cover its daily operating expenses, as measured by days cash coverage, has declined slightly since the fourth quarter of 1990. This indicates that the company is consistently able to maintain its liquidity and is meeting its short term obligations. See Chart 8, *USAir's Days Cash Coverage 1Q85 - 1Q92*.

4. Expansion/Contractions: USAir's attempts to expand into several new markets outside the northeast have not been successful. In May 1991, USAir ceased operations in eight of the West Coast markets it had operated since acquiring PSA,

eliminated its Dayton hub, and closed four crew bases, two heavy maintenance bases, and one ticket reservation office. As part of the pending transaction with British Airways, USAir would sell the Philadelphia-London and Baltimore-London routes that it just bought from TWA for \$50 million.

5. Fare War: The continuing pace of airline competition (as demonstrated by the recent fare war in which fares were reduced by 50 percent for tickets good through September 13) will substantially dilute USAir's third quarter yields even though RPMs will be higher. Thus, USAir's chances for earnings improvements in the third quarter 1992 are nil. In Chart 9, *USAir's Actual and Projected Yield/RPM and Operating Cost/ASM 1Q 85 to 2Q 93*, we project a rise in ASMs and RPMs resulting from the 1992 summer fare war and will continue to grow through the fourth quarter.

6. Load Factors: The cumulative effect of the previously cited factors has been to raise USAir's breakeven load factor, which has increased its need for high yields and raised the threshold of profitability. USAir's breakeven load factor, which has traditionally been high, remains so. In 1991 its breakeven load factor was 60.8 percent, while its actual load factor was 58.7 percent, the lowest in the industry and below the industry average of 62.9 percent. See Chart 10, *USAir's Load Factors, 1985-1993*.

7. Yields: USAir's yield averaged 16.7 cents per RPM in 1991 compared with the industry average of 12.8 cents per RPM. USAir's high costs require that it achieve high yields to be profitable. However, the prolonged recession, heightened airline competition, and fare wars have eroded yields and hindered USAir's efforts to achieve profitability. See Chart 9.

Consequently, taking the seven cited factors into account, USAir's sustained operations at below-breakeven load factors and the industry's inability to maintain adequate yields arising from a declining economy have produced mounting quarterly operating and net losses. These losses are exacerbated by the increased debt burden undertaken in 1987 with the acquisition of PSA and Piedmont. Long-term debt rose from \$311 million in 1988 to \$1.9 billion by second quarter 1992. The associated debt service costs have risen 320 percent from \$55 million in 1988 to \$178 million in 1991.

Sustained losses have also weakened USAir's working capital and cash flow position. Working capital (current assets minus current liabilities) has been negative since late 1987. See Chart 11, *USAir's Total Current Assets and Liabilities, 1Q80-1Q92*, and Chart 12, *USAir's Working Capital 1980 - 1 Quarter 1992*. Current liabilities have grown more rapidly than current

assets. The level of working capital indicates the extent to which claims of short-term creditors are covered by assets that are expected to be converted to cash in a period corresponding to the maturity of claims.

As of the first quarter 1992, USAir had cash and cash equivalents of \$312 million, down from \$415 million at the end of 1991, a decline of \$103 million. By the beginning of the second quarter, USAir's Statement of Cash Flows listed cash and cash equivalents at \$209 million and is now estimated by USAir to be \$211 million, a decline of \$204 million in six months.

BASES FOR ASSESSMENT AND PROGNOSIS

The assumptions upon which the Public Proceedings Division's projections are based are listed in Table 13, *List of Forecast Assumptions*.

USAir's long-term viability is dependent upon a resurgence in the economy, which will lead to increased revenues through traffic growth, higher yields, or both, and continued management attention to cost reduction.

A number of factors may contribute to USAir's efforts to improve its profitability in the next 12 months.

First, the economy remains sluggish. The Air Transport Association, in late May 1992, projected domestic airline traffic to grow about 6 percent in 1992, assuming a growth in U.S. gross domestic product of 1.4 percent. Forecasters cited in the July 4, 1992, Economist (p. 51) are expecting an annualized GDP growth rate between 2.5 and 3 percent in the second half of 1992, while the Federal Reserve Board projects between 2 and 2.5 percent.

The Federal Reserve Board's Current Economic Conditions report released August 5, 1992, indicates that economic activity, in recent weeks, has been uneven across the nation. Manufacturing increased moderately in most Reserve districts, but showed no discernable direction in others. Retail sales rose modestly overall. Lower interest rates have provided little impetus to residential and commercial real estate activity. Tourist activity has been flat. Conditions in agriculture were slightly improved. In general, reports on trends in economic activity in the Boston, New York, Philadelphia and Atlanta Federal Reserve Districts remained mixed and uneven. The Federal Reserve anticipates weak and uneven improvement in economic growth across regions of the country in the next six months.

In a rising economy domestic airline traffic grows between two and three times the rate of general economic expansion. If the GDP grows at a faster rate, between 3 and 4 percent, airline traffic will increase more rapidly, reflecting the close

relationship between economic health and the demand for air transportation. IATA has projected North American traffic to grow 4 percent in 1992 and 5.8 percent in 1993. (AW&ST, June 8, 1992, p. 34.)

A low projected inflation rate of 3.2 percent for 1992 and 1993 will assist USAir's management in containing costs. Fuel prices have been the exception. American and Delta have experienced 11 and 16 percent increases, respectively, in the price of fuel per gallon between the end of the first quarter and late June (Aviation Daily, June 25, 1992, p. 538) Northwest, Continental, America West, and USAir have not reported the extent of their recent cost increases. Several carriers, including USAir, have proposed a domestic fare increase of 4 percent and referred to the increase as a "fuel cost adjustment".

Second, USAir's new four-year labor contract, ratified by its pilots' union in May 1992, will save the carrier \$70 million the first year and as much as \$100 million in subsequent years. The airline estimates that the contract will yield a \$55 million reduction in pay-outs to its pilot group alone. The airline will also realize a \$15 million annual benefit from new work rules that will increase pilot productivity. The labor agreement also allows USAir to reduce non-contract workers' pay, saving the company an additional \$21 million annually.

Third, the company has instituted a pension freeze on non-contract workers, which it estimated will save \$56 million, and a managed care program for non-contract employees, which will further reduce costs by \$20 million. Labor costs constituted 42 percent of USAir's total costs in the first quarter 1992 compared to 35.8 percent for the industry. USAir planned to reduce the management and clerical staff by 10 percent of 1991 levels through layoffs and attritions by the end of 1992. These reductions have now been implemented.

Fourth, USAir is simultaneously attempting to improve service quality in an increasingly competitive airline business. The company already has one of the industry's best records in overall consumer complaints, and has an improving record in lost baggage.

Fifth, reduced fares sparked increased demand in the Washington-New York-Boston shuttle markets. USAir has added flights as demand continues to grow. With the acquisition of Continental's slots and terminal facilities at LaGuardia, USAir can institute new service in September 1992 using the East Terminal built next to the shuttle operation.

Sixth, USAir will further improve service in October 1992 with the opening of Pittsburgh's new Midfield Terminal. The terminal will have an advanced automated baggage handling system. The terminal's placement between the two main runways

will reduce aircraft taxi time and fuel consumption, while providing faster service for travellers. It is expected that the new terminal will enhance the airline's service image and make travel through Pittsburgh more convenient.

Seventh, some Wall Street analysts believe that USAir represents an attractive turnaround story, if it can continue lowering costs, improving service, and enhancing its critical mass, perhaps through a long-term strategic alliance with a healthy domestic or foreign air carrier.

CONCLUSIONS

- o USAir is not on the verge of insolvency, nor is it a candidate for bankruptcy in the immediate future, given information available today.

- o Although operating at a loss, USAir can continue to operate over the next twelve months without the significant level of capital infusion proposed by British Airways. This presumes, however, that the economy will turn around and that USAir can achieve positive net earnings by the second or third quarter of 1993. Should the economy worsen and yields decline along with demand, USAir could face a critical cash flow problem by the third quarter of 1993.

- o USAir's prospects for near-term profits remain dim. The cost-cutting measures it has implemented, although positive, are not nearly enough to offset the negative effects of slow growth in the economy, lack of domestic traffic growth, and the recent fare war. Its costs are still high, making USAir more vulnerable to competition and future fare wars that may erupt again in the fall and winter off-peak season, when demand declines.

- o USAir's second quarter 1992 operating loss was \$54 million and its net loss \$78 million. We estimate that USAir will incur a third quarter operating loss of \$69 million with a net loss of \$116 million, due primarily to the lingering effects of the fare war. For the fourth quarter 1992, we estimate a net loss of \$79 million because of the traditional seasonal traffic decline, lower consumer confidence (the Conference Board's June Consumer Confidence Index declined 9.2 percent), and various promotional fare programs. On July 31, 1992, American, United Delta, TWA and Continental reduced the 14-day advanced purchase fares by 30 percent for travel from September 14 through December 14 for anywhere in the U.S., except Alaska and Hawaii.

- Projections for the fourth quarter 1992 and for the first two quarters of 1993 are more speculative because of unforeseen circumstances involving the economy, discount fare programs, acquisitions and mergers, airline failures, and changes in the capital markets. See Chart 14, USAir's

Operating Revenues and Expenses 1Q80 TO 2Q93, Chart 15, USAir's Operating Profit (Loss) and Net Income (Loss) 1Q80 - 2Q93 and Table 16, USAir's Total Operating Revenues, Expenses, and Operating and Net Profits (Losses) 1992-1993.

- We project USAir's accumulated net losses for the four quarters ending June 1993 at approximately \$294 million.

USAir's Projected Profit and Loss
(\$ Millions)

	<u>Actual</u>		<u>Projected</u>			
	<u>92 1Q</u>	<u>92 2Q</u>	<u>92 3Q</u>	<u>92 4Q</u>	<u>93 1Q</u>	<u>93 2Q</u>
Operating profit (loss)	(\$33)	(\$54)	(\$69)	(\$48)	(\$51)	\$73
Net profit (loss)	(\$54)	(\$78)	(\$116)	(\$79)	(\$120)	\$21
QTR End Cash Balance	\$209	\$211	\$165	\$156	\$105	\$197

o As of June 30, 1992, USAir had total cash and cash equivalents of \$211 million available. Assuming no additional cash is raised from bank loans, assets sales, equipment sale and lease-backs over the next four quarters, we estimate that the carrier's cash balance at June 30, 1993, would be \$197 million after (1) deducting net losses for the year ended June 1993, and (2) adding back depreciation and amortization expense.²

o USAir has a \$900 million bank line of credit with a "step down" provision, established in 1987, against which it has drawn down \$261 million.

- In the third quarter of 1992, the credit line will drop to \$600 million. The credit is scheduled to step down again to \$300 million in the second quarter of 1993.

- USAir is seeking waivers on required coverage and net worth ratio tests which would require repayment of funds outstanding under the credit agreement. USAir has received waivers of these provisions twice in the past.

o If the economy does not show significant growth improvement, at least 3 percent, and a return of consumer confidence leading to increased travel demand, then USAir's total net loss for the 12 months ending June 1993 could

²Depreciation and amortization are expense items appearing on the income statement that do not represent actual cash outlays. These are reserve accounts that provide for the replacement of depreciated assets. Funds accumulated in these reserve accounts can be used as a source of working capital to help improve the company's cash flow during periods of negative earnings.

approach \$466.8 million. See Table 17, *USAir's Total Operating Revenues, Expenses, and Operating and Net Profits (Losses) 1992-1993, Pessimistic Scenario*.

- o This would increase USAir's capital deficit to \$255.8 million (or cash of \$24 million after depreciation and amortization are added back to net income).

- o USAir's balance sheet is reasonably strong. USAir's debt-to-total assets ratio has increased to 57 percent as a result of some added long-term debt, but mainly an increase in current liabilities. See Chart 18, *USAir's Debt Ratio*. The long-term debt component of USAir's total debt has remained between 11 and 28 percent of total assets, consistently lower than current liabilities. The debt ratio indicates the percentage of total capital provided by the creditors. A debt ratio comprised of relatively low level of long-term debt suggests that a company, that is profitable, might support increased debt and thereby take advantage of positive leverage.

- Increased debt amplifies losses during unprofitable periods.

- o There are a number of sources of additional capital that USAir could draw on to sustain its operations.

- For example, the sale and lease-back of older aircraft (USAir owns approximately one half of its fleet of which 87 percent were used as collateral for loans as of December 31, 1991) and computer, reservation, and training facilities could provide USAir with additional operating capital.

- In June 1992 Standard & Poor's Corp. lowered USAir Group, Inc.'s bond rating, citing a weak economic recovery and intensified fare wars.

- USAir filed with the SEC in 1991 a shelf registration for \$500 million in debt securities to be guaranteed by USAir Group. These securities may be sold from time to time as determined by market conditions. As a consequence of a lower bond rating, USAir would have to sell its corporate bonds at a higher discount rate thereby increasing its yield. As a result of declining interest rates, USAir's weighted cost of capital declined to 10.2 percent in 1991 from 10.4 percent in 1990. Long-term interest rates have declined further during 1992. Recently, corporate bonds have been paying 6 to 7 percent: these yields rival the Treasury bonds at 7 percent. USAir might sell bonds with higher yields that are acceptable to management given USAir's weighted cost of capital.

- USAir could raise capital through a gradual sale of assets to U.S. or foreign-based investors and thereby avoid foreign ownership and/or control.

- USAir's reliance on the equity markets as source of capital may not be desirable as a result of lower stock prices brought on by accumulated losses. Although the BA proposal utilizes 7 percent cumulative convertible preferred stock as financing means for USAir, this proposed preferred issue is not convertible for four years.

- o Forecasts of USAir's operating and net profit and losses by DOT, Shearson Lehman Brothers, Salomon Brothers, and USAir are compared for the second half of 1992 and the first half of 1993 or CY1993. See Table 19, *Comparison of Forecasts for USAir's Operating and Net Profit (Loss)*.

- o British Airways is, in essence, proposing the purchase of 44 percent of USAir's assets for \$750 million. This implies a total value of the airline of \$1.705 billion. USAir's history of profitability, route structure, terminals, young fleet, and other assets, together with its restructured labor costs and balance sheet, suggest to us that BA's offer may be underpriced.

Accordingly, we conclude that USAir could raise interim capital based on its value from sources other than outright sale to a foreign entity. On the other hand, a strategic alliance with a large international carrier might benefit USAir's employees and stockholders in the long term.

Our analysis of USAir reveals a company that has been conservatively managed and has remained profitable during periods when other carriers have failed. The company is not over burdened with long-term debt. Its cost are high, but management is attempting to contain costs and reconfigure the company to be more competitive. The company's current ratio has declined reflecting increased current liabilities resulting from the increases in accounts payable, accrued salaries and wages, accrued vacation pay and air transport liabilities. A firm that has incurred net losses can be expected to increase and slow its payables. The air transport liabilities account has grown expectedly because of increased ticket sales. Wages and salaries can be further reduced through planned reductions in employment.

Recent losses have strained the company's capital resources. The company has cash to operate and is not facing an imminent liquidity or solvency crisis. USAir, like most U.S. airlines, must return to profitability.

The BA proposal is really more a long-term strategic marketing opportunity for USAir than a source of "bailout" capital. In

private discussions with USAir concerning the company's finances, emphasis on the dire straits of the airline has been muted. USAir's management has, for some time, sought access to international markets.

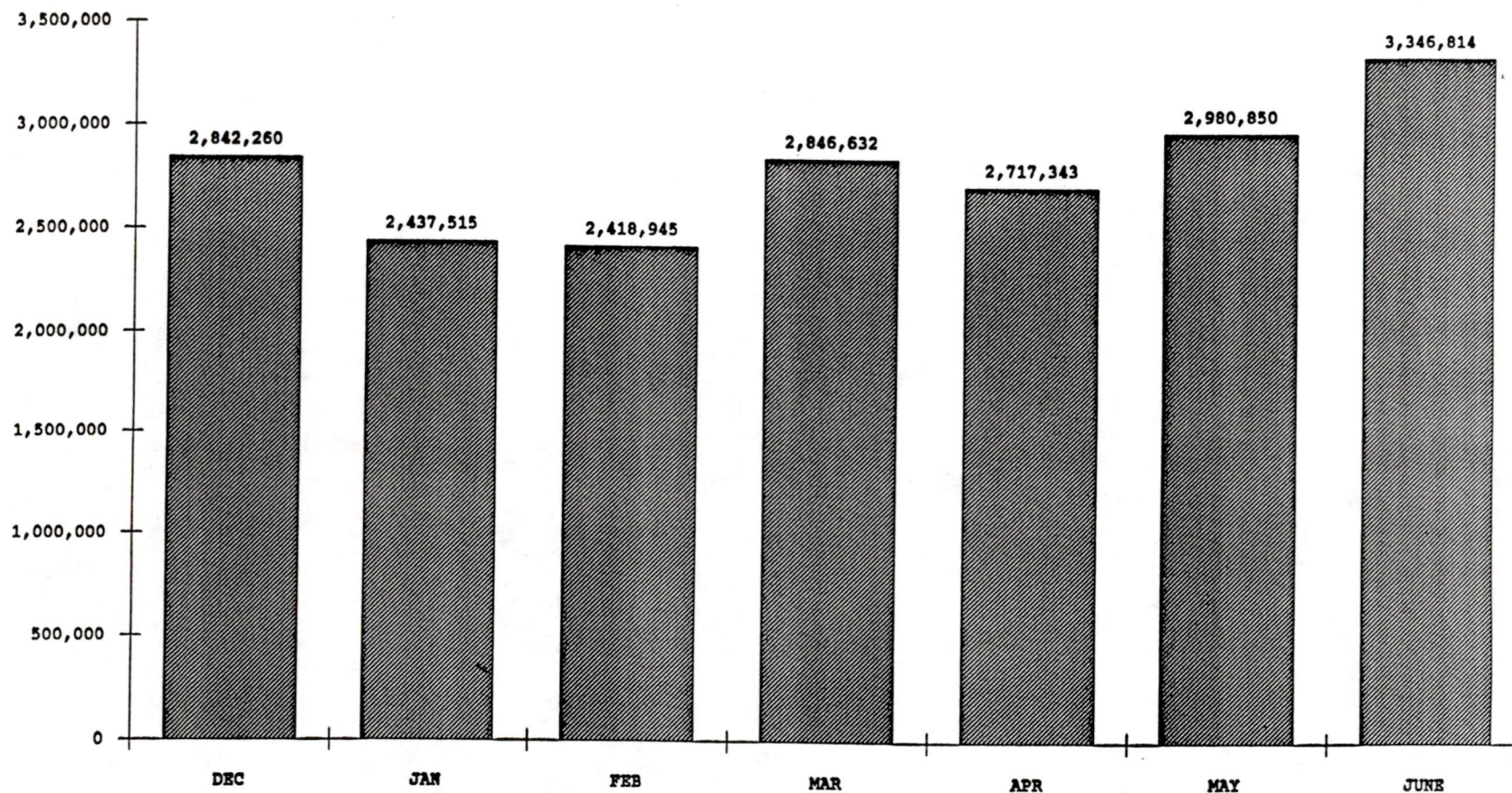
Ultimately, the BA/USAir transaction would provide a \$750 million capital infusion to USAir that would replenish about 75 percent of its recent losses and provide USAir with immediate market access to a global network of international routes. In turn, the transaction would provide BA with a strategic partner that has a strong foothold in the world's premier air transport market.

TABLE 1
 USAIR'S TOTAL OPERATING REVENUES, EXPENSES, AND OPERATING AND NET PROFITS (LOSSES) 1980-1992
 (000)

YEAR	TOTAL OP REVENUES	TOTAL OP EXPENSES	OPERATING PROFIT (LOSS)	NET PROFIT (LOSS)
1980	\$971,825	\$880,438	\$91,387	\$60,386
1981	\$1,110,491	\$1,052,022	\$58,469	\$51,084
1982	\$1,273,012	\$1,193,676	\$79,336	\$59,104
1983	\$1,432,264	\$1,303,393	\$128,871	\$78,382
1984	\$1,629,696	\$1,436,972	\$192,724	\$118,331
1985	\$1,749,126	\$1,582,204	\$166,922	\$109,850
1986	\$1,786,958	\$1,622,825	\$164,133	\$89,162
1987	\$2,070,312	\$1,806,855	\$263,457	\$164,113
1988	\$2,802,994	\$2,659,266	\$143,728	\$76,169
1989	\$4,204,661	\$4,432,755	(\$228,094)	(\$137,652)
1990	\$6,084,704	\$6,627,939	(\$543,235)	(\$410,748)
1991	\$6,049,170	\$6,251,271	(\$202,101)	(\$259,998)
1991 1Q	\$1,465,493	\$1,632,078	(\$166,585)	(\$153,234)
1991 2Q	\$1,539,068	\$1,579,262	(\$40,194)	(\$45,627)
1992 1Q	\$1,488,178	\$1,521,366	(\$33,188)	(\$53,478)
1992 2Q	\$1,579,639	\$1,633,170	(\$53,531)	(\$77,573)
6 MOS 1992	\$3,067,817	\$3,154,536	(\$86,719)	(\$131,051)

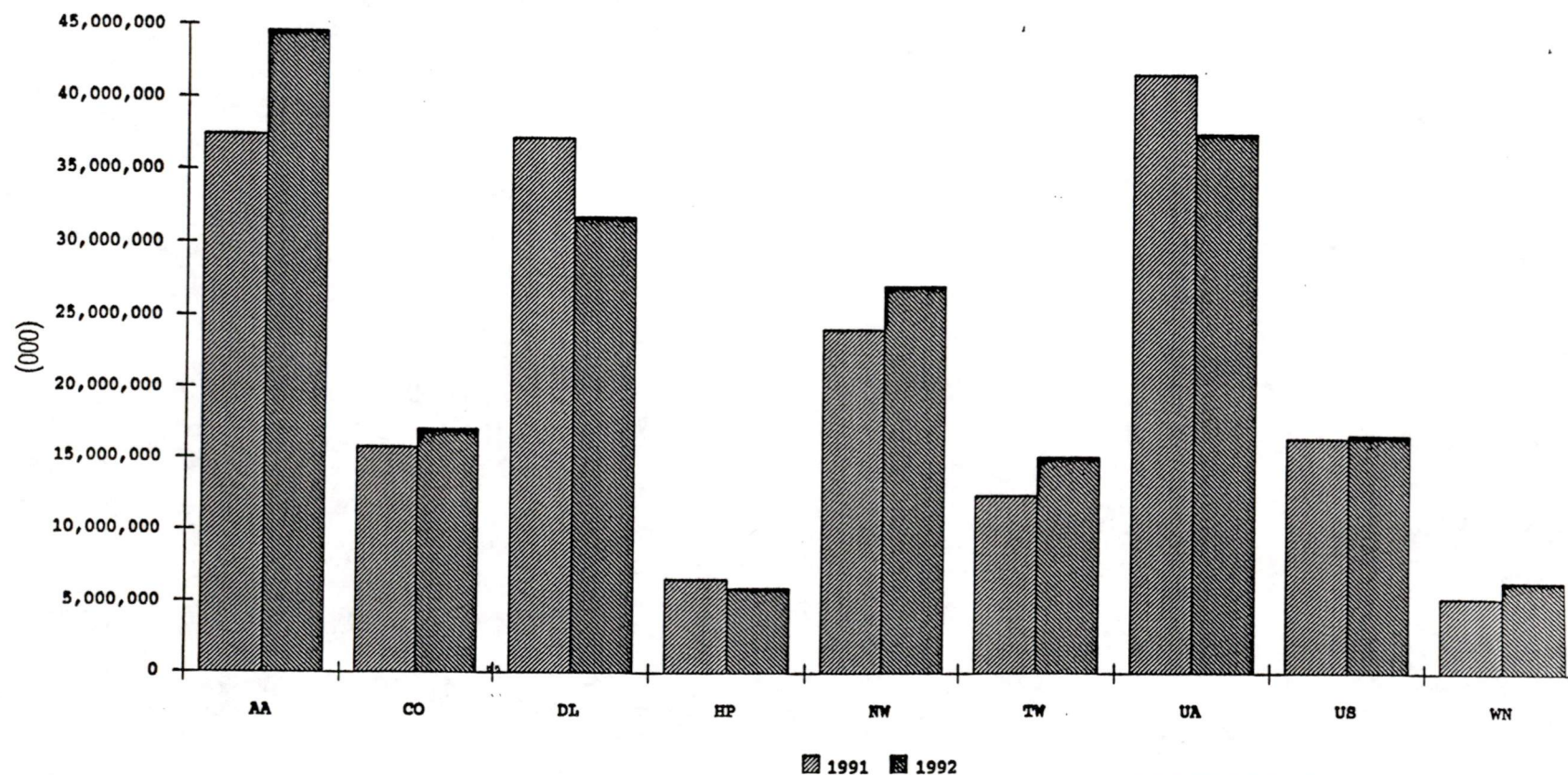
SOURCE: DOT FORM 41 REPORTS

CHART 2 USAIR'S SYSTEM RPMS DEC 1991 - JUN 1992



SOURCE: DOT FORM 41 REPORTS

CHART 3 COMPARISON OF AIRLINE REVENUE PASSENGER-MILES FOR THE FIRST SIX MONTHS OF 1991 AND 1992



CONTINENTAL DATA FIVE MONTHS
SOURCE: DOT FORM 41 REPORTS

CHART 4 USAIR'S LONG-TERM DEBT AND NET STOCKHOLDERS EQUITY 1Q80 TO 1Q92

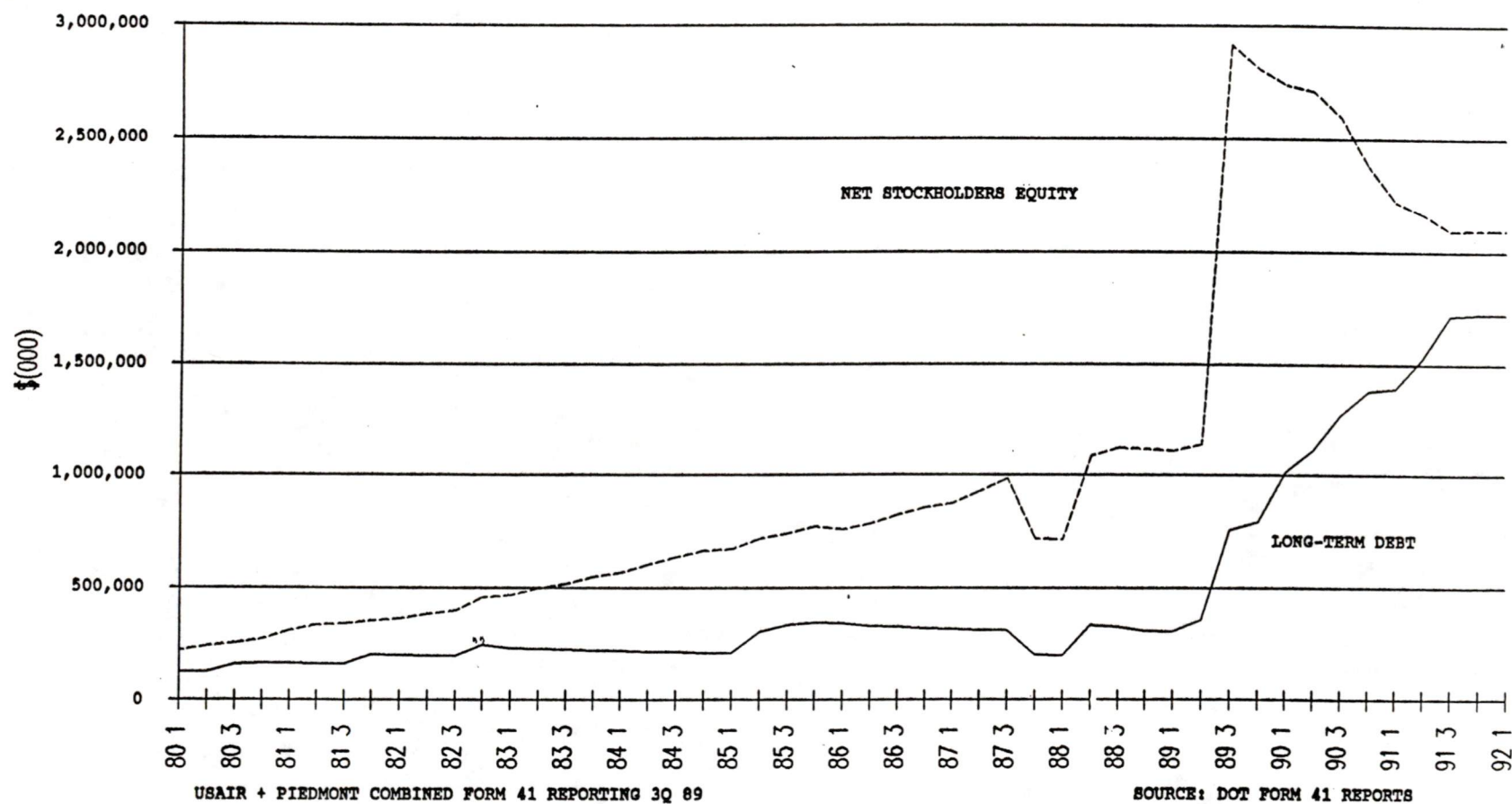
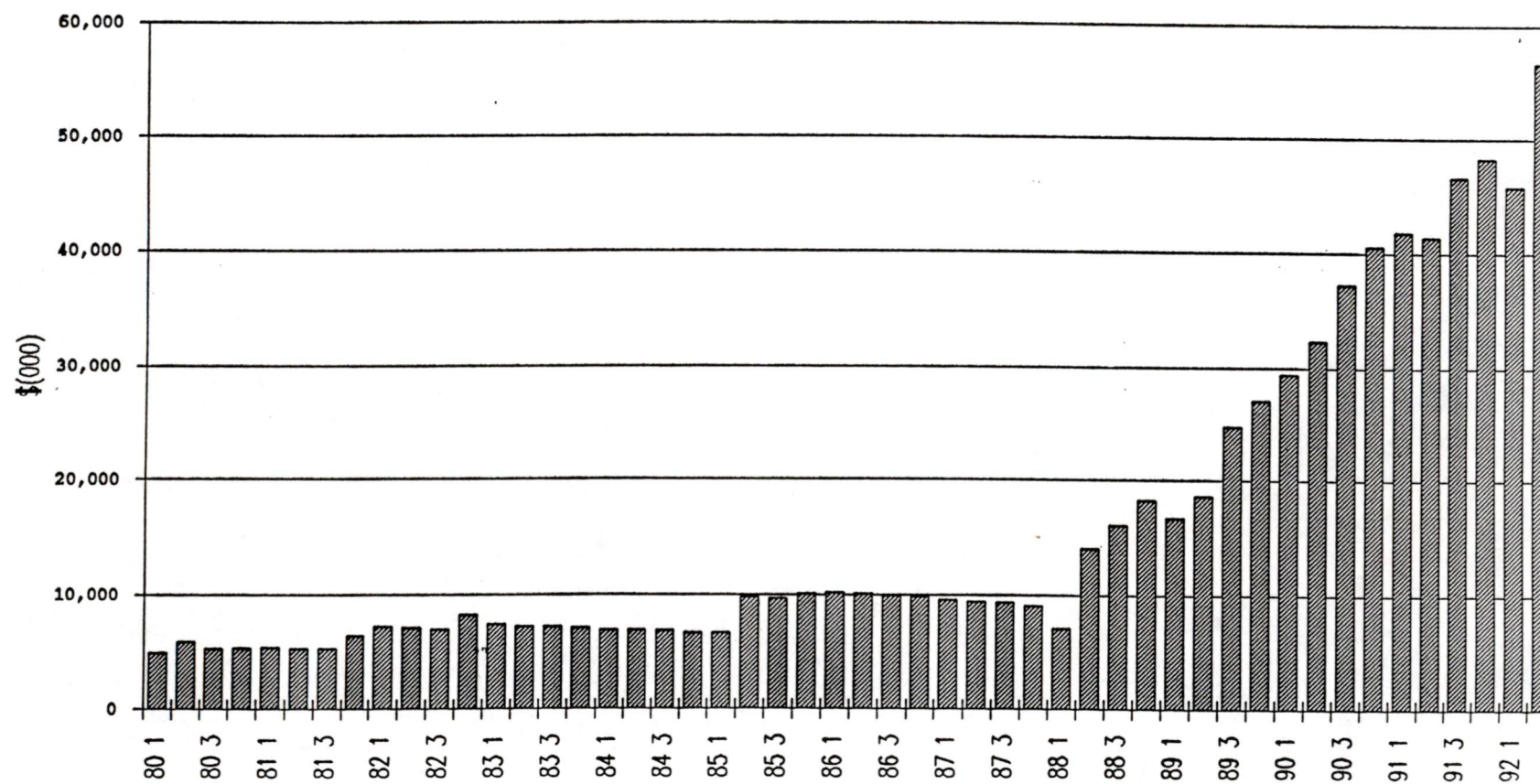
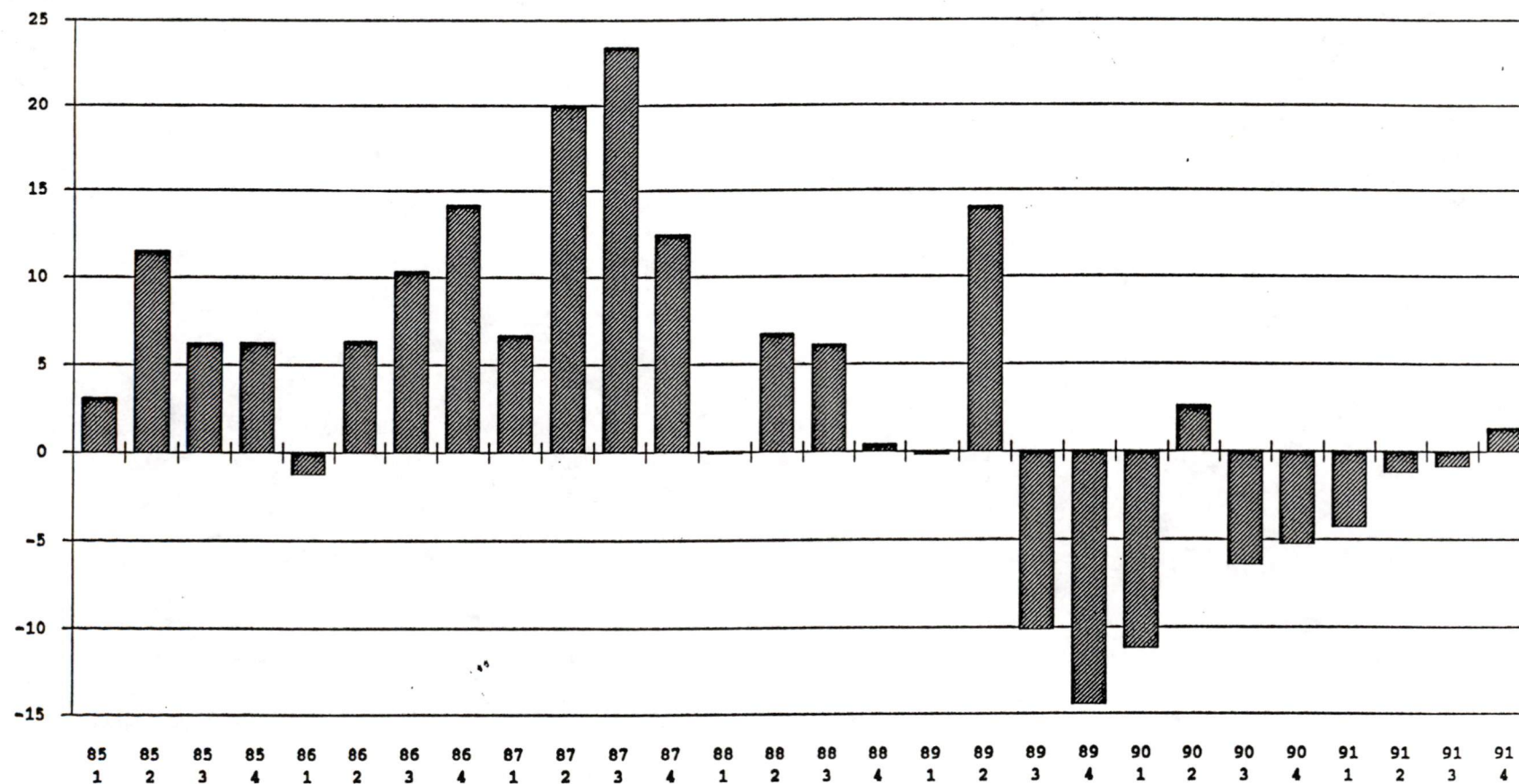


CHART 5 USAIR'S INTEREST ON LONG-TERM DEBT & CAPITAL LEASES 1Q80 TO 2Q92



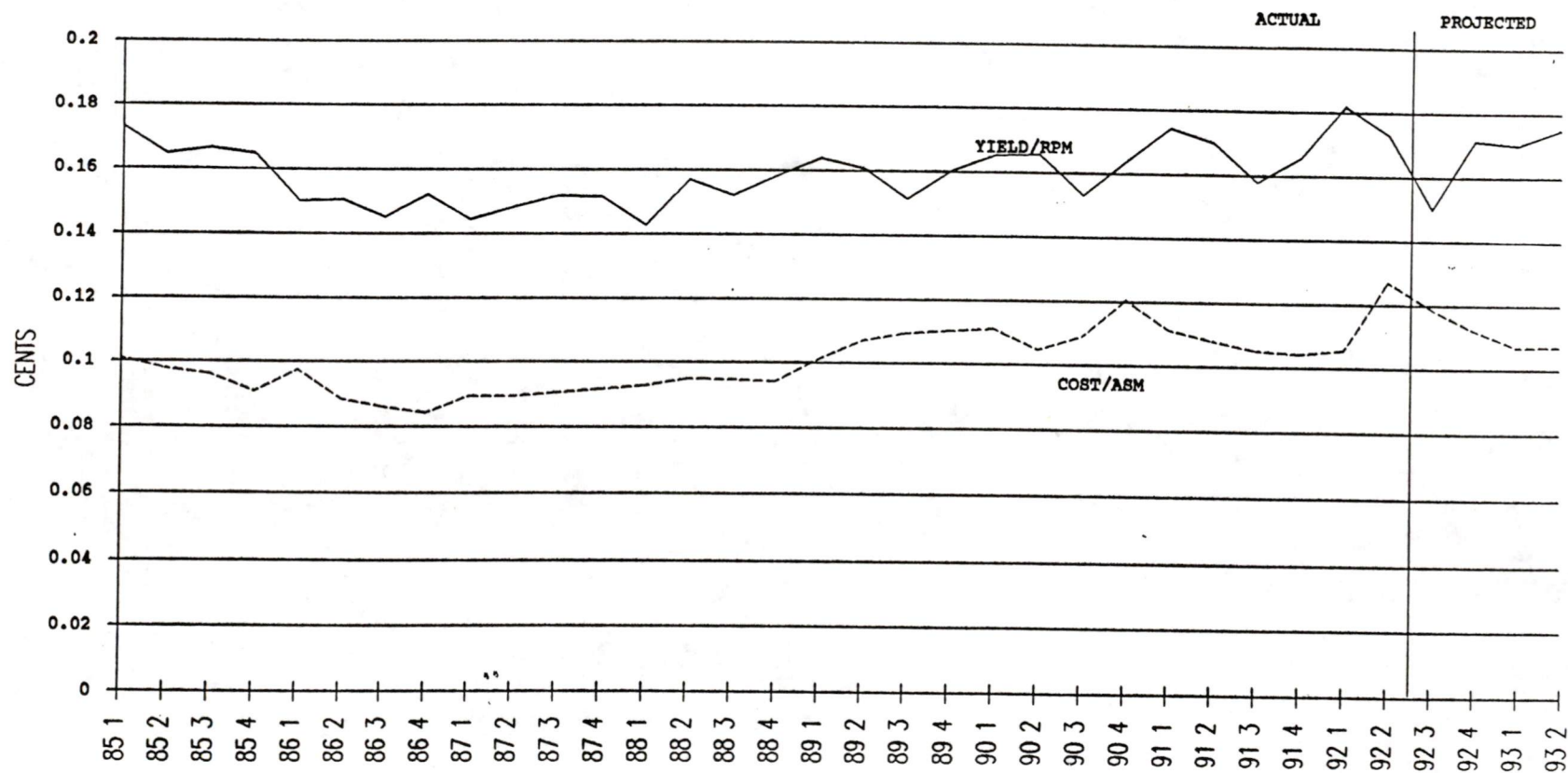
SOURCE: DOT FORM 41 REPORTS

CHART 6 USAIR'S TIMES INTEREST EARNED 1985 - 1991



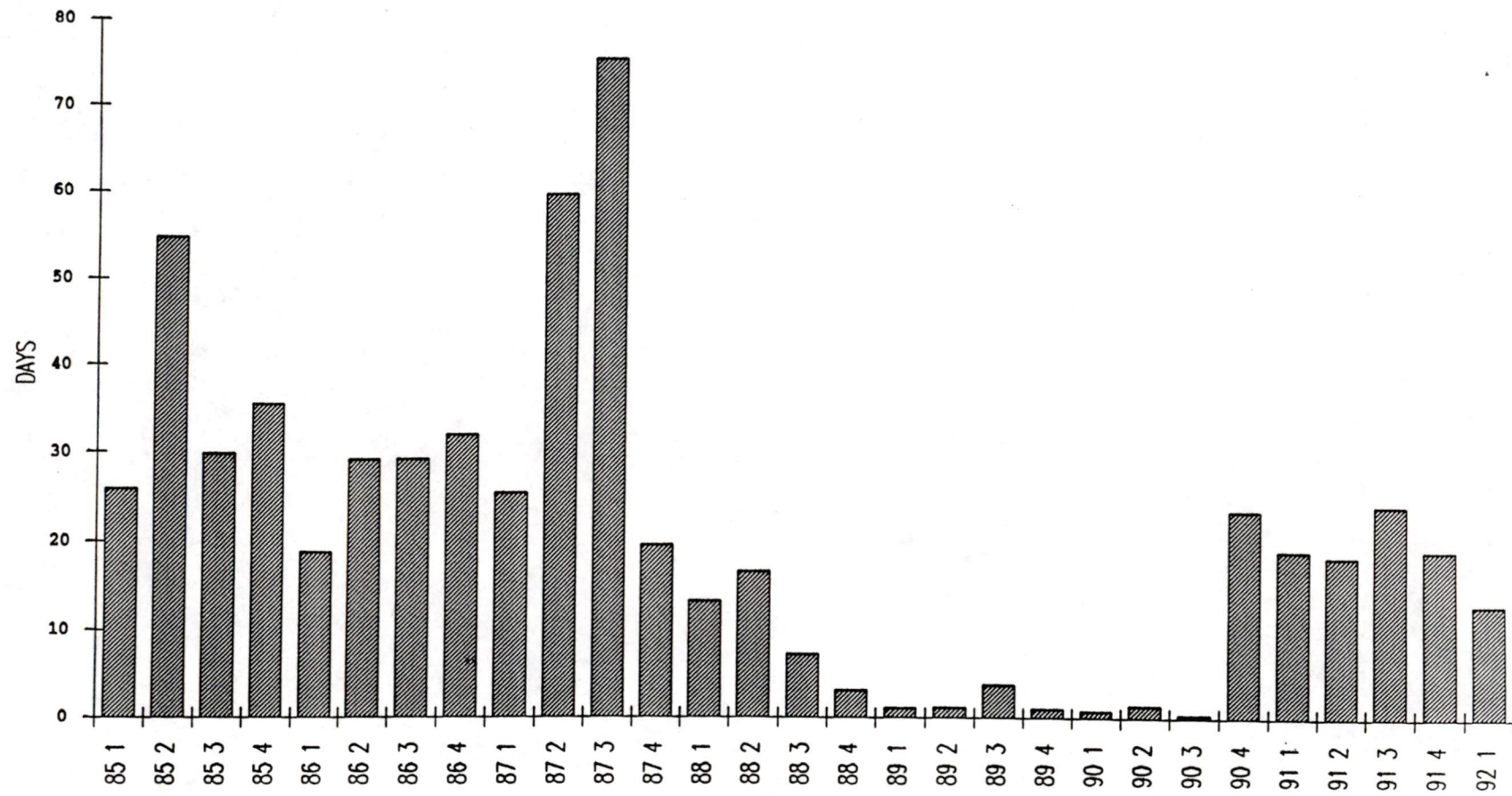
SOURCE: DOT FORM 41 REPORTS

CHART 7 USAIR'S ACTUAL AND PROJECTED YIELD/RPM AND OPERATING COST/ASM 1Q 85 TO 2Q 93



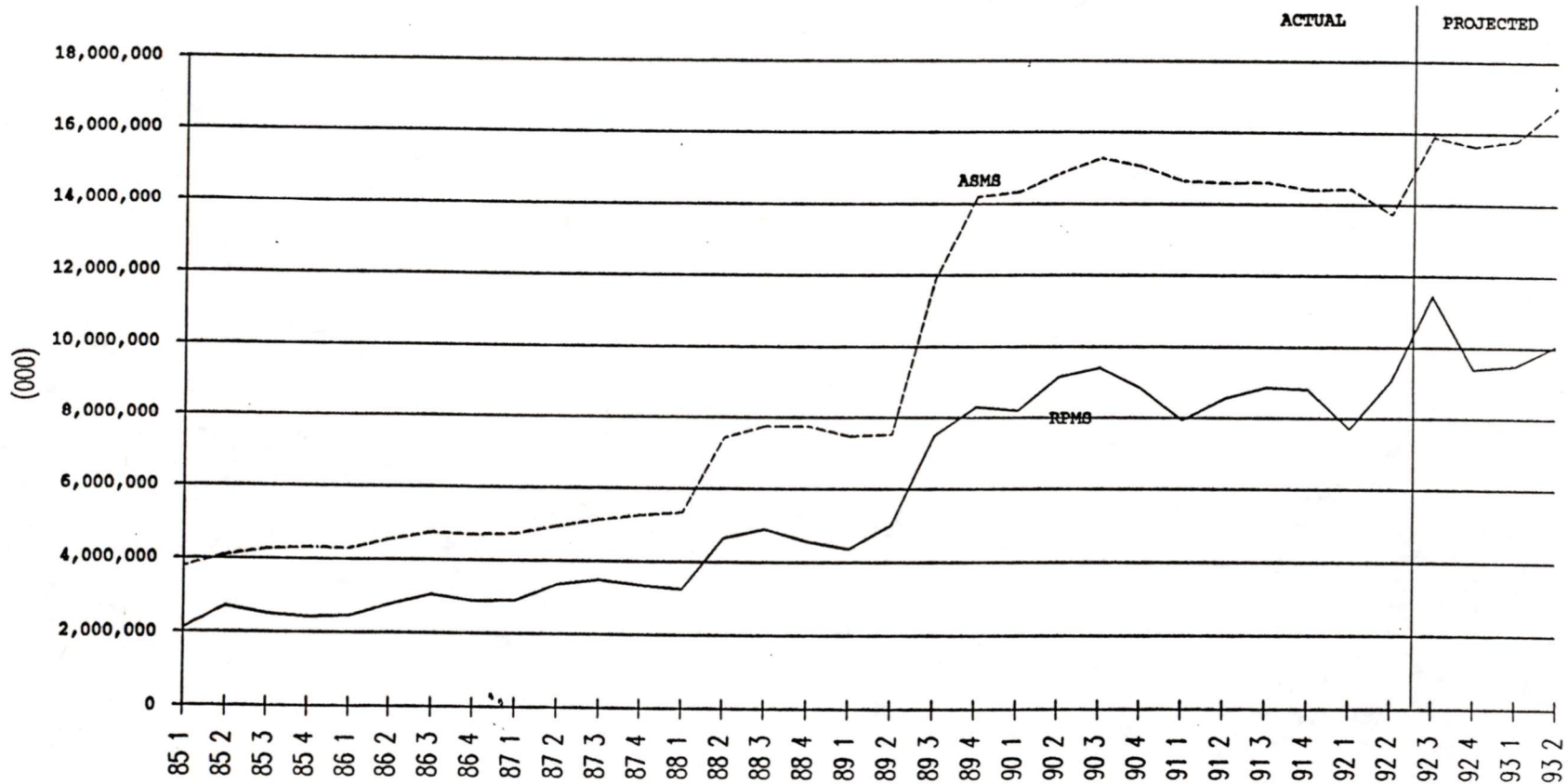
SOURCE: DOT FORM 41 REPORTS

CHART 8 USAIR'S DAYS CASH COVERAGE 1Q85 - 1Q92



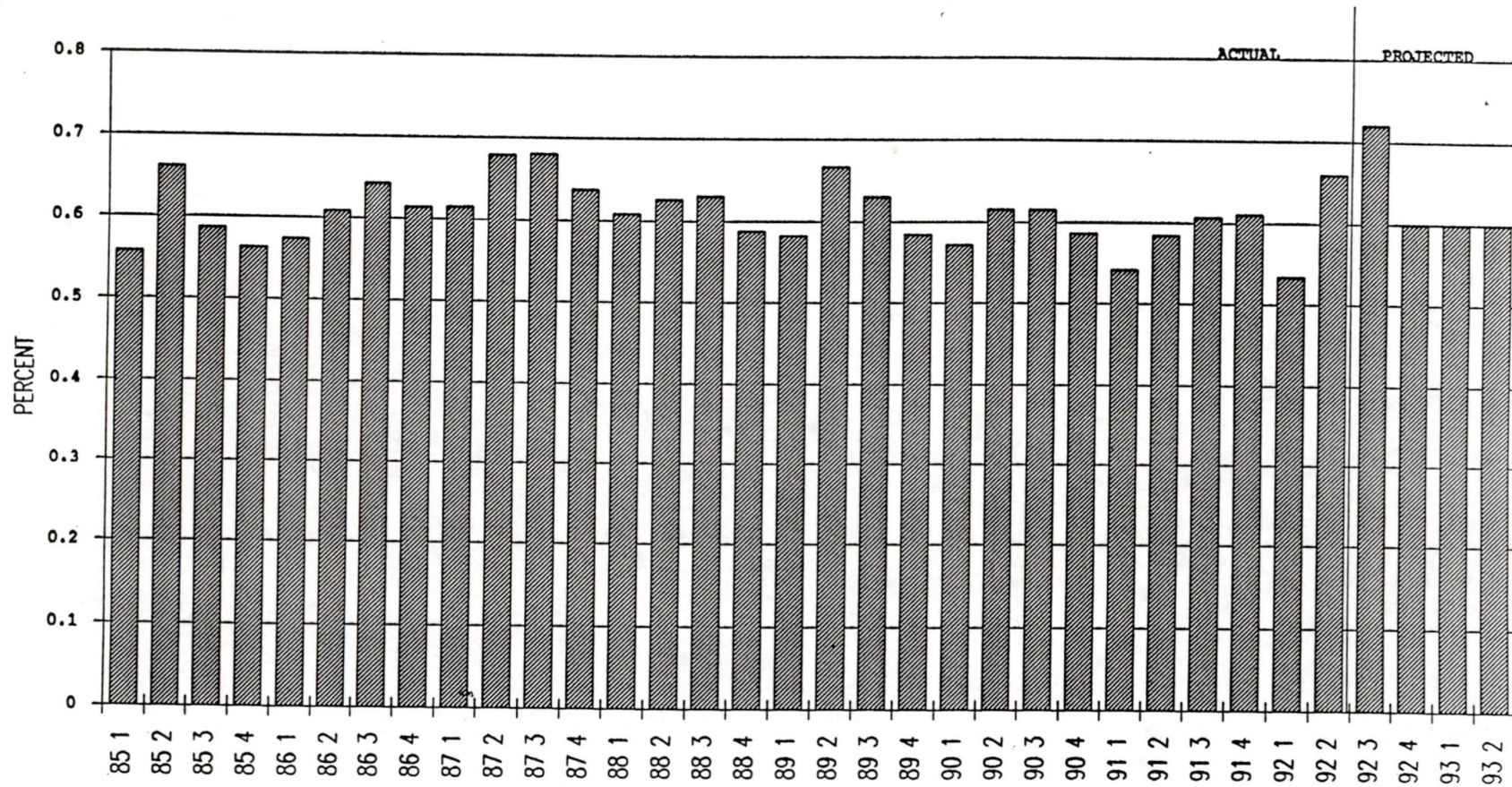
SOURCE: DOT FORM 41 REPORTS

CHART 9 USAIR'S ACTUAL & PROJECTED PASSENGER-REVENUE AND AVAILABLE SEAT-MILES 1Q85 TO 2Q93



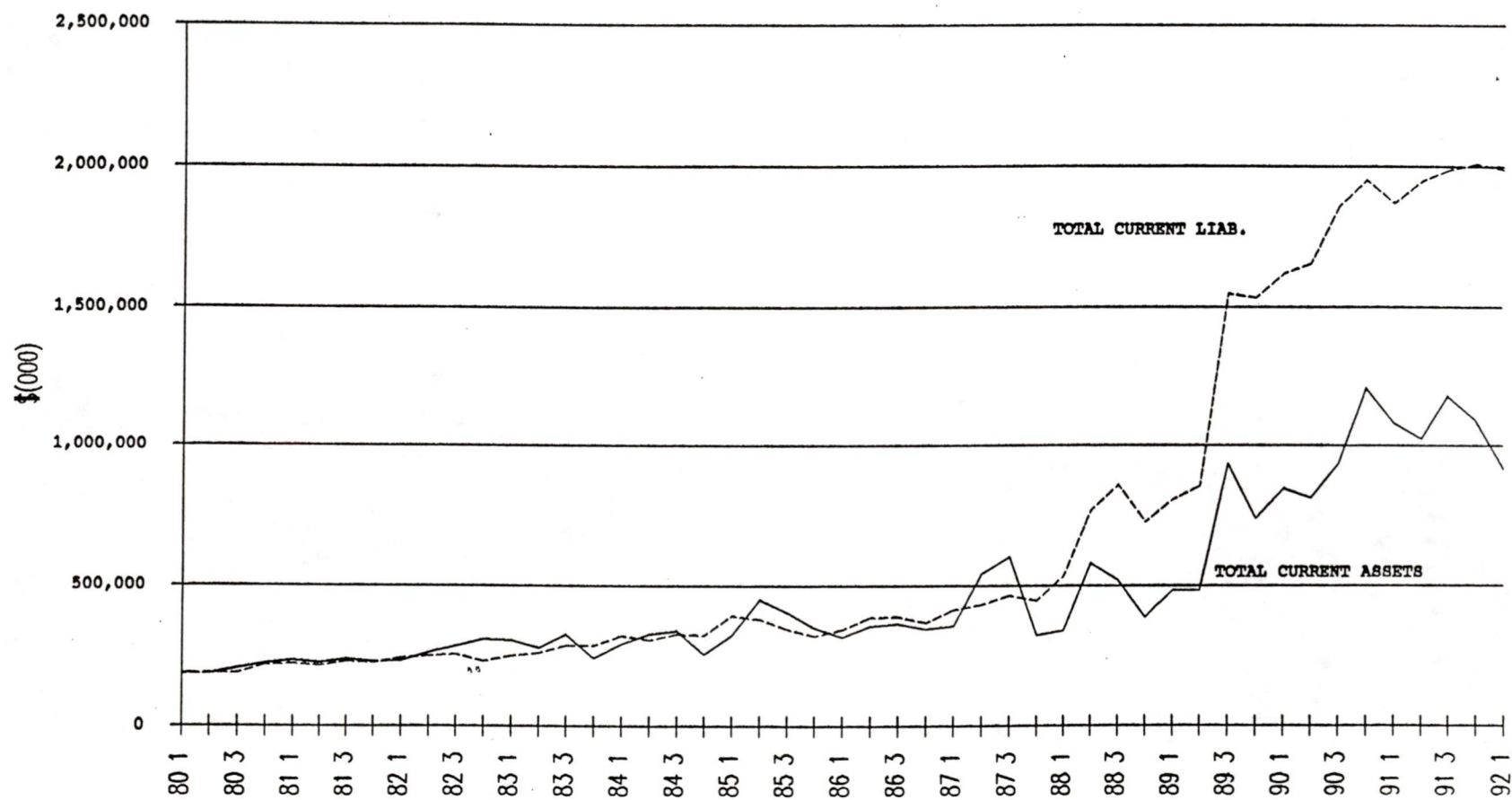
SOURCE: DOT FORM 41 REPORTS

CHART 10 USAIR'S LOAD FACTOR 1Q 85 TO 2Q 93



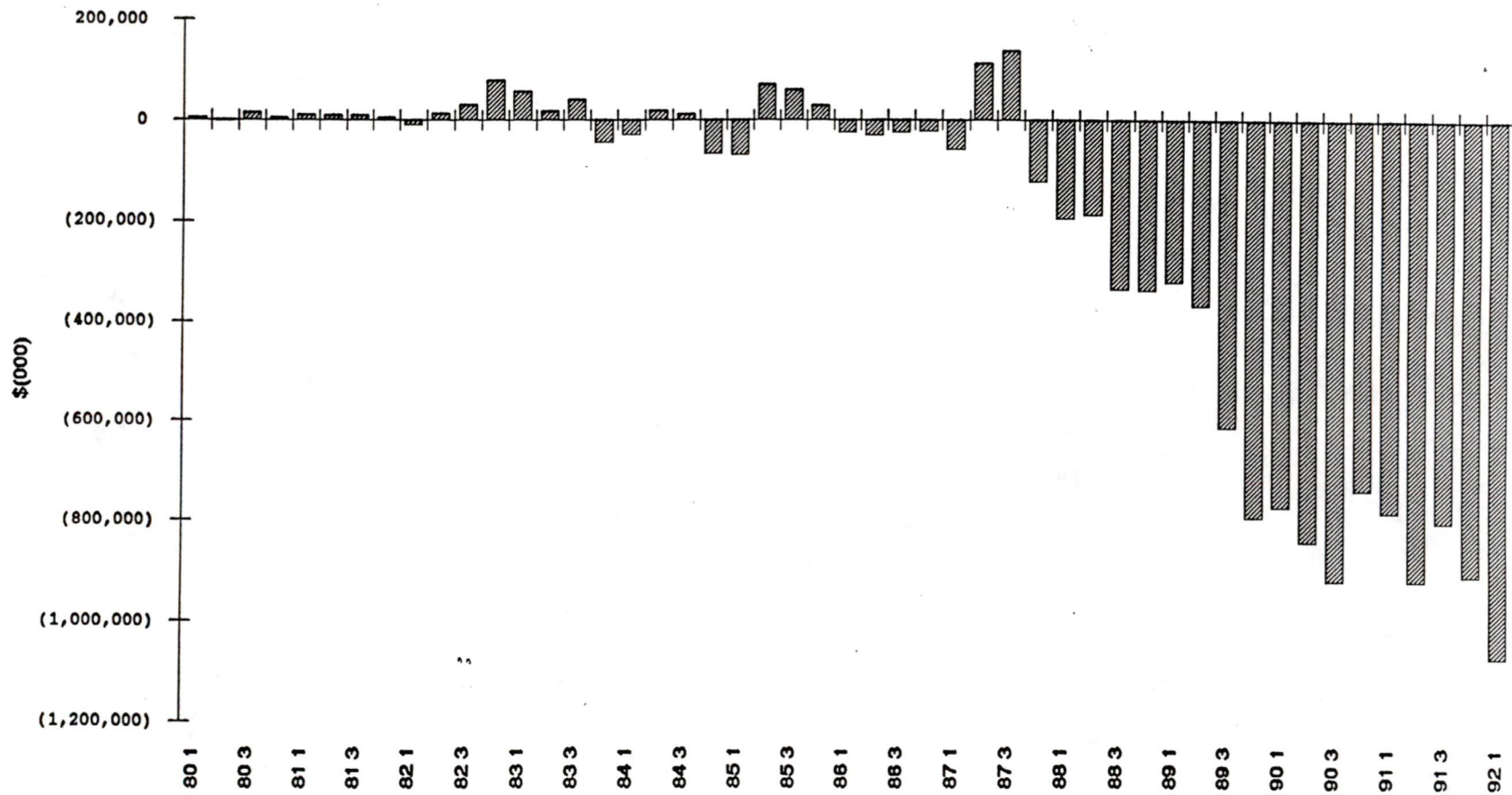
SOURCE: DOT FORM 41 REPORTS

CHART 11 USAIR'S TOTAL CURRENT ASSETS AND LIABILITIES 1Q80 TO 1Q92



SOURCE: DOT FORM 41 REPORTS

CHART 12 USAIR'S WORKING CAPITAL 1980 - 1 QUARTER 1992

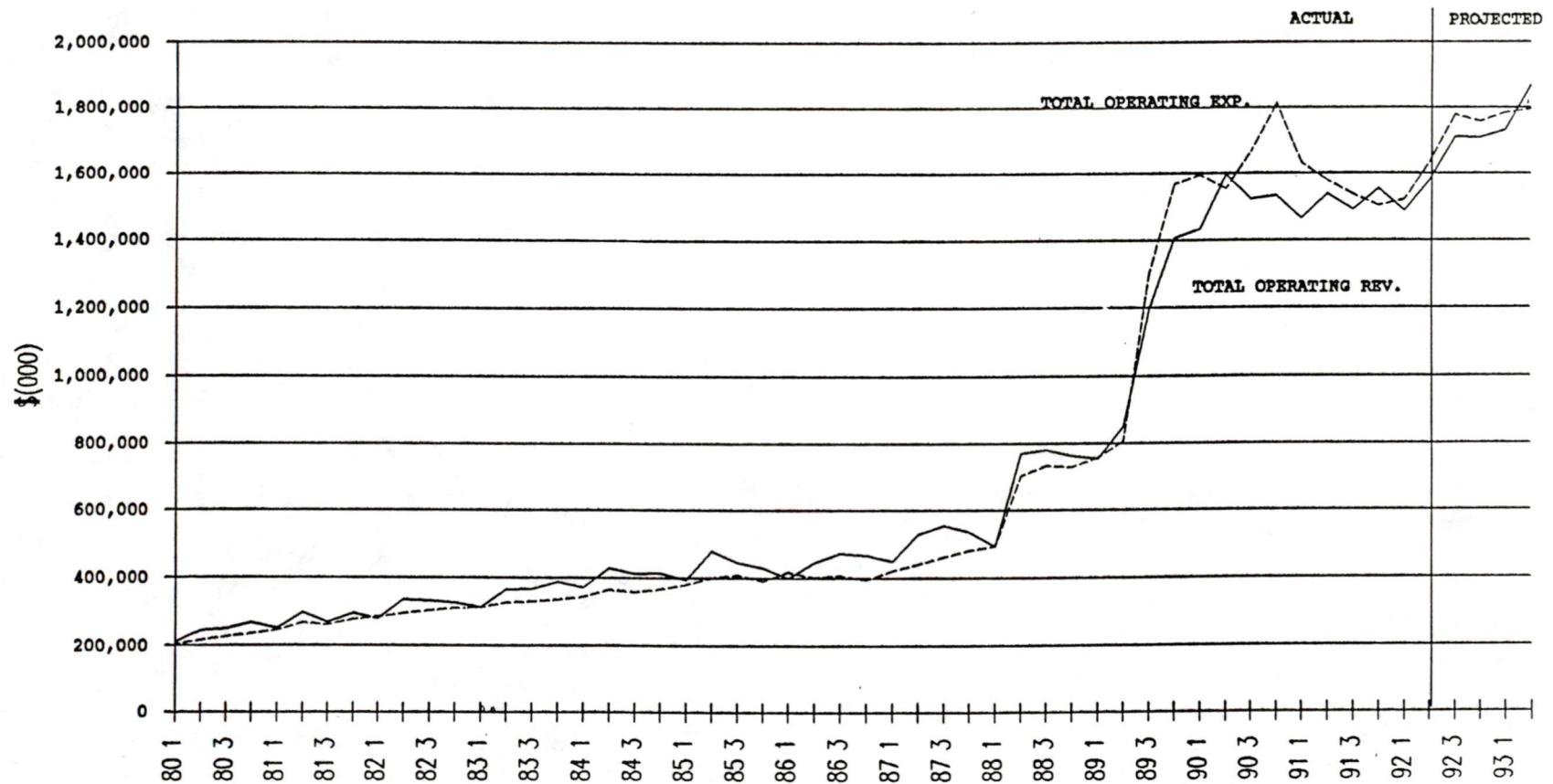


SOURCE: DOT FORM 41 REPORTS

TABLE 13 LIST OF FORECAST ASSUMPTIONS

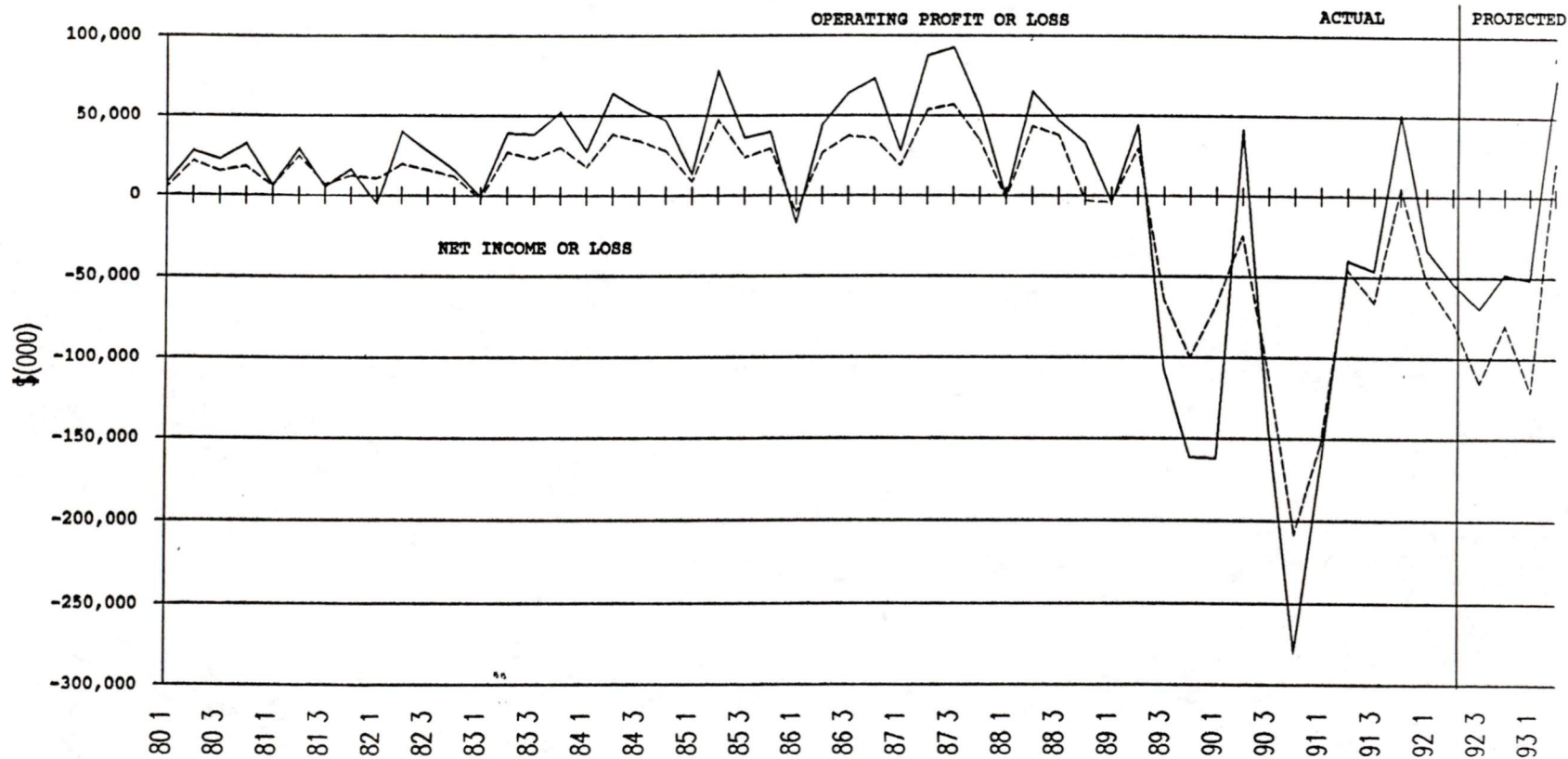
	1992	1993
Inflation Rate	3.20%	3.20%
U.S. GDP Growth Rate	2.00%	3.00%
Traffic Growth Rate-Domestic	6.50%	7.00%
Traffic Growth Rate-Intlernational	27%	30%
Load Factors	58.50%	60%
Fare Increases	5%	5%
Cost Increases (fuel, materials)	4.25%	5%

CHART 14 USAIR'S OPERATING REVENUES AND EXPENSES 1Q80 TO 2Q93



SOURCE: DOT FORM 41 REPORTS

CHART 15 USAIR'S OPERATING PROFIT (LOSS) AND NET INCOME (LOSS) 1Q80 - 2Q93



SOURCE: DOT FORM 41 REPORTS

TABLE 16
 USAIR'S TOTAL OPERATING REVENUES, EXPENSES, AND OPERATING AND NET PROFITS (LOSSES) 1992-1993
 \$(000)
 BEST ESTIMATE

YEAR	TOTAL OP REVENUES	TOTAL OP EXPENSES	OPERATING PROFIT (LOSS)	NET PROFIT (LOSS)	
1992 1Q	\$1,488,178	\$1,521,366	(\$33,188)	(\$53,478)	
1992 2Q	\$1,579,639	\$1,633,170	(\$53,531)	(\$77,573)	ACTUAL
1992 3Q	\$1,709,696	\$1,778,796	(\$69,100)	(\$115,526)	PROJECTED
1992 4Q	\$1,709,300	\$1,757,265	(\$47,965)	(\$79,333)	
TOTAL	\$6,486,813	\$6,690,597	(\$203,784)	(\$325,910)	
1993 1Q	\$1,732,437	\$1,783,811	(\$51,375)	(\$120,871)	
1993 2Q	\$1,868,413	\$1,794,780	\$73,633	\$21,374	
FORECAST	JUNE 92 TO JUNE 93	\$7,019,846	\$7,114,652	(\$94,806)	(\$294,356)
			CASH AVAILABLE 6/30/92		\$211,000
			CASH DEFICIT		(\$83,356)
			ACCUM. DEP + AMORT.		\$280,000
			CASH + DEP + AMORT		\$196,644

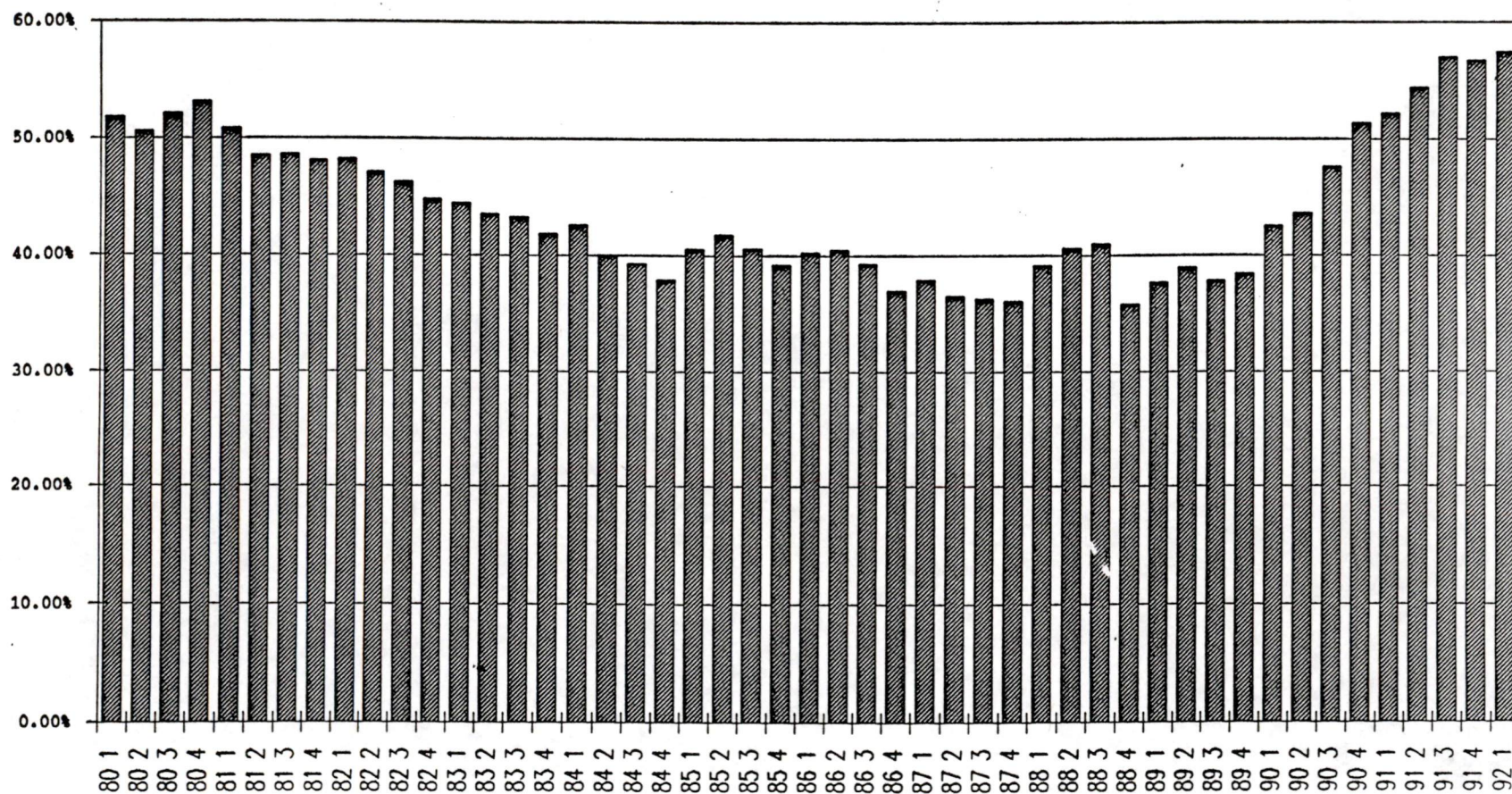
SOURCE: DOT FORM 41 REPORTS

TABLE 17
 USAIR'S TOTAL OPERATING REVENUES, EXPENSES, AND OPERATING AND NET PROFITS (LOSSES) 1992-1993
 \$(000)
 PESSIMISTIC CASE SENARIO

YEAR	TOTAL OP REVENUES	TOTAL OP EXPENSES	OPERATING PROFIT (LOSS)	NET PROFIT (LOSS)	
1992 1Q	\$1,488,178	\$1,521,366	(\$33,188)	(\$53,478)	
1992 2Q	\$1,579,639	\$1,633,170	(\$53,531)	(\$77,573)	ACTUAL
1992 3Q	\$1,621,846	\$1,704,049	(\$82,203)	(\$128,629)	PROJECTED
1992 4Q	\$1,495,166	\$1,575,855	(\$80,689)	(\$112,057)	
TOTAL	\$6,184,829	\$6,434,440	(\$249,611)	(\$371,737)	
1993 1Q	\$1,502,642	\$1,593,207	(\$90,565)	(\$160,061)	
1993 2Q	\$1,517,668	\$1,619,010	(\$101,342)	(\$66,114)	
FORECAST	JUNE 92 TO JUNE 93	\$6,137,322	\$6,492,122	(\$354,799)	(\$466,861)
			CASH AVAILABLE 6/30/92		\$211,000
			CASH DEFICIT		(\$255,861)
			ACCUM. DEP + AMORT.		\$280,000
			CASH + DEP + AMORT		\$24,139

SOURCE: DOT FORM 41 REPORTS

CHART 18 USAIR'S DEBT TO TOTAL ASSETS RATIO 1Q80 TO 1Q92



SOURCE: DOT FORM 41 REPORTS

Table 19
Comparison of Forecasts for USAir's Operating and Net Profit (Loss)
(\$000)

	DOT Policy	Shearson	Salomon	USAir Gp.
3Q 92	Operating Profit (Loss)	(\$69,100)	(\$69,946)	\$21,792
	Net Profit (Loss)	(\$115,526)	(\$88,757)	(\$24,634)
				(\$93,700)
4Q 92	Operating Profit (Loss)	(\$47,965)	(\$2,450)	\$105,998
	Net Profit (Loss)	(\$79,333)	(\$64,400)	\$29,701
				(\$66,600)
CY1992	Operating Profit (Loss)	(\$203,784)	(\$155,652)	\$43,289
	Net Profit (Loss)	(\$325,910)	(\$285,960)	(\$125,714)
				(\$308,300)
1Q 93	Operating Profit (Loss)	(\$51,375)	(\$2,450)	-
	Net Profit (Loss)	(\$120,871)	(\$64,400)	-
				-
2Q 93	Operating Profit (Loss)	\$73,633	(\$10,750)	-
	Net Profit (Loss)	\$21,374	(\$70,600)	-
				-
CY1993	Operating Profit (Loss)	-	-	\$150,342
	Net Profit (Loss)	-	-	(\$59,813)
				(\$47,600)

SOURCES: Public Proceedings Division, Office of Aviation A
Shearson Lehman Brothers, August 5, 1992
Salomon Brothers Inc. July 22, 1992
USAir Group Inc. (Consolidated)

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strained. Some airlines could be forced out altogether, and USAir could be forced to further curtail its operations. However, should this pessimistic scenario prevail, causing some carriers to fail, the remaining carriers would benefit. We note that USAir has a very dominant position in the northeast, which puts it in a better position than perhaps any other carrier to successfully "shrink" to a relatively solid core system, should that be necessitated by a continuing sluggish economy. When the economy does recover and traffic growth resumes, USAir's position in the northeast should allow it to return to profitability, albeit as a smaller airline.