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COMMERCIAL AVIATION

Bankruptcy and Pension Problems Are Symptoms of Underlying Structural Issues

GAO

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Highlights

Highlights of GAO-05-945, a report to congressional committees

Why GAO Did This Study

Since 2001 the U.S. airline industry has lost over $30 billion. Delta, Northwest, United, and US Airways have filed for bankruptcy, the latter two terminating and transferring their pension plans to the Pension Benefit Guaranty Corporation (PBGC). The net claim on PBGC from these terminations was $9.7 billion; plan participants lost $5.3 billion in benefits (in constant 2005 dollars).

Considerable debate has ensued over airlines' use of bankruptcy protection as a means to continue operations. Many in the industry have maintained that airlines' use of this approach is harmful to the industry. This debate has received even sharper focus with pension defaults. Critics argue that by not having to meet their pension obligations, airlines in bankruptcy have an advantage that may encourage other companies to take the same approach.

At the request of the Congress, we have continued to assess the financial condition of the airline industry and focused on the problems of bankruptcy and pension terminations. This report details: (1) the role of bankruptcy in the airline industry, (2) whether bankruptcies are harming the industry, and (3) the effect of airline pension underfunding on employees, airlines, and the PBGC.

DOT and PBGC agreed with this report's conclusions. GAO is making no recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-05-945.

To view the full product, including the scope and methodology, click on the link above.
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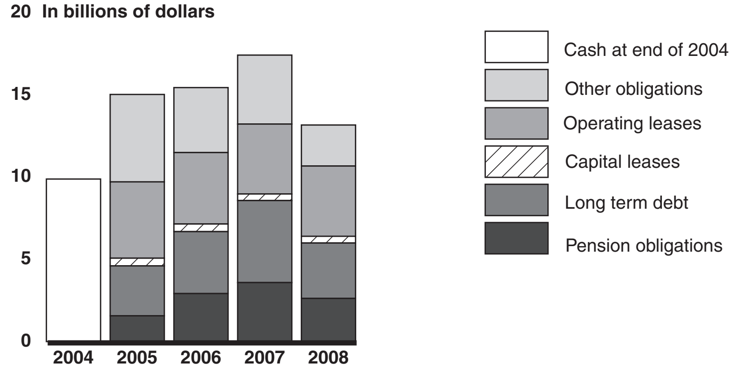
What GAO Found

Bankruptcy is endemic to the airline industry, owing to long-standing structural challenges and weak financial performance in the industry. Structurally, the industry is characterized by high fixed costs, cyclical demand for its services, and intense competition. Consequently, since deregulation in 1978, there have been 162 airline bankruptcy filings, 22 of them in the last five years. Airlines have used bankruptcy in response to liquidity pressures and as a means to restructure their costs. Our analysis of major airline bankruptcies shows mixed results in being able to significantly reduce costs—most but not all airlines were able to do so. However, bankruptcy is not a panacea for airlines. Few have emerged from bankruptcy and are still operating.

There is no clear evidence that airlines in bankruptcy keep capacity in the system that otherwise would have been eliminated, or harm the industry by lowering fares below what other airlines charge. While the liquidation of an airline may reduce capacity in the near-term, capacity returns relatively quickly. In individual markets where a dominant carrier significantly reduces operations, other carriers expand capacity to compensate. Several studies have found that airlines in bankruptcy have not reduced fares and rival airlines were not harmed financially.

The defined benefit pension plans of the remaining airlines with active plans are underfunded by $13.7 billion, raising the potential of more sizeable losses to PBGC and plan participants. These airlines face an estimated $10.4 billion in minimum pension contribution requirements over the next 4 years, significantly more than some of them may be able to afford given their continued operating losses and other fixed obligations (see figure). While spreading these contributions over more years would relieve some of these airlines' liquidity pressures, it does not ensure that they will avoid bankruptcy because it does not fully address other fundamental structural problems, such as other high fixed costs.

Comparison of Legacy Airline Cash Balance with Future Fixed Obligations



Source: PBGC data and SEC 10K filings.