COUNCIL AGENDA: 8/5/08
ITEM: 6.2

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: William E. Sherry, A.A.E.

SUBJECT: Presentation by the Director of Aviation Regarding the Current Status of the Airline Industry

DATE: July 23, 2008

Approved Deanna Santana   Date 7/23/08

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Accept presentation by the San Jose Director of Aviation regarding the current status of the airline industry.

SUMMARY

Attached is the information memo that staff distributed to the City Council on June 23 regarding the current status of the airline industry. Staff is redistributing this memo in advance of the oral presentation by the Director of Aviation to the City Council that is scheduled for the Council's agenda for the August 5 meeting as requested by the Office of the Mayor. Staff also has attached recent correspondence from airlines regarding their proposed actions that could affect service or employment at the Airport.

CEQA

Not a project

William F. Sherry, A.A.E.
Director of Aviation

For additional information, contact William F. Sherry at (408) 501-7600.

SENT TO COUNCIL: Distributed on:

JUN 2 3 2008

by City Manager's Office

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: William E. Sherry, A.A.E

SUBJECT: **Status of Airline Industry and Fuel Cost Increases**

DATE: June 20, 2008

Approved [signature] Date 6/22/08

FOR INFORMATION

Reason for This Memo

The commercial aviation industry is currently going through major economic and financial turmoil primarily driven by the rapidly rising cost of oil. That turmoil is resulting in the loss of flights, capacity, passengers and revenue. The Airport is already experiencing serious budget and fiscal ramifications from the instability of the airline industry. Over the next 2-3 months, Council will be reviewing major policy and budget issues related to the Airport. The purpose of this memo is to provide Council with a broad overview of the current state of the airline industry to provide needed background information for the budget and policy issues that will soon be coming forward.

Summary

An Industry in Crisis

Because of the near doubling in the price of fuel over the past twelve months, the United States commercial aviation industry is facing its worst crisis in its history. Since December 2007, six airlines have filed for bankruptcy and ceased operations. Others have announced plans to ground aircraft, reduce flights and capacity by 10 to 17 percent this year, and lay off thousands of airline employees. Record financial losses are being reported by carriers.

These changes are already being felt at Mineta San José International Airport. Since September 2007, passenger traffic has been lower each month compared to the prior year. SJC passenger traffic in April 2008 fell by ten percent from April 2007, and May 2008 fell by nearly six percent. Airline schedules over the coming quarter show the continuing erosion of service and capacity for San José, and the airport forecasts a drop of at least five to ten percent in passenger traffic in the coming year.

Industry observers are forecasting continuing severe challenges for carriers if the cost of fuel continues to increase. Continuing reductions in capacity, flights, and employees are being predicted, along with the serious possibility of additional bankruptcies in the coming year.

Industry Impacts on the Airport

Aviation activity and passenger traffic drive revenues for the Airport (SJC), which is a self-supporting enterprise of the City of San José. When the Airport originally prepared its budget for the coming fiscal year, it had based its projections on what was then a conservative assumption of passenger growth rate at only one percent, a reduction from prior assumptions of 3.5 percent growth. However, if traffic instead decreases by ten percent in the coming fiscal year 2008-09, the Airport estimates that its revenues will decrease by $7 million to $9 million. This will be a critical challenge at a time when the Airport is building and opening new terminal facilities over the next two years.

Staff is monitoring aviation industry trends closely and is working in partnership with SJC carriers to ensure that the Airport continues to operate safely and prudently within its means. The Airport plans to return to the City Council in September with plans for managing in this fiscally challenging environment for the nation's airports and airlines. This memo presents a current overview of the airline industry condition and its response to rising oil prices. Information presented reflects the major and rapid changes that have occurred within the industry over the past several months. Also attached a report entitled "*Oil Prices and the Looming U.S. Aviation Industry Catastrophe: A Hole In The Transport Grid Industry.*" The June 13, 2008 report was released by the Business Travel Coalition. The report predicts a crisis in the commercial aviation industry (see Attachment A).

Airline Operations: Key Factors

Key cost factors for airlines are fuel, aircraft, and labor. Operating an airline is labor-intensive, and until this year staffing costs generally accounted for more than 40% of an airline's total costs. As fuel costs have steeply increased, however, fuel now is the principal cost center and now is approaching about half of an airline's costs. Unlike other modes of transport, airlines have no alternative source of energy, though newer aircraft have become more fuel efficient.

The terrorist attacks of September 11, 2001, followed by industry recession, security threats, and concerns about epidemic diseases crossing international boundaries have caused a sharp drop in airline passenger traffic. Airlines have responded by cutting less profitable flights, laying off employees, and grounding aircraft. Since 2000 "legacy" carriers (e.g., American, United, Delta, Northwest, etc.) have reduced domestic capacity by 21 percent. This drop was offset, however, by low-cost and regional carriers that increased capacity by 57 and 141 percent, respectively. At San José, this pattern has been reflected with legacy carrier American Airlines dismantling its hub operation at SJC since 2000, reducing flights from approximately 90 to 30 per day, and canceling its international routes here. At the same time, Southwest Airlines, a low-cost carrier, has grown in San José to become the largest operation with nearly 80 daily flights.

Since deregulation in the mid-1970s, airlines are free to negotiate their own operating arrangements with different airports, enter and exit routes easily, and to set fares and flight volumes according to market conditions. However, this deregulated environment has had a significant impact on airports that now must compete for new flights and become more responsive to airline costs and industry volatility.

The Price of Oil: Key Factors

Oil provides 40 percent of U.S. energy needs, and 100 percent of the fuel source airlines use to fly their aircraft. Many factors determine the price of oil, but primary factors are supply and demand. Although short-term demand typically does not fluctuate unpredictably, long-term demand around the world is growing as developing nations industrialize and modernize. Supply can be volatile for number of reasons, including:

- bad weather that can affect shipping and refining;
- acts or threats of terrorism or war that can impact pipelines or production facilities;
- production policy changes by oil-producing nations;
- general economic conditions nationally and globally; and
- financial and market speculation.

All these factors are beyond the control of airlines or travelers.

There have been few new discoveries of oil in recent years; there is greater global demand for oil, especially from large emerging Asian economies, and China is now one of the world's largest importers of oil after the United States. The weak U.S. dollar also contributes to the trend of skyrocketing prices in the United States.

Recently the price of oil has reached nearly $140 per barrel, and continues to hit new record highs almost every week. This price compares to $60 per barrel in early 2007 (see Figure 1 below). The cost of fuel has radically changed the business environment for all airlines, especially in the U.S where jet fuel costs have tripled in the past five years. New Goldman Sachs predictions foresee oil prices could rise to $150 to $200 within two years. Not everyone, however, shares Goldman's view. Analysts at Citigroup, Inc, countered Goldman's analysis with

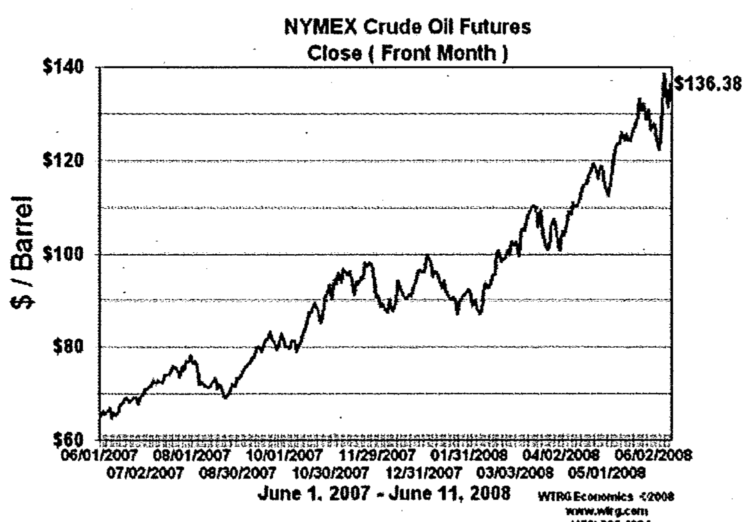


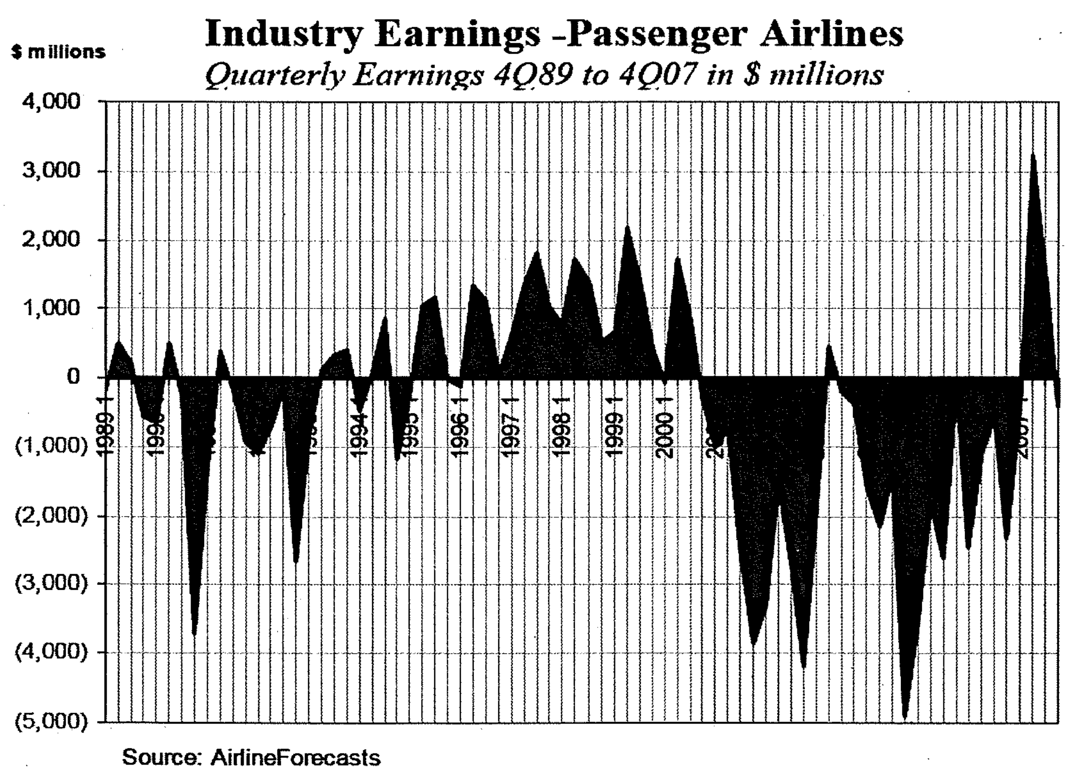
Figure 1

note predicting that crude prices could as easily fall to $40 a barrel as rise to $200. In May 2008 a monthly report, the Energy Department's Energy Information Administration predicted oil prices will average $110 a barrel this year. (USA Today, May 5, 2008)

Airline Industry Responses to Rising Fuel Costs

Just six months ago, US legacy carriers started reporting profits for the first time since 2001 (see Figure 2). At the same time, the price of oil started its growing trend. In response to unprecedented high fuel costs since the beginning of 2008, the airline industry has been taking

Figure 2



actions to raise fares and increase revenues, reduce capacity, and reduce costs. Below are examples of actions and trends, as reported in the media, airlines are taking to reduce costs and services and to increase revenues:

Financial Losses: First quarter 2008 results show significant industry losses. Delta Air Lines and Northwest Airlines posted losses totaling $10.5 billion because of the fuel prices and write-downs of their companies' values. US Airways reported loss of $239 million, with Alaska Air reporting a loss of $35.9 million. The International Air Transportation Association, an industry advocacy organization, lowered its industry profit expectations in April for the second time in four months.

Bankruptcies: Since December 2007 six airlines, including Aloha, ATA, and Skybus, have filed for bankruptcy and ceased operations. Frontier Airlines filed for bankruptcy but has remained in service.

Mergers: In April Delta and Northwest announced their plan to merge, subject to Government approval, to obtain system wide efficiencies and reduce redundant flights. United Airlines has been seeking potential merger partners, though so far without success.

Reducing capacity by parking planes: American Airlines will cut its domestic capacity by at least 11 percent after the peak summer travel season and it plans to retire approximately 50 planes. Its American Eagle affiliate also will retire another 30 to 35 jets. United Airlines plans to remove 100 aircraft, cutting its domestic and international capacity by approximately 17 percent. Delta will make further domestic capacity cuts, in addition to its previously announced 10 percent reduction, and will park 15-20 mainline aircraft and 20-25 regional jets. Continental plans to cut its domestic capacity at least five percent this fall. Northwest will reduce its domestic flying beginning in September by five percent more than initially planned and has said further domestic capacity reductions are likely. US Airways will trim its capacity two to four percent in the second half of the year and also will replace older aircraft.

Layoffs: Since May 30, carriers have announced that they will cut nearly 10,000 airline jobs. Continental Airlines plans to cut 3,000 jobs, representing about 6.5 percent of the company's workforce. United Airlines, the nation's second largest carrier, announced this month it would cut up to 1,100 jobs. American Airlines says it would cut thousands of jobs, though it has not announced an exact figure.

Raising fares, new fees, and reduced customer service: American and United are now charging for all checked baggage. Airlines have increased a wide range of transaction fees such as charging fees for making booking changes. Many amenities for passengers, such as food and beverage service, in-flight earphones, and similar services are no longer free or even available on many carriers.

New services: Unlike other major carriers, Southwest has been carefully adding flights, including here at SJC. In recognition of the uncertain future, however, Southwest also has delayed taking delivery of new 737s. Southwest continues to benefit from its financial agreements years ago to lock in fuel prices at a stable level. It has enabled the company to keep its fuel costs substantially lower than current market prices and lower than their competitors. Southwest will pay $51 a barrel for most of its oil consumed in 2007.

The Future of the Commercial Aviation Industry

In reaction to a sagging economy and higher prices for travel, passenger traffic is likely to slip in the near future. According to IATA, global passenger numbers grew by a seemingly healthy four percent in the first four months of the year, but that is less than the 6.7 percent increase in the same period a year ago. In addition, fewer business and first-class flyers are taking to the air; these numbers fell by 3.9 percent worldwide in March compared with a year before, and by 8.5 percent in North America.

The Business Travel Coalition in the Report (June, 2008) provide implications of different price levels of crude oil. Table bellow summarizes this data.

Fuel Cost Impact on Jobs, Fares & Capacity
(systemwide for 40 passenger-only airlines)

Oil price	Jet fuel Costs	Industry Fuel costs	Increase in Fuel costs	Per passenger req'd price incr	req'd price incr	Loss of Jobs	Reduction in Capacity
$/bbl	*$/gal*	*($millions)*	*($millions)*	*($)*	*(percentage)*		
100	3.1	51,375	17,481	24	13%	44,300	11%
110	3.3	55,327	21,433	29	16%	54,315	13%
120	3.6	59,279	25,385	34	18%	64,329	15%
130	**3.8**	**63,231**	**29,337**	**40**	**21%**	**74,344**	**18%**
140	**4.0**	**67,183**	**33,289**	**45**	**24%**	**84,359**	**20%**
150	4.3	71,135	37,241	50	27%	94,374	23%
170	4.8	79,039	45,145	61	33%	114,403	28%
200	5.5	90,894	57,000	77	41%	144,448	35%

Per passenger price is based on revenue per enplaned passenger
Loss of jobs and capacity is based on estimated price elasticity of demand
The increase in fuel costs do not include fuel hedge benefits and is relative to 2007
Source: AirlineForecasts

The more airlines cut costs, reduce the quantity and quality of their services, raise fares and add new charges, the more these changes will discourage travelers who are resistant to higher prices – both leisure travelers and businesses. Weaker airlines might go bankrupt. Those who survive will probably raise fares. Such scenarios will highly impact airports and all related businesses.

Impact on Domestic and Smaller Airports

Due to a weakening dollar, over capacity, and aggressive competition, domestic carriers are far more vulnerable to higher oil prices than their overseas competitors. A declining U.S domestic market will consequently affect domestic airports as bankruptcies, mergers, and service reductions directly and negatively affect passenger traffic and revenues for airports. A decline in passenger traffic negatively affects on-site businesses, which in turn reduces airport revenue from concessions and rents, as well from parking.

Smaller airports will take the biggest hit as airlines reduce capacity by eliminating smaller aircraft that are less profitable in the face of costly fuel. Small regional jets serving smaller cities and airports cannot make a profit with fuel twice as expensive as last year, and larger aircraft cannot be supported by the market. Smaller airports are already facing difficult decisions; for example Reno-Tahoe International Airport, where passenger traffic dropped by 10 percent in March and 13 percent in April, has already frozen all jobs not related to safety and security and announced layoffs of eleven part-time passenger aides. Major hubs, such as San Francisco, have seen growth in flights because of competition among the airlines, new international carriers launching service, and the SFO's stronger industry visibility compared to either Oakland or San José. However, over the long term, given the state of the industry and the current trends, even larger hub airports, like SFO, will not be able to sustain growth in flights but rather will simply be the last group of airports to experience the impact of industry trends and actions.

Like other airports, SJC is subject to the same economic pressures from declining passengers and reduced flights. Traffic at SJC has declined over twelve months by 2.1 percent. The Official Airport Guide schedule forecast indicates that San José flights will decrease by about six percent by this October. For Oakland this number is even higher. However, as the travel market weakens and more flights are removed, traffic loss may equal or exceed capacity loss, which will have direct impact on Airport revenue.

SJC Strategy to Deal with the Industry Crisis

Staff is monitoring aviation industry trends very closely and is working in partnership with SJC carriers to ensure that the Airport continues to operate safely and prudently. Understanding that oil prices are beyond the control of the Airport, staff is reviewing expenditure plans, revenue estimates, and other various strategies that might help manage the negative impacts of the airline industry crisis.

Airport staff not only continues to focus on keeping its fees as low as possible and improving SJC's competitiveness for its travelers and carriers. Last month, San José International became the first Bay Area Airport to provide free, high quality WiFi at the Airport. In June, Council approved a revised air service fee-waiver incentive program to encourage the development of new and enhanced air service. Finally, the comprehensive modernization program under construction now will result in a much more efficient, comfortable, and convenient airport for passengers and carriers as new facilities come into service over the next two and a half years.

Despite proactive efforts to manage the Airport and its budget during this period of extreme industry uncertainty, SJC and most of the nation's airports are very vulnerable to the airline crisis. If negative trends continue, and traffic indeed decreases by ten percent in the coming fiscal year 2008-09, the Airport estimates decrease in its annual revenues of $7 million to $9 million. This is a critical challenge at a time when the Airport is building and opening new terminal facilities over the next two years. To navigate the current volatile industry environment, the Airport will continue to do as it has done in the past decade: manage to budget, continue to seek innovations and efficiencies, and work in productive partnership with its tenant carriers.

William F. Sherry, A.A.E.
Director of Aviation

For additional information, contact William F. Sherry at (408) 501-7600.

Attachment A: "*Oil Prices and the Looming U.S. Aviation Industry Catastrophe: A Hole In The Transport Grid Industry*" – Business Travel Coalition, June 13, 2008

Oil Prices and the Looming U.S. Aviation Industry Catastrophe:

A Hole In The Transport Grid

Published by Business Travel Coalition and AirlineForecasts, LLC – June 13, 2008

Kevin Mitchell (BTC) – 610.341.1850

Vaughn Cordle (AirlineForecasts, LLC) 703.830.1701

At Risk

While economic theory suggests higher and unsustainable fuels costs will lead to a smaller industry, it does not necessarily follow that the industry will reach its smaller size before collapsing along the way under the weight of higher fuel prices.

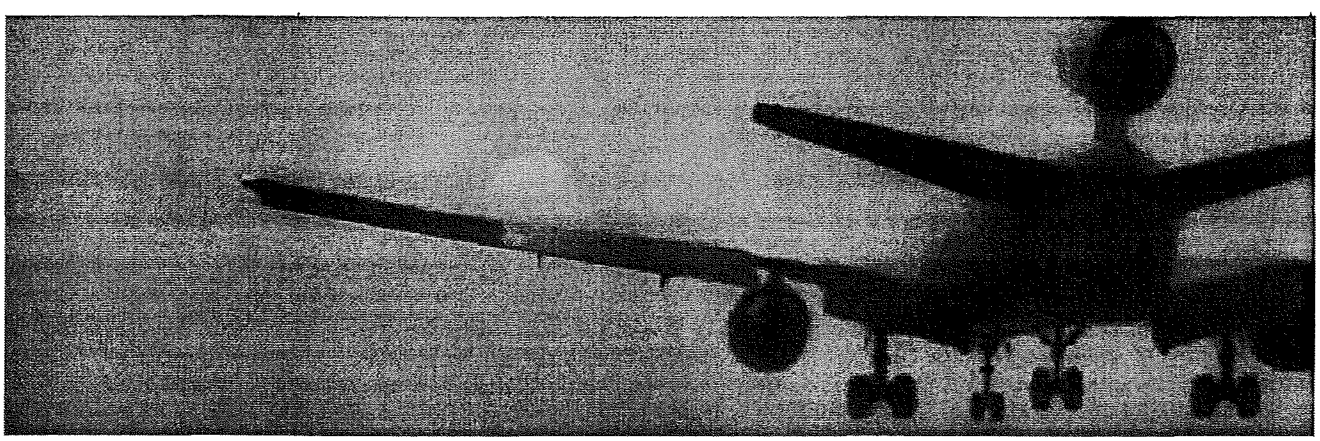
INTRODUCTION

As a consequence of the skyrocketing price of oil, the U.S. commercial aviation industry is in full-blown crisis and heading toward a catastrophe.

In the hopes of bringing attention to the magnitude of the oil crises, Business Travel Coalition (BTC) commissioned AirlineForecasts, LLC to provide an analysis of what oil at several different price points means in terms of lost airline jobs, reduced seat capacity and increased fare levels.

AirlineForecasts concludes that if oil prices stay anywhere near $130/barrel, all major legacy airlines will be in default on various debt covenants by the end of 2008 or early 2009. The implication is that several large and small airlines will ultimately end up in bankruptcy, and of those, some will be forced to liquidate.

While economic theory suggests higher and unsustainable fuels costs will lead to a smaller industry, it does not necessarily follow that the industry will reach its smaller size before collapsing along the way under the weight of higher fuel prices.

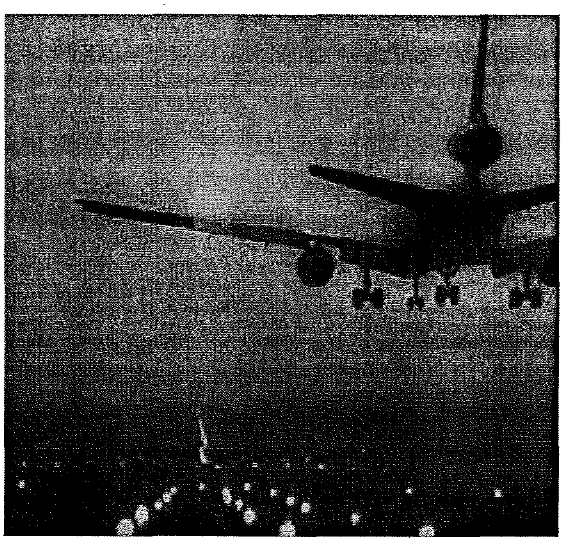


A Consequence

With oil prices in the $135 range, the airline industry could be forced to park upwards of 1,000 aircraft and shed over 80,000 employees, and still not return to health.

Every $10 increase in the price of oil results in $4 billion in additional costs for the 40 passenger-only airlines. Oil prices have spiked to $135/barrel from last year's $72/barrel average. With oil prices in the $135 range, the airline industry could be forced to park upwards of 1,000 aircraft and shed over 80,000 employees, and still not return to health. The consequences will be devastating to U.S. jobs, families, businesses, communities and our American way of life.

The U.S. airlines, and those who depend upon them, are watching with growing alarm as their cash reserves fall precipitously toward zero as the price of oil, already at unsustainable levels,



continuously spikes into uncharted territory. These airlines and their stakeholders have never faced a darker future.

With airlines gravely threatened, so is our economic well-being in the United States. Airlines are the primary source for inter-city transportation and are critical to national and local economic development, the flow of human capital, the movement of just-in-time parts for manufacturing and the transport of perishable food and other goods our economy depends upon.

The democratization of air travel and freedom of movement we have come to take for granted in the past thirty years are disappearing before our eyes, while the sad prospect of airlines once again providing transport only for the wealthy is coming into view – a view recently articulated by Herb Kelleher, the visionary founder and former chairman of discount carrier Southwest Airlines.

Stabilizing this ailing industry must become a national policy priority. Many Members of Congress, federal regulatory officials, state legislators and Governors have yet to fully appreciate the devastating impact an oil-crippled airline industry will wreak on our culture and our national and local economies.

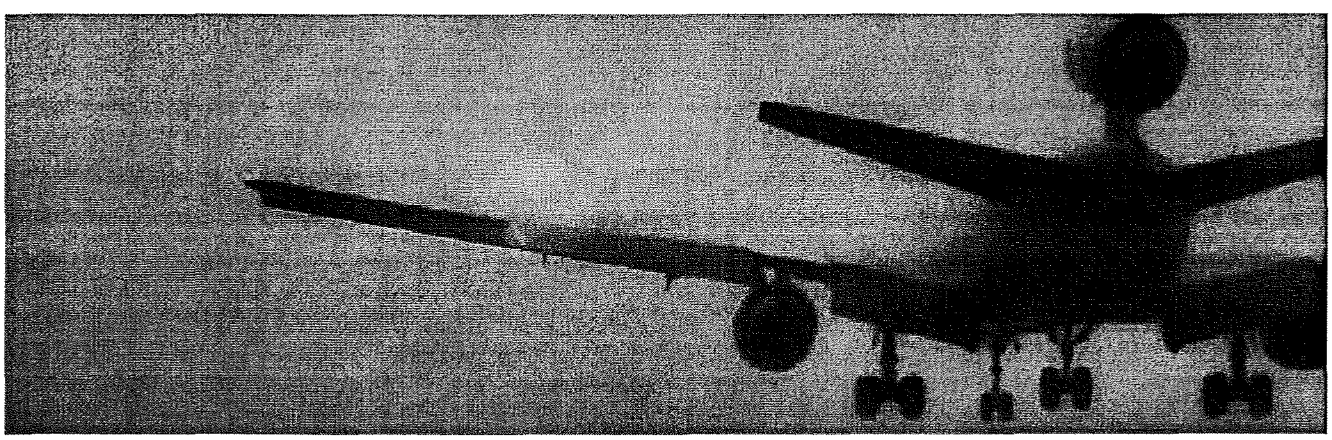
There are many serious problems facing the airline industry, some self-inflicted and others beyond its control. These problems need to be addressed in the fullness of time by policymakers. However, skyrocketing fuel prices is the immediate, heart-stopping crisis that threatens the very existence of this industry, one which is as vital as the electrical power grid. It's a looming catastrophe that deserves urgent attention.

QUANTITATIVE ANALYSIS

Based on analysis by AirlineForecasts, most airlines will be in violation of minimum fixed charge coverage ratios or/and minimum cash balances with lenders by the end of this year, given $130 plus oil. This situation would drive multiple carriers into bankruptcy.

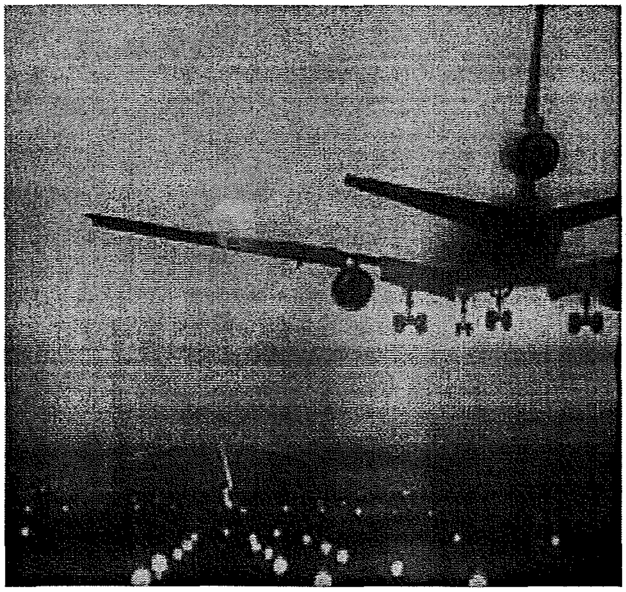
Findings include:

- The top 10 U.S. airlines will spend almost $25 billion in higher fuel costs this year over last year when jet fuel averaged $2.11 per gallon. Fuel hedge benefits could offset $5 to $6 billion of the increased fuel costs.
- Earnings for the group, when one-time reorganization charges are removed, were less than $4 billion in 2007. The group could lose as much as $9 billion over the next 12 months if the current range of oil prices holds.
- Industry fares will have to increase at least 20% - across the board and on average - just to cover the dramatic gap-up in fuel costs from 2007. This is not possible given the level of uneconomic seat capacity in the system today.
- The upshot of higher fares is less traffic, and given a reasonable estimate of price elasticity, the industry will eventually be forced to shrink its seat capacity by 15% to 20%. However, there is no guarantee that a transition to a smaller, more expensive (for the consumer) airline industry would be successful and sustainable.
- Airlines have the ability to raise some cash, and moreover, suppliers such as aircraft manufacturers, leasing companies and travel management companies will have an incentive to support large airlines that provide a stream of value. Nevertheless, without a swift reduction in the price of fuel, the industry is headed toward a massive failure that will result in more bankruptcies, including liquidations.



The Burden

The airlines are on pace to spend $30 billion more on jet fuel in 2008 versus 2007.



The impact of sky-high oil prices at $130 to $140 levels could result in the loss of 75,000 to 85,000 direct airline industry jobs, many of which are high-paying, including 11,500 pilot positions. To cover oil prices at these levels, fares would have to go up 21% to 24% and airline seat capacity reduced by 18% to 20%. Were oil to climb toward $200, as some analysts predict, the damage escalates and the airline industry could be forced to shrink 35% or more.

The airlines are on pace to spend $30 billion more on jet fuel in 2008 versus 2007. At best, and based upon the past four-year top-line revenue increases, the airline industry will be able to generate only $3 billion in fare increases to offset this higher cost. What's more, all the extra-bag charges and other fees implemented by airlines recently will only yield $1 to $1.5 billion at the industry level. Airlines can attempt to radically shrink capacity, but given the competitive situation they face, it's highly unlikely that they will have the ability to reduce capacity to levels that will allow them earn a normal, risk-adjusted rate of return. Instead, absent direct policy intervention, the likelihood is that there will be more bankruptcies, including some liquidations.

Fuel Cost Impact on Jobs, Fares & Capacity

(systemwide for 40 passenger-only airlines)

Oil price	Jet fuel Costs	Industry Fuel costs	Increase in Fuel costs	Per passenger req'd price incr	req'd price incr	Loss of Jobs	Reduction in Capacity
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The increase in fuel costs do not include fuel hedge benefits and is relative to 2007

Source: AirlineForecasts

Note: The following earnings estimates are nothing more than a snapshot based on current assumptions. The tables are for illustrative purposes only to assess the status quo scenario.

2008 Earnings: $9 billion in Pre-Tax losses

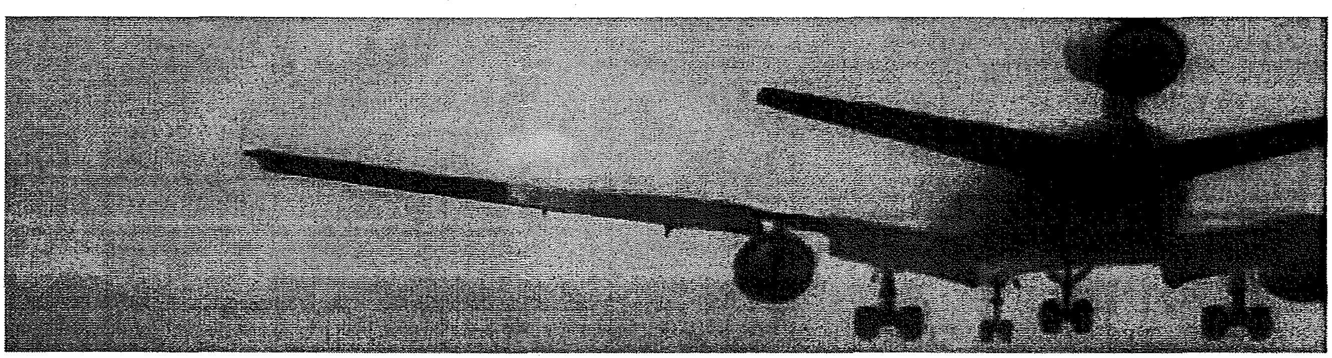
		Total Revenue ($millions)	Operating Earnings ($millions)	Operating Margins	Pre-Tax Earnings ($millions)	Pre-Tax Margins
1	Southwest	11,025	421	3.8%	313	2.8%
2	Alaska	3,690	(130)	-3.5%	(163)	-4.4%
3	Delta	20,900	(769)	-3.7%	(1,266)	-6.1%
4	Northwest	13,700	(684)	-5.0%	(997)	-7.3%
5	AirTran	2,650	(155)	-5.8%	(207)	-7.8%
6	JetBlue	3,400	(129)	-3.8%	(277)	-8.2%
7	United *	21,000	(1,896)	-9.0%	(1,946)	-9.3%
8	US Airways	12,780	(1,224)	-9.6%	(1,269)	-9.9%
9	Continental	15,300	(1,427)	-9.3%	(1,597)	-10.4%
10	American	20,239	(1,862)	-9.2%	(2,229)	-11.0%
	Top 10	**124,684**	**$ (7,854)**	**-6.3%**	**$ (9,638)**	**-7.7%**

Earnings estimates based on $133 oil
* United's estimates are an average of several sell-side analysts
Source: AirlineForecasts

2009 Earnings: $8 billion in losses

		Total Revenue ($millions)	Operating Earnings ($millions)	Operating Margins	Pre-Tax Earnings ($millions)	Pre-Tax Margins
1	Southwest	12,024	518	4.3%	395	3.3%
2	Delta	21,000	(540)	-2.6%	(1,059)	-5.0%
3	Northwest	14,130	(397)	-2.8%	(799)	-5.7%
4	United *	21,450	(1,161)	-5.4%	(1,431)	-6.7%
5	American	24,400	(1,019)	-4.2%	(1,651)	-6.8%
6	Alaska	3,700	(245)	-6.6%	(304)	-8.2%
7	Continental	15,600	(925)	-5.9%	(1,327)	-8.5%
8	Jetblue	3,435	(119)	-3.5%	(293)	-8.5%
9	AirTran	2,650	(208)	-7.8%	(255)	-9.6%
10	US Airways	12,200	(1,065)	-8.7%	(1,263)	-10.4%
	Top 10	**130,589**	**$ (5,162)**	**-4.0%**	**$ (7,988)**	**-6.1%**

Earnings estimates based on $132 oil
* United's estimates are an average of several sell-side analysts
Source: AirlineForecasts

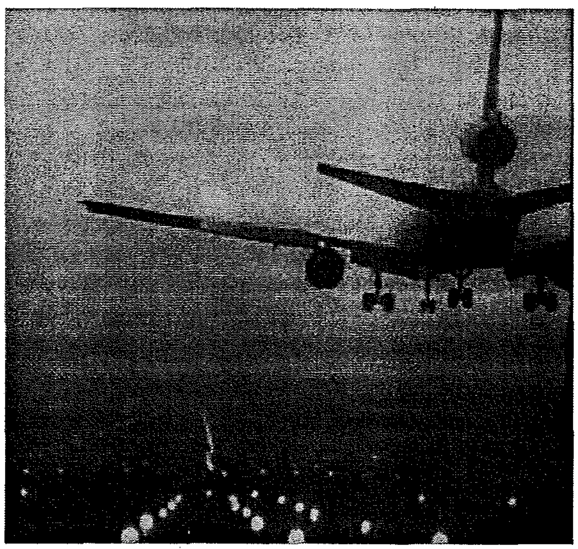


No Break

The industry only had one year of profitability...to begin the balance sheet repair work before it was plunged into deep losses again in 2008.

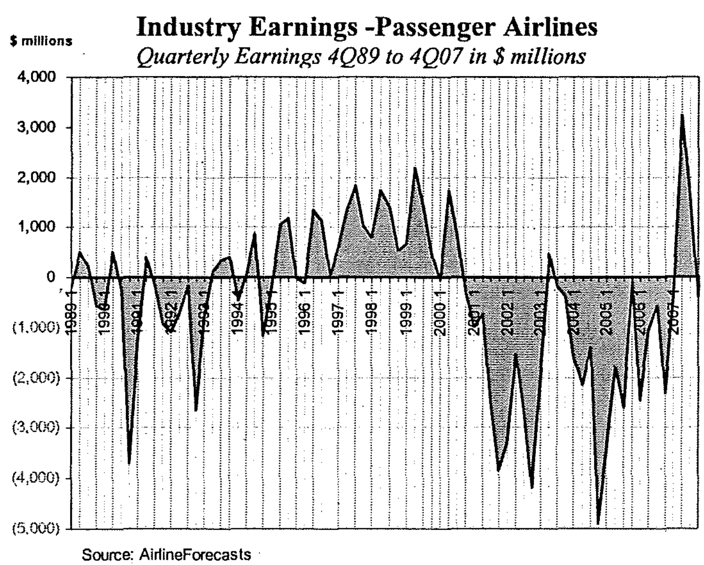
HISTORICAL CONTEXT

To fully grasp the gravity of the current situation, it's useful to reference some historic context. During the airline industry cyclical downturn in the early 1990s, the industry lost a cumulative $12 billion between the fourth quarter of 1990 and the first quarter of 1993. What followed were 6 years of profits sufficient for airlines to repair damaged balance sheets. (US Airways even repurchased $2 billion of its stock.)



The most recent downturn in 2000 lasted until 2006 and reported net losses were over $44 billion. The industry only had one year of profitability, in 2007, at less than $4 billion, to begin the balance sheet repair work before it was plunged into deep losses again in 2008. Importantly, during this most recent downturn, significant costs were taken out of the industry, and for many airlines, virtually all assets were mortgaged. Most airlines have little flexibility now as they face both a slowing economy and record-setting jet fuel prices.

Airlines have been able to generate top-line revenue improvements averaging only $2.7 billion in each of the past 4 years on a $122 billion total [average] revenue base. The top ten airlines need to raise fares 20%, or $24 billion at least, but cannot. The pharmaceutical industry recently imposed an across-the-board price increase of 20% to its customers (large industrial companies) to cover increased direct and indirect energy costs. However, 60% to 70% of airline customers, namely leisure travelers, spend money on airlines as a discretionary matter; they are very price sensitive.



CONCLUSION

As the price of fuel skyrockets, the U.S. airline industry stands on a ledge, staring into an abyss. Before time runs out on the nation's air carriers, policymakers must adopt new energy policy priorities with great purpose and haste.

The trend lines cannot be ignored. Fuel has become the number one expense for U.S. carriers, siphoning off 40 cents or more of every dollar of revenue, and rising. The price of oil has nearly doubled in the last several months to over $130/barrel, and carriers are unlikely to be able to raise airfares or cut capacity sufficiently to adapt their operations to this reality. Instead, as AirlineForecasts' analysis shows, the U.S. airline industry, as we know it, cannot survive at existing fuel price levels, and certainly not at the higher levels some analysts are predicting for this summer and beyond.

Brand name legacy carriers that we and American communities from coast-to-coast have depended upon for decades to provide us with affordable, frequent air service are running out of cash, and therefore, toward a date with bankruptcy, and even liquidation. The consequences of the hole this will leave in our nation's transportation grid will be extremely profound for our economy, society and culture.

A catastrophic result for U.S. airlines can be averted if policymakers, particularly in the White House and Congress, step up purposefully to address this monumental challenge. There is still time to make a difference. This is important not only for airlines and their passengers, but also for every business that uses oil products.

In the weeks ahead, BTC will work with its allies to bring forward to Congress and the Administration some specific proposals that will help address the near and long-term implications of the aviation fuel crisis.

We urgently need a new energy policy that will give the airlines a fighting chance to survive and recover -- and serve all members of the traveling public for many years to come.

...

From: Franklin, Melinda [SFOGV] [melinda.franklin@united.com]

Sent: Thursday, June 19, 2008 10:48 AM

To: Sherry, Bill; Webb, Jim

Cc: Hunt, Korbey [SEAOU]; Cedervall, Paul [SJCOZ]

Subject: Discontinuation of Service from SJC-IAD

Hi Bill and Jim,

Just wanted to inform you of the below announcement. As you know, it is extremely costly for us to operate at SJC (with living wage and other issues, it's only getting worse).

United will discontinue nonstop service between Washington Dulles and San Jose, CA effective September 2, 2008. This market is currently flown once daily using A319 equipment.

This change will appear in Apollo on Saturday, June 21.

Best regards,
Melinda

Melinda Yee Franklin
Government and Public Affairs, Western Region

United Airlines - SFOGV
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Vice President
Corporate Real Estate

(817) 967-1284
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cc: - Airport Senior Staff
- City Manager, ACM, DCM
FYI

June 3, 2008

Mr. William Sherry
Director of Aviation
San Jose International Airport
1732 N. First St.
Suite 600
San Jose, CA 95112-4538

Dear Bill:

I am writing to you regarding the startling downturn in the U.S. airline industry. American Airlines and all other domestic airlines are being severely impacted by the unprecedented rise in fuel costs. The six legacy airlines had a combined loss in the first quarter of $1.7 billion, and all ten of the largest U.S. airlines had operating losses. Eight airlines have filed for bankruptcy protection this year, including five that have ceased operations.

For those of us at the airlines, the current situation is particularly distressing because we have worked so hard post 9/11 to reduce all costs within our control. Unfortunately, high fuel prices have offset all of these savings and more. In the first quarter of 2008 alone, American paid $665 million more for fuel than it did in the first quarter of 2007. If the average price of a gallon of jet fuel is $3.05 in 2008, all U.S. passenger and cargo airlines will pay **$18.3 billion** more for jet fuel in 2008 than in 2007. Currently, jet fuel is hovering around $3.90 per gallon.

Almost all domestic airlines are reacting to the fuel situation by reducing domestic capacity. American announced in May that our fourth quarter domestic mainline capacity would be 11 percent to 12 percent lower than in 2007. Our Eagle affiliate announced a 10 percent to 11 percent reduction in year-over-year fourth quarter capacity. With reduced flying, we expect to retire 40 to 45 mainline jet aircraft, 30 to 45 regional jets and additional turbo-prop aircraft. Unfortunately, such reductions also will lead to workforce reductions and facility closures or consolidation. As our CEO, Gerard Arpey, has said, "The airline industry as it is constituted today was not built to withstand oil prices at $125 a barrel..."

Because of the rate-setting methodology at most airports, reduced operations mean costs must be spread over less landed weight, potentially raising rates. With less capacity, fewer passengers park, rent cars and buy products from your concessionaires. This raises airlines' costs further – just when we can least afford such cost increases.

Having read this far, I am sure you can predict where this letter is heading – another desperate plea by an airline for rate relief. And I am sure you are rightfully thinking that there is nothing SJC can do that will fix (or even put a major dent in) the airlines' fuel problem. Finally, you are probably thinking that despite the airline industry's problems, you have facilities to maintain, aging infrastructure to replace or refurbish and projected passenger growth to accommodate.

I would agree with you that your airport alone cannot fix the overall problem, but I do believe that every little bit helps and that it is only through a series of steps, both big and small, that the airline industry can survive. As my esteemed colleague Bob Montgomery from Southwest often says, "If you watch the pennies, the dollars will follow."

As for the needs of San Jose Airport, I also agree these issues must be addressed. However, given the severity of the entire airline industry's struggles, the future shape of the airline industry is highly uncertain and passenger growth likewise uncertain. Therefore, we would urge you to consider, as we know you will, deferring capital projects that are not immediately operationally essential or do not promise a return on investment within two years. For those capital projects that are urgently necessary, ensure they are designed flexibly, so the project can be scaled - up or down - as the future becomes clearer. We would also ask that, as you did post 9/11, you carefully review all aspects of your operation for opportunities to increase efficiency, reduce costs, and increase non-airline revenues. And if at all possible, we would urge you to consider lowering reserves and using airport discretionary income to lower airline rates and charges as we struggle to weather the latest financial storm.

In closing, I want to say how much we appreciate the many steps all of our airport partners have taken since 9/11 to help American and the other airlines. The airports' help was essential in bringing us through that crisis. Your help will again be essential in helping us through this current crisis. We look forward to the day when the U.S. has a stable, profitable airline industry. We remain committed to working with you as we all strive to reach that end.

Very truly yours,

Laura Einspanier
Vice President – Corporate Real Estate

cc: Bob Montgomery, Southwest Airlines

jetBlue
AIRWAYS.

Scn. on staff

May 19, 2008

Mr. William Sherry
Director of Aviation
San Jose International Airport
1732 N. First Street
Suite 600
San Jose, CA 95112

Dear Bill,

As you know from daily news reports and monitoring your airport's overall budget, energy costs continue to soar at an unprecedented rate, with crude oil reaching a high last week of more than $126/barrel. Set against the backdrop of the softening economy, led by the credit crisis and alarming dollar decline, the U.S. airline industry has announced significant losses or declines in the first quarter. Within the past month, five airlines have filed for bankruptcy protection, and four of those have actually shut down operations. No one yet knows where the bottom of this downward economic cycle will take the industry.

It is within this context that we write to you requesting your assistance as our Business Partner in (Airport) to implement the following:

1) Postponement of discretionary Capital investment that will lead to rate base increases.
2) Top to bottom review of existing operating and maintenance expenses that can be decreased or eliminated.
3) Utilization of non-airline revenues to offset airline rates and charges.
4) Partner with JetBlue Airways on other creative ways to offset and reduce our airport costs.

Air Transport Association President and CEO Jim May has said that soaring fuel prices are "the worst economic shock since 9/11, and, possibly, one that is worse." Just as we got through the post-9/11 storm, JetBlue will get through this downturn, but we need your help.

JetBlue's Corporate Real Estate Properties team will be reaching out to you directly to personally meet and discuss any and all opportunities to partner with you so we might be able to continue the partnership in the years to come.

Very Best Regards

George Sauer
Vice President – Corporate Real Estate

Jim Smith
Director of Properties - CRE

JetBlue Airways Corporation 118-29 Queens Blvd., Forest Hills, NY 11375 Tel (718) 286-7900 Fax (718) 709-3602
To Fly: www.jetblue.com or 1(800) JETBLUE

July 7, 2008

Delivered via E-mail

The Honorable Chuck R. Reed
Mayor, City of San Jose, California
Office of the Mayor and City Council
200 East Santa Clara Street
San Jose, CA 95113

RE: Worker Adjustment and Retraining Notification (WARN) Act Notice

Dear Mayor Reed:

As you know, American Airlines and the airline industry continue to suffer losses due to the challenges with which our airline is contending. Soaring fuel costs combined with a weakening economy require that we review every aspect of our network and service infrastructure.

It is quite clear that we can no longer operate our airline at its current levels. This reality has forced us to make some very tough, but immediate decisions to secure American's future. We must quickly reduce our operating schedule for the coming months and, as a result, will need fewer people to operate the airline.

We are sending you this letter to comply with the Federal Worker Adjustment and Retraining Notification Act ("WARN"). This letter is to inform you that we will affect the employment of a number of American Airlines employees in San Jose, California on or around September 5, 2008. In accordance with this reduction, we expect a total employment loss of approximately 25 employees. Below is a breakdown of the job classifications and number of employees in each classification that may suffer an "employment loss" as defined by WARN:

1	Management
1	Support Staff
7	Airport Agents
16	Fleet Service and Crew Chiefs

The San Jose International Airport (SFO) facility is located at the following address:

American Airlines, Inc.
2077 Airport Blvd.
Terminal A
San Jose, California 95110

American Airlines Fleet Service/Crew Chief employees are represented by the following labor union:

> Transport Workers Union of America, AFL-CIO
> Air Transport Division
> James C. Little, Director
> 1791 Hurstview Dr.
> Hurst, TX 76054

Involuntary reductions in force will be governed by the terms of the collective bargaining agreements (if applicable) and corporate policy, including the seniority lists and any provisions regarding "bumping rights." We expect that these job reductions will be permanent.

This is all of the information we have at this time. If you have any questions, please contact Tiffany Schildge, Manager- Talent Services, at (817)963-7684.

Sincerely,

Kevin E. Cox

Kevin Cox
Vice President – State and Community Affairs