

**Speech of Douglas M. Steenland
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Before the International Aviation Club of Washington
July 19, 2005**

Charlie, thank you for that very kind introduction. The International Aviation Club has a well-deserved reputation as a forum that brings key policy makers and industry leaders together to discuss the most important issues confronting commercial aviation. I appreciate the opportunity to address this distinguished group today.

Normally, one starts a speech of this sort with a funny anecdote or story. But it's hard to find anything humorous in the U.S. airline industry today.

Put simply, the U.S. aviation industry today is facing its biggest crisis ever. In the big picture, over the past four to five years, the U.S. legacy carriers have been in a race against time to restructure themselves so as to become profitable on a long-term sustainable basis. Each of us has business practices and obligations that date back to a different and distant era, be it defined benefit pension plans, productivity sapping work rules, work done internally that is most efficiently performed by third-party vendors and an overall cost structure that customers are no longer willing to support.

Today, almost 30% of U.S. domestic ASM's are provided by new entrant carriers (in case you haven't noticed, entry into the U.S. airline business is very easy) who have had the advantage of learning from the legacy carriers' experiences and used a "clean sheet of paper" to apply modern practices to their companies without the encumbrances of the past. If you add to this the 25% of domestic ASM's provided by bankrupt US Airways and United, over one-half of U.S. ASM's have new entrant or quasi-new entrant costs.

The rest of us have no choice but to join this crowd. We all come to this challenge with different strengths and weaknesses. And our time frame to complete this restructuring process has been materially and adversely affected by the drain on liquidity caused by September 11, Iraq War, SARS, and now, the extraordinary high price of fuel.

Let me say that the labor cost restructuring process is difficult. At Northwest, we have great employees who have dedicated their careers to the airline and who do a great job day in and day out providing our customers with the service they expect and are entitled to. The cost problems we face are not their fault; they're not anyone's fault. The life style changes caused by this can be wrenching. Yet the "rules of the business" have changed, and the legacy carriers have no choice but to change with them. As Mark McClain, head of the NW MEC, said in a letter to other NW labor leaders, there is no answer that doesn't involve pain.

Now, I'm sure many of the policy makers in the audience are running asking themselves – what can we do to solve this problem? After all, air service is critical to the country's and a region's economic success, and we can't allow disruptions in air service. Truth be told, many of the restructuring issues facing the legacy carriers are our responsibility to work out with our employees, creditors and shareholders without government assistance or aid.

Having said that, I would like to focus today on two specific issues in play in Washington that clearly will have a major impact on the restructuring process.

The first one pertains to U.S. international aviation policy. The decade-old, two-prong U.S. policy of open skies and antitrust immune international alliances is currently under attack. From Northwest's and just about everyone else's perspective, this policy has been a great success - as Yogi Berra would say, "a grand slam with bases loaded" - and it must be preserved and maintained.

Thirteen years ago, before the Wings Club, a distinguished speaker described the U.S. airline industry as "an industry preparing itself for a very different future – a future characterized by new, seamless connections between domestic and international operations, and between airlines of different flags." He predicted the U.S.-Netherlands open skies agreement, initialed just a week and a half prior, would have "enormous implications for the future of international aviation", and described the Northwest/KLM alliance as "an important harbinger of things to come in international aviation."

The distinguished speaker that day in September 1992 was then Secretary of Transportation Andy Card. The bold international aviation policy course Secretary Card and others charted in the early 1990s has succeeded in creating nothing less than a new world order for aviation.

The U.S. now has 70 open skies agreements including the recent U.S.-India Open Skies agreement. Simultaneously, the DOT has promoted effective expansion of U.S. carrier networks worldwide through international antitrust immunity approvals on over 20 occasions since the groundbreaking Northwest/KLM application.

For over a decade there has been broad consensus that the DOT's open skies and ATI policies, working in tandem, have benefited consumers, U.S. carriers and our nation's air service balance of trade. For example, DOT reports issued in 1999 and 2000 documented profound and positive effects of multinational alliances in open skies markets, including: pro-competitive changes in industry structure; stimulated demand; consumer benefits in the form of improved service and price reductions; and important consequences for local and national economies. The 2000 report specifically found that "alliance-based networks are the principal driving force behind transatlantic price reductions and traffic gains". American Airlines in August 2001 agreed, "the proof is in -- alliances benefit both the public and participating carriers through better service at lower prices, including gateway-to-gateway routes linking the hubs of the respective alliance partners". The extensive December 2002 study prepared by the Brattle Group

for the EU calculated a 10% increase in transatlantic capacity under U.S. open skies agreements, and concluded that consumer surplus is maximized through a combination of open skies and encouraging firms to engage in “deep” alliances.

The NW/KLM alliance, the most integrated alliance, demonstrates the wisdom of these various conclusions. Before Northwest and KLM teamed up, none of Northwest’s current U.S. hubs had nonstop service to Amsterdam. Today, Northwest operates nine daily flights between its three U.S. hubs (Detroit, Minneapolis and Memphis) and Amsterdam. By linking Northwest’s domestic network to KLM’s Amsterdam beyond network and vice versa, each of Northwest and KLM has been able to introduce expanded transatlantic capacity. For example, look at Northwest’s largest U.S. hub, Detroit. The Detroit–Amsterdam city pair has approximately 85 passengers daily each way. Yet this summer, NW/KLM are operating 5 daily nonstop widebody flights. 82% of the total traffic on the NW/KLM Detroit-Amsterdam route connects behind Amsterdam. Even though Northwest’s U.S. hubs collectively account for slightly more than 4% of U.S.-Europe O&D bookings and KLM’s Amsterdam hub is smaller than Frankfurt, Paris, and London-Heathrow, the NW/KLM alliance has enabled Northwest and KLM to be an effective transatlantic competitive force, and our joint venture generates approximately \$2 billion in annual revenues for the two companies. A smashing success by any measure.

But, the marketplace in which we operate is dynamic. Commercial relations evolve, and aviation policy must take this into account. Different regions of the world are responding at varying paces to the global trend toward industry consolidation. In Europe, to a chorus of support from government officials, stakeholders and U.S. policy makers, Air France and KLM merged. As a result, two successful and first-rate alliances (Northwest/KLM and SkyTeam) with proven consumer-friendly track records were brought together.

The Air France-KLM merger is the genesis for our pending application with DOT for antitrust immunity to link the networks of NW/KLM and the existing SkyTeam ATI carriers, Air France, Delta, Alitalia, and CSA Czech. Grant of this application is the final chapter of the merger transaction. The DOJ and the EC already reviewed the competitive implications of our six-carrier ATI application, in the context of their reviews of the Air France-KLM merger. DOJ Deputy Assistant Attorney General Bruce McDonald explained: “Because Air France and KLM are members in competing alliances, the post merger Air France-KLM would have the incentive and ability to coordinate the activities of the SkyTeam and ‘Wings’ carriers.” Thus, DOJ considered the Air France-KLM merger as “a four-to-three worldwide merger of alliances” and cleared the merger under the antitrust laws without even the issuance of a second request. The merger transaction is now closed. Air France and KLM are now one firm.

The benefits of our ATI application are compelling. First, as Air France and KLM continue to integrate under their merger, it is necessary to bridge the immunities held by NW/KLM and SkyTeam in order to fully preserve the efficiencies and consumer benefits

of the existing alliances and protect the parties from unacceptable risks of liability in private antitrust actions.

Any analysis that suggests that NW/KLM will continue to compete with Air France/Delta/Alitalia/Czech post merger must be rejected out of hand. With the EU's and U.S.'s approval of the Air France-KLM merger, the regulatory agencies decided what already was becoming obvious – that there will be 3, not 4, global alliances.

Linking the NW/KLM and SkyTeam alliance networks will generate substantial new benefits, including: new and expanded transatlantic nonstop service; new online connecting service in 8,700 markets not currently served by either of the alliances; increased pathway options (a passenger will have options to travel over Paris or Amsterdam, for example) benefiting 16,280 city pairs that account for 79% of transatlantic travel; greater discount opportunities by allowing passengers to choose from numerous itineraries; improved time of day coverage; and reduced travel time in 4,263 transatlantic city pairs, representing 18% of transatlantic markets.

Reaction to our application has been almost universally positive. We have received overwhelming support by the communities we serve and substantial purchasers of international travel, including Minneapolis, Detroit, Memphis, Cincinnati/Northern Kentucky and Atlanta/Georgia Parties, the Business Travel Coalition, major corporations such as Federal Express, Ford Motor Company, General Motors and General Mills, to name just a few, as well as the Air Line Pilots Association. It's hard to imagine why very sophisticated purchasers of corporate travel would support this application if it were to result in high fares. The community support also should not be surprising. A George Mason University study a few years ago suggested the addition of a single new direct air service from a U.S. city to Europe creates anywhere from 440 to 2,900 jobs, depending on the amount of service already enjoyed by the U.S. gateway. Other studies have suggested that when a U.S. city gains daily access to a new international market, the city experiences an economic increase of \$265-\$720 million per year from the direct spending caused by the flight and the new air travelers. Clearly, the potential benefits to American communities, carriers, and consumers from an expanded SkyTeam alliance are substantial.

The lone opponent is American Airlines. To gauge the likely competitive impact of a proposal, competition authorities typically rely on consumer views as opposed to views of competitors. Indeed, complaints by competitors are routinely considered by such authorities to be strong evidence of the pro-competitive nature of a transaction. We suggest that this is the case here.

The Northwest/KLM/SkyTeam application is consistent with longstanding U.S. policy and would complement ongoing efforts to fully liberalize the transatlantic aviation market. All of the home countries involved are open skies markets, with no barriers to entry. The six-carrier application presents no substantial lessening of competition, as already concluded by competition authorities on both sides of the Atlantic in their review of the Air France-KLM merger as a consolidation of the two alliances. The public

benefits of linking the NW/KLM and SkyTeam ATI networks are compelling, including preserving consumer and carrier benefits under the existing alliances and enhancing those benefits through a more extensive and more competitive global SkyTeam network. American's opposition only confirms these benefits and suggests American is more concerned about passengers being drawn to SkyTeam, while American has declined to engage in similar integration with its largest European partner, British Airways, due to the absence of an open skies agreement with the U.K.

This application involves, for the first time, two U.S. carriers, but this is only optically unique. Northwest and Delta are not seeking antitrust immunity for domestic operations, nor does DOT have jurisdiction to extend domestic immunity. The parties have demonstrated there will be no need to exchange competitively sensitive domestic information in order to effectively implement their international alliance. We will be subject to existing penalties if we fail to comply with U.S. antitrust laws in domestic markets. DOT adopting a per se "one U.S. carrier per global alliance" rule would mean only three U.S. carriers will be permitted to benefit as an integrated member of a global alliance, since there are now only three global alliances: oneworld, SkyTeam and Star. This would leave most U.S. carriers at a substantial competitive disadvantage, including either Northwest or Delta and either United or US Airways/America West.

Finally, there is the potential catalyst the DOT's prompt approval of our application may present to move the ball forward in U.S.-EU negotiations. Approval of our application will increase competition within Europe and over the transatlantic and should create the necessary incentives for comprehensive support among European countries and airlines for a U.S.-EU agreement.

Guided by the best interest of consumers and the U.S. airline industry alike, I'm confident the DOT will embrace the future by granting our request, and we encourage the DOT to do so with all deliberate speed.

The second policy issue of note is pensions.

Northwest Airlines' defined benefit pension plans were first established in 1946, well before deregulation of the airline industry and well before the advent of defined contribution plans. These pension plans, while successful in a regulated cost plus environment, do not work in today's deregulated world and today are underfunded. The federal law regarding underfunded defined benefit pension plans is seriously broken and must be fixed. As you know, both United Airlines and US Airways have already terminated their defined benefit plans in bankruptcy and transferred them to the PBGC. Absent immediate action by Congress, the defined benefit plans at Northwest and at other carriers may very well suffer the same fate. There is a sensible path out of the difficulty we all find ourselves in, and if Congress acts we will be able to protect the current defined pension benefits of our employees.

Let me tell you how we got here and how we can get out.

At the end of 1999, airline industry defined benefit plans were more than 100% funded, on average. In 2000, Northwest's plans, in the aggregate, were more than 100% funded under current law. At the end of 2004, Northwest's plans were funded at less than 60%.

What happened?

1. 3 year stock market decline
2. Record low interest rates
3. Modest benefit increases
4. September 11th began the current airline crisis

As a result of these events, the deficit reduction contribution or DRC rules kicked in and required that Northwest and other carriers make massive additional contributions to its defined benefit plans that we could not afford.

It is difficult to overstate how profoundly the DRC has impacted the funding or, more precisely, the underfunding – of our defined benefit plans.

It is as if Congress had issued an edict to homeowners with 30-year mortgages that, if the value of their homes drop below 80% of the purchase price (for whatever reason), their loan will be accelerated such that the balance will become due in just three to five years. Worse yet, the accelerated funding kicks in at a time when homeowners cannot repay the loans because of the very same adverse economic circumstances that caused the value of their home to drop.

In fact, when the DRC kicked in, the airline industry was, and remains today, in the midst of its worst financial crisis ever.

In short, the current pension funding rules are too volatile, unpredictable, inflexible and expensive for our company to survive and compete in the modern, deregulated airline industry that demands that we deliver service to our customers at competitive prices. Defined benefit plans are one of the last vestiges of the airline regulation era. Northwest has concluded that defined benefit plans simply do not work for an industry that is as competitive and as vulnerable to forces, ranging from terrorism to international oil prices, that are largely beyond its control, as the airline industry.

Given this reality, Northwest could be left with a stark choice:

- We can follow United Airlines and US Airways, file for bankruptcy and apply to terminate our defined benefit plans. We all know that this is a lose-lose approach; or
- Congress can enact legislation that allows us to fully fund our defined benefit plans and to make a gradual and orderly transition from defined benefit plans, while at the same time protecting our employees, retirees, and the PBGC.

Working with our labor unions and other airlines, we have developed a proposal that would allow us to follow the second course. Specifically, the proposal would:

- Stop adding to the underfunding of airline plans by requiring airlines and their affected unions to "freeze" their plans, ceasing future benefit accruals;
- Protect the PBGC by freezing the PBGC guarantee; and
- Fix the broken DRC rules by extending the term of our pension "mortgage" from its current DRC 3-5 year amortization period to a longer amortization period.

Under this proposal, retirees and plan participants would receive the benefit they had earned to the date of the freeze. Retirees would be protected. In addition, the PBGC will be in better shape financially since its liability will be capped, and each payment that an airline makes to the plan will reduce that liability.

We are not seeking a "subsidy" or a "bailout" from the government. Just the opposite. We are asking for a responsible alternative to current law that lets us pay our pension liabilities ourselves versus shifting those obligations onto a government agency. Congress should act on this and should act now.

In my remaining moments, let me briefly give you a progress report on NWA's labor cost restructuring efforts.

We have set a goal of at least \$1.1 billion in annual labor cost savings. To date, we've realized almost \$300 million of that amount through agreements with our pilots and management that went into effect on December 1, 2004.

We are now engaged in NMB-mediated negotiations with AMFA representing our technicians; the IAM representing our customer and ground service employees and the PFAA representing our flight attendants. Our ALPA-represented pilots understand that last December's agreement was the first step with respect to their participation in the process.

Our negotiations with AMFA are the most advanced. We require from AMFA \$176 million in annual cost savings. We're committed to reaching a consensual collective bargaining agreement with AMFA, but we also realize that we need a deadline to achieve that result. That's why we asked the NMB to declare an impasse in our negotiations. AMFA made a similar request. The NMB proffer of arbitration has not been accepted, and we await for the NMB to start the 30-day cooling off period.

In the event that we are unable to reach an agreement during this period, we will be prepared.

Upon completion of the goal to realize labor cost savings from AMFA, we hope to be able to announce expeditiously agreements with our other unions on their participation in the plan.

Conclusion

Needless to say, these are challenging times in the U.S. airline industry. To help the industry successfully meet these challenges we urge the U.S. DOT to reaffirm its proven, successful U.S. international aviation policy of open skies coupled with global alliances holding antitrust immunity and to grant the pending ATI application promptly. We also urge the Congress to enact expeditiously the pension reform legislation we all know is needed.

On behalf of all 39,000 Northwest Airlines employees, thank you again for the opportunity to appear before you today.