



REMARKS OF STEVE RIDGWAY

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“The Aviation Industry in Crisis: Where is US Leadership?”

Thank you for the invitation to speak to you all this afternoon. It's an honour to address such an illustrious audience at such challenging times for our industry and the wider economy.

The eyes of the world have been on Washington over the past few weeks. The Presidential race and the bill to bail out the financial sector have been headline news around the world. On the first, it's still too close to call; but on the second, I suspect that last week's vote now means that the race between banks and airlines as to which will go out of business first has taken a decisive swing towards the airlines.

Virgin Atlantic has been pretty active in this great city over recent weeks discussing a particular anti-trust application with interested parties. And while I won't disappoint you by not mentioning BA/AA, I'll try not to focus on it too much.

There's a buzzword in the aviation industry that seems to be included in every speech or article – “sustainability”.

It's one of those words that gets used a lot but I'm not always convinced the speaker or writer actually knows what it means. This is often because, like many useful words, it has a flexible meaning and can be adapted to the user's wishes.

I want to talk today about the role of the US in creating a sustainable aviation industry – and I'll be referring to three aspects of sustainability.

Firstly, an industry that is sustainable for the consumer – by this, I mean that the consumer has a choice between safe and reliable airlines

providing different products and services at a fair price, operating on routes the passenger wants to fly.

Secondly, an industry that is sustainable for investors – by this, I mean a profitable industry that delivers returns to those who invest in it and that has full access to global investment sources thereby ensuring it has the lowest cost of capital possible.

And thirdly, an industry that is sustainable for the planet – an industry that strives to achieve improved environmental performance and that accepts and mitigates its unavoidable impact in our global economy.

The crisis currently facing the aviation industry has been described by my colleague and friend, IATA Director General, Giovanni Bisignani as a “perfect storm”. Oil prices have increased dramatically; we’re at the start of an economic downturn which has affected demand; and at the same time, we’re facing increased government taxation burdens. All this leaves the industry facing unprecedented difficulties. But I am an optimist and I have no doubt that the industry will recover. But how quickly it recovers, and what the industry looks like when it emerges from this period of uncertainty is not clear. What is clear is that the US should play a significant, in fact I would go so far as to say, the leading, role in this recovery. My big fear is that it will not.

Potentially the US airline industry has the world at its feet. The US domestic market represents about 25% of total world aviation. This traffic feeds into airports dedicated to individual airline’s hub and spoke networks. 6 of the 10 largest airlines in the world are US-based.

US manufacturers “invented” air travel as we currently know it. The Boeing 707 and 747 have contributed like very few other technological developments to the creation of the modern world we live in.

US officials have been at the forefront of developments in the regulatory sphere. From ‘deregulation’ in the 1970s to the promotion of “open skies” deals since the 1990s, US politicians and officials demonstrated foresight and leadership to create an environment in which US airlines could thrive, for example, SouthWest and JetBlue and Northwest's alliance with KLM. But the industry elsewhere around the world, for example in Europe and in Australasia, has moved on while the protectionist approach adopted by the US in the 21st century has, to all effects and purposes, represented an abdication of that leadership role. It is no longer enough to glibly state that “open skies” is enough. It is not. US vision and leadership is

indispensable to ensuring we successfully reach the horizon beyond Open Skies – that we develop a truly sustainable industry.

Two weeks ago, Daniel Calleja, the lead negotiator of the European delegation in the EU/US aviation talks, addressed this forum and set out Europe's vision for a transatlantic open aviation area – an idea that Virgin Atlantic strongly supports. Under this concept, traditional barriers to investment and freedom of routeings would be removed. Virgin Atlantic would be able to carry passengers between Washington and Las Vegas in its own right or by using a fully-owned US subsidiary. In his speech, Daniel hesitated from using words such as “cabotage” and phrases such as “normalisation of the aviation industry” for fear of offending his audience. Perhaps I lack some of his diplomacy but I don't believe in being obtuse or too careful with words. That's not the Virgin way – so it should come as no surprise to you that I don't plan to talk around the issues today but to address them head on. At the same time, I don't intend to cause offence. But I trust that we are able to engage in an open-minded and thoughtful debate.

The US response to the EU's vision of an Open Aviation Area has been, to say the least, disappointing. Of course, there are challenges and issues, some valid, some purely hypothetical and some deliberately obstructive.

It is particularly depressing, and I believe surprising, given the US track record for leadership and innovation, that the underlying tone of much of the opinion on the US side is defensive and appears to view changes as a threat rather than as an opportunity. While we can all appreciate that some legislative changes may be required to open the market, we should be rising to that challenge, not shrinking from it, and we should be searching for other ways to eliminate barriers to progress. Some carriers may win under the new regime and some may struggle. That's how it should be. That's how we make our industry sustainable. Failing airlines must be allowed to go out of business. To do otherwise, for governments to artificially keep such airlines in business, not only wastes tax payers' money, but also hurts those airlines that are viable and do not receive support.

I fully accept that Europe needs to get its own house in order – the situation with Alitalia is unacceptable. But in most cases, the EU relies on markets to determine which carriers stay in business – as the demise this year of Silverjet, Alpi Eagles, Zoom and XL has shown so graphically, and for employees and passengers so painfully.

In the US, Chapter 11 has a chequered past. Chapter 11 serves a purpose but as practised in recent years it has at times distorted competition. While I understand that there have been more Chapter 7 liquidations as of late, we must be mindful of the need to minimise the risk of government intervention, and picking winners and losers. The market should decide if companies succeed or fail. Airlines are not banks. Nobody puts their life savings into an airline ticket or borrows their mortgage from a low-cost airline. Historically, the system has allowed catastrophically failing businesses to keep operating, pricing for cash and acting irrationally in the market, distorting the competitive landscape and damaging viable airlines.

The US needs to return to providing leadership on the issues at the heart of the second stage of the EU/US negotiations – unlimited market access and freedom for foreign investors. Both sides need to work together to overcome the legislative obstacles to progress. We owe it to consumers, and our economies that rely heavily on aviation as a commercial engine, to roll-up our sleeves and do the heavy lifting to reach a consensus for meaningful progress. The goal is too important to do otherwise. And don't forget, if the US decides not to engage productively with the EU in the second stage negotiations, EU Member States have the ability to terminate the first stage agreement removing the newly created rights contained in it – the so-called “claw-back clause”. If used, this would mean that we would go back to a situation where US airline access to Heathrow would be restricted to only United and American. It should not be used lightly, but the “claw-back” clause is the only leverage the EU has to encourage the US to be serious about progress in the second stage.

I agree with many commentators who argue that the current fragmentation of the airline industry is contributing to its woes. To put it simply, there are too many airlines and the current situation is not sustainable. But while consolidation is both desirable and essential, and Virgin Atlantic may play a part in it over the coming months, it should not be allowed to take place irrespective of the consequences for the consumer. Every proposed merger or application of anti-trust immunity must be considered carefully by the regulators. Where consolidation can deliver tangible consumer benefits, facilitate improved competition and support continued services which consumers value, regulators should be supportive. But when the proposal is from two of the world's largest carriers and would lead to domination of the world's biggest international airport that is effectively closed to any new competition, then the regulators must draw a line in the sand and say “No Way!”

You'll all be aware that Virgin Atlantic opposes the proposed alliance between British Airways and American. We've started a campaign against it. In these challenging times, every source of revenue should be sought so I've told Willie Walsh and Gerard Arpey to expect an invoice for advertising their airlines now that we've re-painted "No Way, BA/AA" on the side of our aircraft.

Virgin Atlantic is against BA/AA because if the application goes ahead, the new entity would have a stranglehold and insurmountable monopoly on some of the busiest and most profitable routes between Europe and the US. The two airlines, effectively working as one, would operate 79% of all capacity between Heathrow and Boston, 66% between Heathrow and Chicago and 63% between Heathrow and JFK. Not to mention the 100% pure monopoly between Dallas and Heathrow. They would also be highly dominant on several other Heathrow to the US routes.

American recently publicly accused us of playing "fast and loose" with city-pair market concentration statistics. Apparently AA and BA believe consumers and their wallets will be relieved to know the BA/AA monopoly might only have a 60% stranglehold on particular Heathrow markets when the data we rely on shows it will be 65%. To a consumer faced with the ominous prospect of governments giving BA and AA a blank check to freely wield their monopoly power to fix fares unchecked by meaningful competition, quibbling over a few percentage points here and there is a totally meaningless exercise and a total red herring. But, to respond to American's desperate charge about the reliability of the market share numbers we use, ABN AMRO's June 2008 report on the proposed alliance indicates the BA/AA colossus would have an 83% stranglehold on Heathrow-Boston seats, 62% of Heathrow-O'Hare seats and 63% of Heathrow-JFK seats. If these numbers sound familiar, they should – they're virtually identical to the numbers we use. Facts are stubborn things.

BA and AA would have us believe that EU/US Open Skies have brought a raft of new competition between Heathrow and the US. Those numbers show that is not the case. We may be accused of wheeling out the same old arguments. But why shouldn't we when they are as strong today as they were in 1997 and 2001.

While AA and BA have proclaimed that US carriers now have "free" access to Heathrow, public financial filings show that Continental had to pay \$209million for 4 Heathrow slot pairs, or over \$50million per roundtrip

flight. "Free" access to Heathrow? HARDLY. The rare slot that does emerge does not enable carriers to compete on transatlantic routes. Also, with JFK recently joining the Heathrow club as a closed airport with virtually no competitive entry, red flags should be flying high on both sides of the Atlantic.

BA argues that it needs to link up with American because SkyTeam and Star are dominant at their hubs. But the fact is that BA on its own is already bigger between Heathrow and the US, the thickest airway out of Europe, than Star is from Frankfurt or SkyTeam is from Paris – and that's before it gets together with American. Heathrow accounts for nearly a quarter of all passengers travelling between Europe and the US, and in stark contrast to other European hubs where competitive entry is possible, it is effectively full. This makes it physically and financially impossible for any carrier to offer any meaningful level of new competitive service, let alone attempt to replicate the network that BA/AA would have.

Heathrow truly is unique. Despite the fact that it is full to bursting and all the resultant bad press it receives, it continues to attract plenty of connecting passengers between the US and Europe – around 3 million each year. And without any immunity in place for BA, it carries the lion's share of that traffic. That's why it's crucial that regulators understand that BA/AA isn't just another alliance: it's an attempt to stitch up the most important long-haul routes from Europe's most important airport. BA and AA want to roll back the successes of deregulation and liberalisation in international aviation – yet in the case of BA, the lack of ATI didn't stop them achieving a 10% operating margin last year. BA and AA want to have their cake and eat it, at consumers' expense.

If BA/AA were to receive clearance, fares would rise because there would be less competition. Why else would BA and AA want to join forces at an airport effectively closed to newcomers? In addition, for the travel trade and large corporate accounts, BA/AA would be very damaging. A bigger airline, with less competition, would force up prices because it wouldn't face as much pricing pressure. Travellers would pay higher fares in return for a poorer product.

These are all good reasons to prevent BA/AA from going ahead. So supporters of this alliance have to resort to other arguments to persuade the regulators to permit what they would normally prevent.

The current economic malaise is no justification for regulators to let the application for anti-trust immunity through. BA and American had hoped to

see the application approved by the end of this year. Yet this would have represented a dereliction of regulators' duties because consumers rely on regulators to rigorously assess the long-term impact of a BA/AA tie-up on competition, not to provide special protection from the immediate challenges of the economic cycle. What would the BA/AA monster monopoly be like when the economy recovers? Anti-trust laws should not be ignored during an economic downturn for good reason because when the economy recovers, competition and consumers would be faced with a permanently changed market. That would be unsustainable, and consumers, the intended beneficiaries of competition laws, would be the biggest losers.

Of course there is an element of self-interest in Virgin Atlantic's opposition to BA/AA – the proposed alliance would impact on our ability to compete fairly on some of our most important routes – but there is a much wider consequence. At Heathrow, competitors cannot challenge BA's dominance and where there is no meaningful competition, BA and American will be able to increase fares on the most important air corridors in the world. Consequently the regulators need to show more than ever that they are guarding consumers' interest.

Protecting monopolies is not acceptable to consumers who end up paying higher prices for poorer service standards. And it shouldn't be acceptable to regulators. We've seen in the UK over the past few months with the proposed break-up of BAA's monopoly of London's airports, that regulators are finally listening to what many have been telling them for years - that protected monopolies don't invest and yet raise costs as service levels decline. It's not very surprising – after all monopolies don't need to invest to stay ahead of the competition – by definition, there is no competition.

In these more unpredictable times, we have cushioned our business well for the downturn. We had a very good start to our financial year, with revenues up 15% in the first half, and a strong increase in pretax profits. Crucially, we have also continued to grow our cash position, with nearly \$1.3billion in the bank. In the first half, we carried 3 million passengers, up 3% on the same period last year and, encouragingly, Upper Class passenger numbers rose by 6%.

We saw signs two years ago that the downturn was around the corner and adjusted our capacity, deferred aircraft orders, ensured we were well hedged and built up our cash in the bank. Given the oil price, thank God we did.

In a downturn, good value and a quality product really matter. Passengers choose to fly with us because we deliver both.

As I said earlier, not only must our industry be economically sustainable to meet the needs of our customers and investors, it must also strive for environmental sustainability in order to maintain a licence to operate and grow. We should not, of course, be ashamed or defensive of our industry. We know that aviation underpins economic stability and growth and is vital to developing nations for trade and tourism. So we must continue to act swiftly to address how our industry impacts the environment and understand how we can best mitigate and reduce that impact. Of course there will always be airlines and we must have a vision for our future where the social benefits of flying, of connecting people around the globe, of learning about other cultures and exploring our world and all the amazing places within it, will be available to future generations.

The IATA four pillars environmental strategy is sound and I am proud of the progress the industry is making and working together to progress its goals. In the short term we are all striving for fuel efficiency, re-engineering our operations and investing in new technology – which with any luck might be delivered before the next millennium!! We must not let the current economic pressures divert us – and why should they when the goal of fuel efficiency and reduced costs go hand in hand.

And we must continue to accelerate the technologies which will provide the building blocks towards a more sustainable industry. I'm sure that no-one in this industry wants to use or pay for the last barrel of oil and the issues of fuel cost and security are at the forefront of our minds.

On 24 September, Virgin Atlantic announced a joint initiative with Boeing and several other major air carriers - collectively we represent 15% of global fuel uplift – which aims to accelerate the development of sustainable biofuels.

In addition, we support a global solution to emissions trading schemes and would urge international policy-makers to ensure that aviation is invited to the table in Copenhagen in December 2009, and that emissions from this sector are included in the resulting climate change framework and global policy instruments.

Ladies and gentlemen, our industry is hurting and needs urgent life support.

The US were the pioneers of our industry. We now need pioneers with the courage of their convictions – CEOs of US airlines, and their staff, backed by brave owners domestic or foreign who are all prepared to stand up and say enough is enough. Why isn't it a US carrier that flies non-stop between JFK and Singapore? Or JFK and Dubai? Using the very aircraft developed in the USA. There is no reason to fear everybody else. There is every reason to work with the rest of the world because the ultimate beneficiary of bringing down barriers will be, as it always has been, the US. Where's the downside? US airlines will still create wealth; US innovation will still develop new technologies and products; US employees will still have their jobs. To me, that is sustainability – for customers, for investors and for the environment. Thank you. (END)

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