TESTIMONY OF BEN HIRST
SENIOR VICE PRESIDENT AND GENERAL COUNSEL FOR DELTA AIR LINES
ON BEHALF OF THE AIR TRANSPORT ASSOCIATION

BEFORE THE HOUSE COMMITTEE ON AGRICULTURE

SEPTEMBER 17, 2009

INTRODUCTION

Good morning Chairman Peterson, Ranking Member Lucas, and members of the Committee. I am Ben Hirst, General Counsel of Delta Air Lines, and I am appearing today on behalf of the Air Transport Association, which represents the U.S. commercial airline industry, an industry that has been devastated in the past two years by the high price of fuel and volatility in oil markets. We, and our employees, are grateful for your commitment to addressing the causes of these conditions, which have destroyed some airlines and deeply damaged the rest.

INDUSTRY CONDITIONS

As an industry, commercial aviation helps drive $1.14 trillion in annual economic activity in the U.S., $346 billion per year in personal earnings, and 10.2 million jobs. It also contributes $692 billion per year to our nation's gross domestic product – roughly 5.2% of GDP.Unfortunately, U.S. commercial aviation is suffering through a very difficult economic climate. Recently, Merrill Lynch analyst Michael Linenberg was quoted as saying, "We are lowering our 2009…net income forecast [for the airline industry]…from a profit of $1.0 billion to a loss of $2.3 billion. While at the start of the year we were projecting a modest net profit for the industry despite the worst global economic downturn since World War II, our forecast has been stymied by the impact of the H1N1 influenza, creeping energy prices, and a revenue environment that is showing no signs of improvement."Demand for air travel and air cargo is down sharply in 2009 – by approximately 21 percent below the same period last year – and U.S. airlines expect 14 million fewer passengers in the summer 2009 than we had in 2008. This has forced our industry to do the only thing it can to survive – cut capacity, ground planes, eliminate routes, and reduce the number of cities served.

The number of full-time employees at passenger airlines is down 29 percent from our peak employment in May 2001– a total of 154,000 jobs lost in our industry. And airlines continue to cut. In the fourth quarter of this year, domestic seating capacity is expected to decline to levels we last saw in the fourth quarter of 2001, in the immediate aftermath of 9/11. In fact, by the fourth quarter of this year, U.S. carriers will offer almost 1.8 billion fewer available seat miles[1] *every week* than they did in the fourth quarter of 2007. And that figure represents the cuts on domestic routes only. When you add the cuts that have been made to international routes, the numbers are even larger.Unfortunately, all of these problems are being exacerbated by volatility in fuel markets. In 2008, U.S. airlines spent $16 billion more on fuel than they did the year prior – almost $60 billion in total – despite consuming more than five percent fewer gallons of fuel.

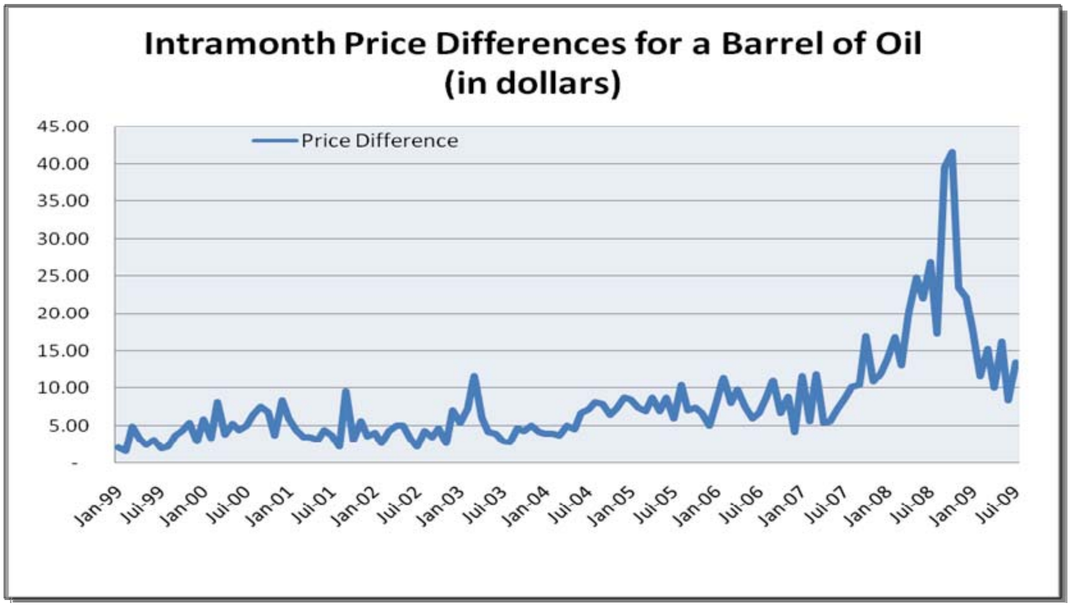
We at Delta Air Lines employ over 70,000 people worldwide and offer service to more than 170 million passengers each year to 382 destinations in 69 different countries. We consume approximately four billion gallons of jet fuel annually, making us the second largest consumer of jet fuel in the world, next to the U.S. government. Our business is dramatically impacted by volatility in the oil markets. Each $1 change in the cost of a barrel of oil has an annual impact of $100 million to Delta's bottom line. In 2008, as oil prices and volatility peaked, fuel expense (including the cost of hedging) consumed 40 percent of our total revenues directly resulting in the need to reduce our capacity by more than 10 percent and eliminate nearly 10,000 jobs.The financial health and security of the airline industry depends, in significant part, on a commodities

[1] An available seat mile (ASM) is one passenger seat flown one mile and is the standard unit of capacity in the passenger airline sector.

market structure that is stable, rational and predictable. Today's energy commodities markets, however, do not display these characteristics.

EXCESSIVE SPECULATION DRIVES VOLATILITY

Since 2005 we have seen a significant increase in the volatility of oil prices. The increase has been particularly dramatic in the last two years. From 1999 through 2004, the average annual variance between the high price of a barrel of oil for the year and the low price was about $16. From 2005 through 2008 the average annual per-barrel variance was about $52. In 2007 the variance between the high and low prices was $48 and in 2008 it was $111. Daily volatility in 2004 was generally under one dollar. In 2008, the price of a barrel of oil rose $10.75 in a single day (June 6), and daily volatility of $3 or more became the norm. The average monthly difference in prices in 2008 was over $19 per barrel.



This increase in volatility has been associated with a massive increase in speculative investment in oil futures. A recent study by the Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs noted that over the last six years, financial institutions have aggressively marketed commodity index funds, which are heavily weighted to oil futures, as a way for hedge funds, pension funds, and other investors to diversify portfolios and speculate on rising commodity prices. The study noted that the total value of investment in commodity indexes has increased tenfold since 2003, from an estimated $15 billion in 2003 to around $200 billion in mid-2008. During that period, the volumes of oil futures traded on the exchanges quadrupled despite the fact that, over the same period, global demand for physical barrels of oil remained virtually unchanged.[2] Moreover, these indices tend to have a very heavy bias toward long investing, further increasing the upward pressure on

[2] Total world demand for oil from 2005 to 2008 (in million barrels per day):

2005 – 84.00
2006 – 84.98
2007 – 85.90
2008 – 85.33

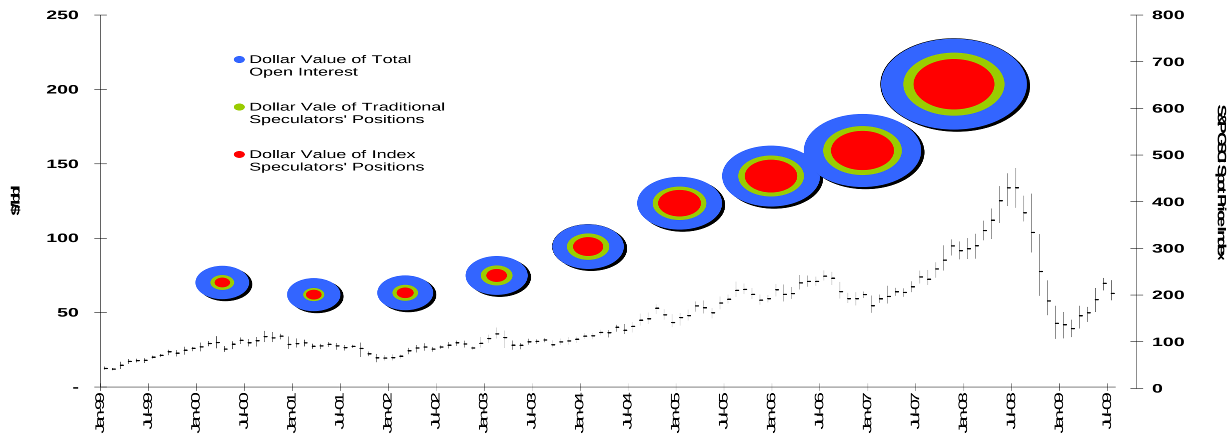
Source: Energy Information Administration energy markets. This increase in speculative activity is closely correlated with the increased volatility of oil prices, which has caused so much harm.

For an airline, an oil market characterized by high volatility driven by speculation presents a number of serious problems. First, it increases the costs and risks of hedging. Second, in recent years this volatility has pushed prices to levels so high that they have depleted the capital of the firms in our industry. Third, with each spike in oil prices, airlines ground aircraft, reduce air service, and eliminate jobs.

To be clear, we acknowledge that a certain level of speculative investment in commodity markets injects much-needed liquidity in those markets and positively impacts market functions. However, because excessive speculation clearly destabilizes commodity markets and harms consumers, Congress should provide the CFTC with the authority and guidance it needs to ascertain the proper level of speculative investment in the market while preventing volatility. The period before the explosion of index fund investment in the early years of this decade can serve as a valuable guide to appropriate levels of speculative positions in relation to acceptable levels of volatility.

OIL PRICES AND VOLATILITY HAVE RISEN AS SPECULATION HAS INCREASED

Volatility Charts



Source: Bloomberg, CFTC Commitments of Traders CIT Supplement, calculations, Testimony of Michael W. Masters before the Senate Committee on Homeland Security and Governmental Affairs on May 20 2008

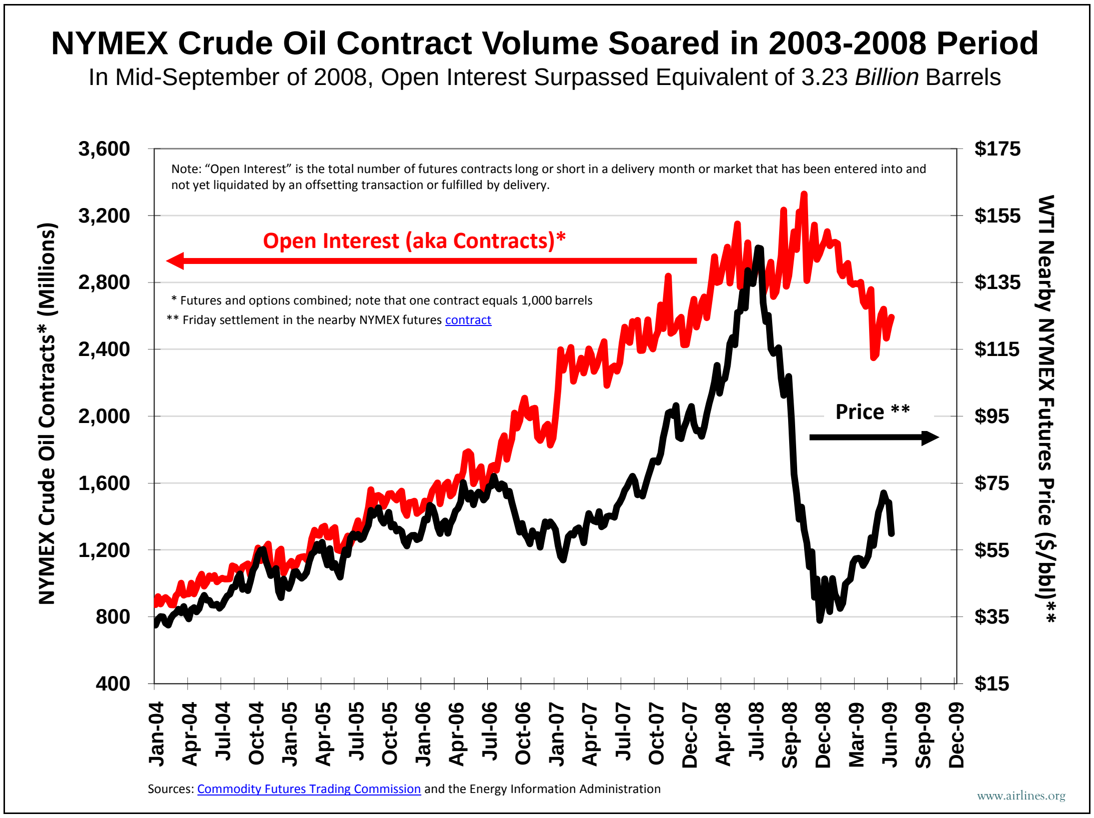
– In the chart above, the bubbles represent the size, measured in dollars (on the right axis), of the commodities futures market. Over time, not only has the total volume increased, but the amount of Index Speculators relative to the Total Open Interest has risen drastically.

– On the left axis, the high, low, and settled prices for crude oil are displayed by month since 1999 through mid-July 2009. The distance between highs and lows has increased in recent years.

– The two charts together show how the increase in volume has affected the volatility of market prices.

Date	High	Low	Settle	H-L Spread
Jul-99	21.12	19.15	20.04	1.97
Jul-00	32.35	27.35	29.74	5.00
Jul-01	28.29	24.60	26.45	3.69
Jul-02	27.95	25.73	26.90	2.22
Jul-03	32.05	29.17	30.62	2.88
Jul-04	43.85	36.69	40.68	7.16
Jul-05	62.10	56.10	58.93	6.00
Jul-06	78.40	71.65	74.53	6.75
Jul-07	78.28	69.57	73.91	8.71
Jul-08	147.27	120.42	133.87	26.85
Jul-09	71.85	58.32	62.86	13.53

We estimate that the speculative oil price bubble that began in mid-2007, peaked in mid-2008, and then plummeted abruptly, cost Delta $8.4 billion, compared with what we would have spent on jet fuel if the price of oil had remained at $60 a barrel. This includes $1.7 billion in hedge losses and premiums. At least we're still in business. Other airlines without our financial reserves have not been so fortunate. Since December 2007, eight airlines have ceased operations.



In 2008 alone, some 28,000 pilots, flight attendants, mechanics, ramp workers, gate agents, reservation sales and service representatives, and office workers lost their jobs due to cutbacks in our industry, and air service was reduced at countless communities across the country. Further capacity reductions, layoffs, bankruptcies and liquidations will occur if oil price volatility is not reduced to more manageable levels.

SOLUTIONS

Delta Air Lines and the Air Transport Association strongly support reforms to energy market regulation that promote price stability, market integrity, and accurate price discovery. This is because the fundamentals of supply and demand alone, while certainly influencing the price of commodities, cannot explain the destructive volatility we have seen in oil markets over the past 16 months. The dramatic and devastating run-up in oil prices that we experienced last summer – and the almost-as-devastating price crash last fall – was largely caused by a massive influx of speculative investment into commodity markets generally and energy markets in particular. Congress must provide the CFTC with the authority needed to prevent a recurrence of these devastating conditions by enacting bold commodity market reform legislation. The draft legislation recently released by the Obama Administration provides a strong blueprint for this reform and we urge congress to consider it in the coming weeks.

Delta Air Lines and the Air Transport Association are pleased that the Obama Administration has taken an active role in advocating significant reforms to the laws governing the regulations and oversight of derivatives markets. We applaud the President for coming forth with a strong and detailed legislative proposal to deal with the many shortcomings we see in the current oversight framework and generally support the reforms that he is advocating.

Furthermore, Delta Air Lines uses derivatives markets to hedge in both financial risk and commodity price risk, and we view both tools as valuable. That said, my company continues to be more concerned with the explosion of price volatility that we have seen in energy commodities in recent years than it is about increased costs for managing financial risks using financial derivatives. Excessive speculation in oil markets, and the volatility it foments, has been our focus throughout this debate and we continue to primarily advocate policies that reform commodities markets – the portion of this provision that is the purview of this committee.

Now to discuss some of the specifics of the bill. The President's proposal addresses most of the policy priorities the ATA has enumerated throughout this debate. It effectively closes the loopholes in the law that hamper the ability of the CFTC to effectively regulate the market – the Swaps Loophole, the "Enron" Loophole, and the foreign exchange loophole. It also has the potential to limit the massive influx of speculative dollars that we have seen flow into the markets in recent years by providing the CFTC the authority to impose speculative position limits, requires more transparency and reporting, implements conflict-of-interest rules in this area for the first time, and increases CFTC funding or staff.

Regarding the imposition of aggregate position limits across all markets, one of the ATA's highest policy priorities, the proposal gives the CFTC clear authority to set position limits for any futures transactions that "perform or affect a significant price discovery function." This change will allow the CFTC to address the excessive speculative pressure – and the concomitant volatility – imposed on oil markets by massive pension funds, sovereign wealth funds, and other major market players that use index funds to trade immense amounts of commodity contracts. While the ATA would prefer language to <u>require</u> the CFTC to take such steps rather than the mere grant of authority contained in the Obama Administration proposal, we are confident that the current leadership of the CFTC would effectively use this authority to increase oversight and inject stability into these markets.

By imposing consistent position limits on all non-commercial traders across all markets, traders will continue to have the opportunity to invest in energy commodities, but only up to the level necessary to ensure adequate liquidity in the market. This would prevent a recurrence of excessive speculative activity that created the 2008 commodity bubble while ensuring that the markets continue to enjoy the liquidity they need to function efficiently.

The Obama proposal also contains major improvements in transparency. It requires traders to report to the CFTC many types of transactions not currently reported and requires CFTC to aggregate that data and make it available to the public. The bill also would require most transactions not cleared or exchange traded to be reported to the CFTC. The collection and dissemination of this information would greatly enhance the ability of both the CFTC and public watchdogs to monitor market activity and maintain market integrity.

The Obama proposal supports the harmonization of regulations regulating commodity and financial derivatives, and imposes conflict-of-interest rules on swap dealers and major swap participants. Swaps dealers would have to create “firewalls” between their market research arms the branch of the company that engages in trading. They also will have to disclose related conflicts, material risks, financial incentives, and other interests to counterparties.

Finally, the proposal requires many transactions in standardized swaps be traded on a board of trade or cleared through an “alternative swap execution facility.” To ensure the integrity of these trades, margin requirements sufficient to cover potential exposure will likely be required. While Delta Air Lines and other ATA members are generally more concerned with market volatility than the potential burdens market reform impose, it is imperative that actual physical hedgers in commodity markets be allowed continued access to these risk management tools without significantly increased cost burdens. Commodity markets were created for the benefit of physical hedgers and they must continue to remain accessible to them. In a trade where at least one party is a legitimate physical hedger in a commodity, the Agriculture Committee should consider provisions that would enable these transactions to occur to with little additional financial burden on the parties involved.

CONCLUSION

Again, thank you for the opportunity to testify before the Committee on these vital issues. Fuel has become airlines’ single largest expense. The extreme volatility we have seen in these markets in recent months has made it impossible to undertake necessary corporate planning and has been devastating to our industry and the employees and communities that depend on us. The Obama Administration has laid out a workable blueprint and we urge congress to take the significant steps needed to reform these markets. We in the airline industry, on behalf of our employees and the communities we serve, commend you for the leadership you are exercising on this critical issue. I look forward to answering any questions you may have.