# TESTIMONY

# OF

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**STATEMENT OF**
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**BEFORE THE**
**HOUSE AVIATION SUBCOMMITTEE**
**"THE ECONOMIC VIABILITY OF THE CIVIL RESERVE AIRFLEET PROGRAM"**
**MAY 13, 2009**

As Chairman of Omni Air International, Inc. (Omni), a United States Federal Aviation Administration certificated Part 121 passenger charter airline based in Tulsa, Oklahoma, it is my distinct privilege to appear before this House Aviation Subcommittee to discuss "The Economic Viability of the Civil Reserve Air Fleet Program".

Providing passenger air charter service is the core competency of our airline, hence, my comments will be focused on the passenger charter segment of the industry and its relevance to the CRAF program. Omni has been an approved CRAF carrier since 1998. Since that time Omni has been an active and significant participant providing passenger operations to the Department of Defense (DoD). It is important to note that the passenger charter segment of the industry and its support of CRAF are unique and distinct. Therefore, while I believe the points contained in this testimony are fully applicable to the passenger charter segment, the exact same issues do not necessarily directly correlate to those issues in other airlift sectors such as the charter freight segment. Each airline sector within CRAF needs to be independently evaluated based on its own unique circumstances.

From January 2003 through September 2008, Omni, along with other charter and scheduled passenger airlines, safely transported over 2.8 million troops in support of DoD operations in Iraq. During the period of September 2001 through September 2008, US passenger airlines transported an additional 735,000 military personnel in support of DoD operations in Afghanistan. With the most recent CRAF activation in 2003, and only the second activation of the CRAF program in its 57 year history, commercial passenger airlines transported over 254,000 troops in support of Operation Iraqi Freedom. Throughout the four and one-half month period of activation in 2003, commercial passenger airlines operated 1,625 missions with 51 aircraft. Notably, and importantly, of the three time periods just described, passenger charter airlines including Omni Air International, World Airways, North American Airlines, ATA, Ryan International Airlines and Miami Air provided nearly 90% of all lift requirements. Legacy scheduled airlines including Continental, Delta, Northwest, American Airlines and United Airlines provided the remaining 10% minority of the required military transportation.

Why this disproportionate amount of business between the charter carriers versus the scheduled carriers? The substantial majority of USTRANSCOM passenger demand requires mission flexibility. This airlift is being met daily by the charter carriers.
In fact, the vast majority of DoD missions are booked within a three-week operating window. Charter airlines are “in the business” of providing on demand lift based on the customer’s schedule, not the airline’s schedule. While scheduled airlines provide an important and meaningful role within CRAF, mostly focused on the war time Stage III requirement, the fact remains that large scheduled airline operating systems are rigid and do not successfully allow for the elasticity required to meet routine DoD operating demand. The charter carriers step forward everyday to meet DoD airlift needs. The charter carriers are those the nation regularly counts on for mobility and readiness no matter what the contingency or mobilization requirement. Omni is proud to be among this elite group of airlines.

Maintaining a continued strong, viable and robust CRAF requires a national focus on those elements that optimize commercial fleet participation along with best value for the government.

The charter carriers are now, as we speak, providing the majority if not all of the augmentation DoD needs to support our troops in Afghanistan, Iraq and other military efforts around the world.

In any national crisis, the charter carriers are the first responders to USTRANSCOM with a "Can Do" philosophy to get the job done. An example in recent time is that of the mass evacuation of US citizens needing to return home from Lebanon after the eruption of war in the region. Charter airlines immediately played a critical role in the evacuation.

An intimate understanding is needed from the unique perspective of charter passenger airlines and their role supporting USTRANSCOM in order to fully understand the charter airlines value within the CRAF program.

Specifically addressing the topic of today's hearing, "The Economic Viability of the CRAF Program", I believe there are four fundamental issues that need to be carefully considered:

**MINIMUM ANNUAL PURCHASE**

The passenger charter airline industry, which supports the daily mission critical needs of USTRANSCOM, commends Congress for passing the 2009 National Defense Authorization Act. Passage of this bill was a necessary step allowing the Secretary of Defense the authority to improve predictability of DoD charter requirements. A key component of this legislation allows for a minimum annual purchase for carriers participating in the CRAF program. To meet peacetime contingency needs, as well as wartime preparedness, it is crucial that the execution of this program be pragmatic, effective and efficient.

In order to achieve a healthy, viable, and sustainable CRAF it is essential that future funding is not only allowed, but appropriated, and assured business be directed appropriately to the sector of the airline industry that has repeatedly proven its ability to provide the pipeline of transportation required in support of the majority of USTRANSCOM operations. To do otherwise would be reckless and not consistent with our national commitment of readiness.

As previously stated, the routine contingency operations of the DoD for the transportation of its troops require airlines that are always flexible and can provide on demand lift as necessitated ultimately by the USTRANSCOM customer. Implementing an effective assured business model should focus on charter airlines. One only needs to look at the statistic that charter airlines provide over 90% of all commercial USTRANSCOM airlift to derive that it is the charter carrier who provide the lion's share of capability to respond on short notice. It is the charter carrier who is always fully prepared to go anywhere at any time to meet USTRANSCOM demand. It is the charter carrier who attracts the scheduled carriers to participate in CRAF by paying commissions to scheduled airlines, incentivizing them to join teaming arrangements. Additionally, the charter carrier acts as an important buffer to the scheduled carriers participating in CRAF who typically do not desire to operate USTRANSCOM peacetime contingency or wartime business due to the disruption of their scheduled systems, low daily DoD utilization, rigid operating structures and unattractive revenue rates for their cost structures.

To maximize the benefit of assured business dollars, the priority of appropriated funding needs to be placed on having the most aircraft tails available at the least possible cost to USTRANSCOM. The best way to achieve this is through a model I call the "Fire Truck Model". In order for a firehouse to be successful, it must always have a predetermined number of fire trucks at the ready. In order for USTRANSCOM to be successful, it must always have charter aircraft at the ready, i.e., assured readiness.

Aircraft costs contain both fixed and variable components. For example, fixed components include airplane purchase or lease costs, insurance, crews and some aspects of maintenance. Variable components include fuel and oil, catering and ground handling.

For purposes of illustration, I offer the following example of the "Fire Truck Model":

> *Assume a wide body aircraft generates $40 million of total annual revenue. Let's further assume that 40% of this revenue is incurred from fixed costs and 60% as a result of variable costs. Next, let's assume that DoD determines that for upcoming years that in order to meet historical contingency demand it believes that there will be a required steady state of 25 Wide Body Equivalent (WBE) aircraft necessary and "at the ready" to meet anticipated contingency airlift. If minimum assured business were to guarantee 25 WBE at a cost of total annual fixed and variable expense of $40 million each, the total annual commitment for these 25 aircraft would equate to $1 billion dollars. However, USTRANSCOM does not know how many hours they may actually use the total aircraft fleet in advance of its commitment. Under the example thus far, DoD would be guaranteeing variable costs that may or may not ever be flown. Our proposal under the "Fire Truck Model" achieves the goal of paying for assured readiness at the least possible cost, works as follows;*
>
> (i) *USTRANSCOM determines 25 WBE aircraft are required to maintain readiness,*
>
> (ii) *utilize minimum assured dollars to guarantee only the FIXED costs of the operation,*
>
> (iii) *do not guarantee but pay the variable rate only when aircraft fly. Under this scenario, the same 25 WBE aircraft can be "at the ready" for a $400 million dollar commitment versus a $1 billion commitment. This concept would assure mobility at the least possible cost.*

This "Fire Truck" methodology optimizes assured business funds to achieve maximum readiness at the best value to USTRANSCOM.

Focusing the minimum annual purchase on the charter sector will ensure a viable CRAF program that optimizes the readiness and daily mobility required by the DoD. Without assured business directed to charter airlines, DoD would risk a substantial reduction in available assets to meet the daily demand required by USTRANSCOM. Specifically, if assured business funding is not directed to the sector of the industry that provides nearly all of the

USTRANSCOM airlift to the DoD then charter airlines would be forced to reduce capacity due to uncertainty of demand. This is a strong risk in an environment anticipating downward trends due to the forecasted reduction in military forces worldwide. As charter airlines are the "backbone" of national mobility, readiness, peacetime contingency and wartime troop movements, I urge decision makers involved in implementation of minimum annual purchase to confer with the charter sector of the airline industry in this process. The previous attempt to implement "Long Term Expansion" and supplant typical contingency operations with a more rigid advance scheduling methodology was not successful due to the impracticality of the DoD to always predict exact dates of airlift requirements months in advance.

With respect to awarding USTRANSCOM business, careful consideration should be given to adopting a competitive approach to contracting in place of the current Uniform Rates and Rules based on mobilization value points (MVP). It is our strong opinion that competitive bidding in lieu of the Uniform Rates and Rules methodology would severely impair the long term economic viability of the CRAF program. Current rates are based on CRAF carrier's historical costs over a two-year period, weight averaged into a single Uniform Rate per seat-mile. USTRANSCOM's objective in establishing these rates is "…to have a pool of accurate cost data that fairly represents the cost of providing DoD charter service" [Notice of Proposed Fiscal Year 2010 (FY10) Uniform Rates and Rules for International Service]. Introducing a competitive rate structure would have a negative effect by creating price instability leading to drastic destabilization of qualified CRAF operators.

RECOMMENDATION:

Minimum Annual Purchase should; a) focus appropriated funding directly to the passenger charter airlines who bring the warfighter to the fight, b) assure optimum readiness, at least cost and best value, through the "Fire Truck Model", c) utilize Uniform Rates and Rule's.

**MULTIYEAR CONTRACTING**

The current CRAF contracting process awards business on an annual basis. Airlines, however, make long term commitments and substantial investments not only in equipment but in training, technical support and personnel. Airlines spend millions of dollars on each aircraft performing heavy maintenance including airframe and engine overhaul costs which cannot be recaptured on an annual basis. These investments require long term financial commitments by the airline in order to secure adequate financing. Multiyear contracting would be beneficial to the DoD and further strengthen the health of the CRAF program. This concept would allow carriers to more adequately plan financial investments. Long term financial planning will yield savings that would ultimately pass through to the direct benefit of the government.

With the current annual contract award cycle and no guarantee of long term business, the industry has to speculate on what they perceive the future DoD demand will be. Under the current annual contracting methodology the DoD is taking substantial risk that the commercial sector appropriately predicts future demand.

Without multiyear contracting, the DoD may be in a position of inadequate readiness to meet airlift requirements. With the DoD and the airlines working collectively to forecast longer term demand, the risk of inadequate airlift capacity would be mitigated.

RECOMMENDATION:

Establish multiyear CRAF contracting with adequate funding to provide a baseline of mobility to meet USTRANSCOM historical contingency requirements

## UTILIZATION AND FLEET MODERNIZATION

As a consequence of peacetime contingency or wartime schedule unpredictability, airlines supporting DoD business are challenged with operations achieving low annualized aircraft utilization. While all airlines would enjoy operating new modern aircraft, high capital costs for modern equipment coupled with low utilization USTRANSCOM operations would not be fiscally viable.

As with any business, airline cost structures have both a fixed and variable component. There is no question that modern aircraft provide efficiency particularly with respect to fuel savings. However, new aircraft also come with a high capital cost. Financial modeling of high capital cost aircraft yields a result that dictates high utilization in order to effectively amortize the capital cost of the aircraft. Industry experts would suggest that new aircraft require utilization rates in excess of 12 hours per day in order for the benefits of these assets to be economically viable.

Conversely, classic aircraft that may not be as fuel efficient as new aircraft, have significantly lower capital cost. In general, USTRANSCOM business generates average daily utilization of eight hours per day. Economic modeling of aircraft in low utilization programs dictates that new aircraft are not affordable for fiscally responsible airlines to successfully operate.

It would be nice if the DoD were able to plan the next war or plan in advance all of its year round peacetime contingency business; however, this is obviously illogical thinking. Over the past decade that Omni has been operating USTRANSCOM business, we have been successful by choosing the best, most reliable assets, at the most competitive price to meet our customers' demands.  It should be up to the airline to choose what type of aircraft best suits the business as long as the operation is safe, reliable and comfortable for our military personnel. The current fleet of commercial passenger aircraft meets these requirements.  However, if the DoD desires fleet modernization, a careful economic study would be required to examine high capital cost assets operating in a low utilization environment.  The outcome will result in a significantly higher Uniform Rate in order to successfully deploy modern aircraft.  Lastly, for airlines to make investments in fleet modernization there will have to be a substantial base of assured business and multiyear contracting for justification to make this shift.

It is incumbent upon the airline to discern and operate the most effective aircraft type that best matches the business under the current Uniform Rate.  No passenger charter airline could afford to speculate on providing new aircraft for an eight hour daily utilization program with missions not known until only days or weeks in advance of the actual operation and no guarantee of what subsequent future long term business would be, particulary at the current uniform rate.

RECOMMENDATION:

Since its inception, DoD business has always been a low utilization program.  It is beneficial to the government to allow airlines to determine what assets provide the best value.

If fleet modernization is desired, the DoD should be prepared to provide funding to allow airlines an assured business base, multiyear contracts and significantly higher Uniform Rates to pay for high capital cost aircraft operating in a low utilization environment.

**60/40 RULE**

The 60/40 rule for passenger charter airlines should be permanently abolished.  This policy requires air carriers operating CRAF business to maintain 60% of their total business from commercial sources. It is a policy that has been consistently waived in recent times. While there was a time in aviation history that the 60/40 rule may have been meaningful, it is no longer advantageous to government or industry.

The 60/40 rule was implemented years ago partly because of safety concerns that charter carriers operating only DoD business may not have the same safety standards if not heavily regulated under the same rules as commercial customers.

Today, this is of no concern as charter carriers are certified in accordance with full compliance of FAA Part 121 regulations. Additionally, the Secretary of Defense requires the Commander of USTRANSCOM to approve supporting CRAF carriers through an extensive safety audit process (32 CFR 861).

Separately, It is not beneficial for the government to mandate what mix of business commercial passenger carriers should operate. It is beneficial for the government to allow airlines to make prudent business decisions based on sound business principles and fiscal responsibility to determine what business they should operate. The 60/40 rules did not save Rich International, Tower Air or ATA, all of which met the intent of this rule, from entering the airline graveyard.

The past decade in aviation history has irrevocably changed the complexion of the passenger charter industry. Prior to the economic downturn of the late 1990s, the charter industry was thriving and generating an estimated $1.5 billion of annual revenue. Until the early 2000 time frame, charter airlines provided full plane load aircraft contracting with tour operators. The fundamental market of the tour operators was to provide lift via full plane load capacity to specialized and unique niche leisure destinations that were mostly under served, if not served at all, by major US scheduled airlines. During times of worldwide economic growth, while tour operators were focused on leisure destinations, large scheduled airlines focused their route structure on demand generated primarily from the business traveler and secondarily from leisure markets. Seats sold to the business traveler resulted in an attractive high yield product while leisure travel resulted in low yield business.

As a result of factors including the economic downturn of the late 1990s, growth of low cost airlines, 9/11, SARS, exorbitant fuel costs and the current global economic meltdown, legacy scheduled air carriers began to re-think their business plans. The outcome was the advent of legacy scheduled carriers now aggressively competing for leisure travel. Previous core markets, largely served by tour operators, now became a target market for legacy and low cost scheduled airlines. With the benefit of hindsight, over the past decade, it is obvious that tour operators began migrating away from committing to full plane load charters in favor of committing to book blocks of seats on scheduled airlines now aggressively serving what once were, historically, markets only served by charter airlines. The net result over the course of the past 10 years has been a dramatic shift in the domestic passenger charter markets that has shrunk from a vibrant $1.5 billion annual revenue stream to the current relatively small market of approximately $200 million of annual charter business.

The resulting impact and the dynamic change in the tour operator market described above makes it impracticable, if not impossible, to achieve a mix of 60% commercial and 40% government business. Additionally, we are not familiar with other sectors within the defense industry where such a rule is imposed.

RECOMMENDATION:

Permanently abolish the 60/40 rule for CRAF passenger carriers. This rule does not enhance safety nor encourage airlines to act fiscally responsible. It is advantageous to the government to allow airlines to make prudent business decisions with respect to their customer base as opposed to mandating business that may be economically disadvantageous. DoD and commercial business are cyclical and airlines will adjust their business through prudent business decisions rather than unrealistic government mandate.

## CONCLUDING REMARKS

The past success of the CRAF government program and industry partnership will evolve to a new level of success, with the benefit of hindsight, only by understanding the current challenges and taking appropriate action.

In summary, such specific actions must include:

1. Minimum Annual Purchase which a) focuses appropriated funding directly to the passenger charter airlines who brings the warfighter to the fight, b) assures optimum readiness, at least cost and best value, through the “Fire Truck Model”, c) utilizes Uniform Rates and Rules.

2. Understand USTRANSCOM’s utilization requirement. This becomes the economic driver dictating best value assets to provide passenger airlift to USTRANSCOM. Such assets should be selected by industry through responsible economic modeling.

3. CRAF can be further stabilized by providing multiyear contracting. This provides predictability to airlines, ultimately benefitting DoD with stability and cost savings which come through long term planning.

4. The 60/40 rule is antiquated and should be permanently abolished. It is advantageous to the government to allow airlines to exercise fiscal responsibility in determining their customer base. An arbitrary business mix requirement is detrimental to the government causing destabilization of airlines.

5. Congress and USTRANSCOM decision makers should collaborate with the passenger charter industry for successful implementation of any changes in CRAF policy.

Incontrovertibly, since its inception in 1952, the CRAF program has proven to be a successful government and industry partnership. The CRAF program has repeatedly demonstrated its significant economic value to the American taxpayer. If the U.S. Government were to invest in a fleet of aircraft equal to the capacity brought to the current CRAF program from the civil aviation sector, such asset investments would exceed $200 billion. In addition to the cost of the assets, the annual expense to the government to appropriately staff and maintain an operation at the equivalent size of the current Civil Reserve Air Fleet would be additional tens of billions of dollars. Providing access to a large number of commercial aircraft "at the ready" for USTRANSCOM, while at the same time greatly reducing the need for the DoD to invest in and maintain large numbers of organic military airlift assets, exemplifies a true win/win partnership.

In closing, CRAF enjoys an enviable proven track record. USTRANSCOM is an exceptional customer with unique requirements. While CRAF remains strong and viable there certainly is room for modification to assure its future health and success. Such improvements can only be achieved by spending dollars wisely that appropriately align with the customer's need of flexible mobility. The economic viability of the CRAF program can be maintained by thoughtful implementation of the specific actions including recommendations in this testimony. We urge those involved in future decision making of CRAF policy to seek continued guidance from its partners in the passenger charter industry.