

ATA Chair Keynote Address to the Commercial Aviation Alternative Fuels (CAAFI) Annual Meeting

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Thank you, Jim for the kind introduction. It is a pleasure to be here with you this afternoon.

I am here today as the chairman of the Air Transport Association, a founding member of CAAFI, and someone who has spent some 30 years in the oil and gas industry, prior to assuming my current role at United Airlines.

When asked to address this conference, it seemed to me the question we should be asking is: If the airlines need alternative fuels, want alternative fuels, and we've flown aircraft with them, why then, don't we have them?

As we all know, as an industry, our biggest environmental impact and our largest and most volatile expense comes from jet fuel. Today, there is no real competition for crude oil as the feedstock for jet and this impacts us as an industry both financially and environmentally.

And yet we are increasingly required to account for and reduce emissions generated from crude oil ... likely by threat of substantial penalties.

Why is there no credible alternative product?

There clearly is a market. There are buyers. There is certainly interest. If this is all so virtuous, why hasn't this happened yet?

Why have we stalled in this effort and still subjected to the volatility of crude oil?

While the answer is not so simple, it is underpinned by a business fundamental -- the need to create a healthy investment environment for the capitalization and commercial deployment of aviation alternative fuels.

Although commercial aviation has an important role as end users -- in sending the right market signals -- this cash-strapped industry cannot provide the capital the fledgling aviation alternative fuels industry needs.

So what is the way forward?

Establishing the market need -- that will provide an adequate return on investment environment for the capitalization and commercial deployment I just mentioned.

The airlines need alternative fuels for three good reasons:

- one - provide competition to petroleum-based fuels to help limit price volatility;
- two -- increase security of supply; and
- three - reduce environmental impact.

As to the need for competition: Fuel is by far our largest expense. The volatility that we have seen in the oil market driven by uncertainty and speculation -- makes this expense one that is virtually unpredictable. And, that unpredictability will exist as long as there continues to be the possibility of unconstrained speculation.

The volatility will also continue without a credible, available physical and economic alternative to crude oil, one does not exist today...despite the fact that we have been talking about it for more than 20 years. That simply has to change.

Ours is a cyclical industry. The unpredictability in price of our largest expense makes the troughs of our cycles even more difficult to manage. Consider the impact on our industry in 2008 when airlines in the U.S. paid \$58 billion for fuel, an increase of \$16 billion from 2007.

This industry used about the same amount of fuel in 2003 as we did in 2008, but our fuel bill was **\$42 billion higher in 2008.**

It is impossible to offset a \$16 billion increase, let alone a \$42 billion increase, with nonfuel cost reductions or new revenues. Volatile increases in fuel costs devastate the industry's bottom line.

As to the need for security of supply: We know very well the significant issues caused by our reliance on oil from unstable regions of the world. With fuel supply lines in the U.S. located in gulf and coastal regions, we also contend with the impact of weather related supply disruptions. Alternative fuels would help bring needed diversity of physical supply.

As to the need for better stewardship of our environment: We must work to mitigate the impact of hydrocarbons. While aviation only accounts for 2 percent of U.S. or 3 percent of global manmade greenhouse gas emissions, we are committed to reducing the impact associated with aviation.

Aviation alternative fuels are a critical part of this commitment – they must produce an environmental benefit on a lifecycle basis relative to traditional fuels.

As an industry, we do our part. Without punitive economic measures, such as taxes or emissions trading schemes, the airlines have done a great deal to limit our carbon footprint. As demonstrated by our fuel efficiency record -- we carry passengers and cargo more than twice as far today on a gallon of jet fuel than we did in the late 1970s.

But we can only manage emissions by the means that are within our control.

So, commercial aviation certainly has "the need" for alternative fuels. What else is required to create a workable market that would prompt would-be fuel producers, investors and governments to invest in aviation alternative fuels?

We have volume.

The potential buyers of alternative aviation fuel are not just the airlines. The military would also be an important consumer. The U.S. armed forces are considerable users of jet fuel and they share exactly the same needs as our industry. Together we represent a significant, long-term market for suppliers.

Just a few weeks ago, the DOD announced a procurement contract for 560,000 gallons of alternative jet fuel for the air force and the navy, to be provided by some of the very folks in this room.

The airlines have begun to buy alternative fuels for ground equipment. In August, multiple airlines, including United, announced the first of its kind ongoing supply agreement with Rentech for renewable synthetic diesel fuel for use at Los Angeles International Airport.

This is a relatively small deal, but it is a start. There is no reason that we cannot expand upon this type of supply agreement and develop an airline fuel purchasing program specifically targeted at alternative fuels.

We have manageable logistics.

Airports are concentrated "demand nodes." Distribution is centered primarily on a few dozen locations to supply over 90 percent of the market. Hardly the same logistical issues posed by retail gas stations supplying autos and trucking.

We have a sustainable market.

As Administrator Babbitt referenced this morning, the market for liquid jet fuel will be with us for decades. Those providing alternatives to gasoline in other industries face competition not only from other liquid fuels, but also electric. As much as we might like the notion ... we don't see an electric "plug in" alternative for aircraft any time soon...

We do, however, see significant progress with the successful approval of a new jet fuel specification for synthetic fuels. While a rigorous process, it clearly can be navigated. And once a fuel meets the specification, it admits the producer to a relatively exclusive club.

CAAFI, now in its third year, is leading the industry's efforts to be ready to take advantage of alternative fuels and to create a market for these products. We're leveraging CAAFI to get over hurdles. The four CAAFI teams are keenly focused on this, with the Business & Economics Team, led by the airlines, particularly focused on the business case.

The ATA airlines are committed to working with potential suppliers to identify commercial terms and strategies, including short- and long-term purchasing contracts and innovative financing mechanisms to overcome financial challenges associated with bringing nontraditional jet fuels to market.

It bears repeating – the first new fuel specification in more than 20 years allows the use of alternative jet fuel options from renewable and non renewable sources for synthetic kerosene. The airlines are committed to seeing it expanded to the full range of feedstocks and processes.

We are actively supporting and seeking funding for this work. We are working with relevant government agencies, and also with agricultural interests, universities, independent researchers and the military.

In early 2009, the U.S. Departments of Energy and Agriculture announced the release of \$25 million for research and development of biofuels, including aviation biofuels, as part of a much broader, critical government grant and loan program.

Securing these funds and recognition of aviation fuels was a good first – but a small step in implementing provisions that the ATA actively supported in the 2008 Farm Bill. These provisions provide grants and guarantee loans for commercial scale alternative fuel projects, including those that produce clean, homegrown, renewable jet fuel.

...Back to the question at hand. If all of this is so virtuous, why aren't we there yet?

We need sustained funding and commitment from government and private investment sources to cross what our Air Force colleague Bill Harrison refers to as "The Valley of Death" to get from what we have demonstrated as possible to full scale commercial deployment.

It is by no means clear that emerging alternative jet fuel producers can get the funding they need for constructing facilities, growing or extracting alternative feedstocks on a commercial scale and making the business financially competitive.

While the airlines have the need and every interest in the alternative jet fuel market succeeding, we are a cash-strapped industry – we do not have the cash or credit capacity to fund the infrastructure for this.

As many in our industry have discussed, and as you have heard from ATA's John Heimlich, our industry has systemically failed to earn its cost of capital.

The industry remains financially fragile. In fact, the International Air Transport Association earlier this month again upped their projected losses for the global industry, bringing it to \$11 billion, from their previous projection of \$9 billion. What's more, they are not projecting profitability for the industry until 2011.

While the airlines are stepping up, seizing every opportunity, and doing what we can with what is within our control, it is not enough to get through The Valley of Death.

The government has a critical role to play. The commercial viability hurdle requires a concerted and sustained commitment from government – we need to create that platform.

Instead of focusing attention on punitive economic measures to address climate change, government should be working with aviation to invest in the very things, such as alternative fuels, that will dramatically reduce our emissions.

Oil price volatility has made investors/capital markets nervous about committing capital to alternative fuels development – that's why government loans and guarantees, and other ways to mitigate risks for private investors, are absolutely essential. With government bridging, private investment can take over.

Alternative jet fuels need the same sort of government incentive programs that supported alternatives for gasoline. Whether or not one considers ethanol an appropriate substitute for gasoline, the process showed us that aggressive incentive programs are absolutely essential to get the ball rolling.

And we can take into account lessons learned, including “don't compete with food supply” and “do sound environmental assessment to support your choice of funded options.”

Another key point is that government should not micromanage or mandate choice of feedstocks or technologies.

As an industry, we are open to the type of jet fuel alternative. We are promoting innovation and competition among all alternatives. We are interested in partnering toward an outcome that provides a safe, environmentally friendly, reliable and economically feasible alternative.

With various alternative fuel markets out there, why focus on aviation?

Simply put – airlines are key economic enablers, with multiplier effects across the economy. We bring a strong return on investment for the nation.

Despite the financial challenges I laid out – and indeed in stark contrast to them – the airline industry drives more than \$3 trillion US a year in global economic and social development and accounts for 8 percent of the global GDP.

Governments have long imposed tremendous burden on this industry, with aviation globally paying \$42 billion annually in user charges – and yet often leave us out in the cold on infrastructure investment. In addition to direct government funding of the Next Generation Air Transportation System, this is a critical way in which the government should support aviation infrastructure.

The airlines are not asking the government to do it for us. We are asking them to do it with us. I have given you many examples of how the airlines are taking responsibility for our own destiny – we're putting in intellectual capital and resources so investment in aviation alternative fuels will bear real fruit – we're plowing the field.

Investors should seize this opportunity. Alternative fuels are viable investments, and they are not new.

Brazil has long been a leader in alternate fuel production, using other feed stocks such as cassava root. Necessity, for Brazil, was the mother of invention... and, of course, Brazil has since become a huge oil producer in the region.

Exxon, BP, Chevron, Shell and others are investing in the development of alternatives.

And why? Because it makes good financial sense to hedge exposure against a diminishing resource that is crude oil and to seek lower carbon alternatives to today's fuel.

The airline industry is organized, committed and unified as buyers of alternative fuels. We consume between 18 and 20 billion gallons of jet fuel annually, creating a great market opportunity for these products.

And, we will continue to be a strong fuel market – as we provide the connectivity for the towns and cities of America and connect them to the world. As I said earlier, we are a critical enabler of the global economy.

We need leadership from government to make the needed investment attractive to those who can and will invest.

We need alternative fuels, want alternative fuels, and we've flown aircraft with them. There is a significant market for such products.

The country has a great opportunity and together we can meet this challenge – or we can continue to flounder around. Not what I would call a tough decision.

With that, be happy to answer any questions.