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U.S. Airways

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The Bankruptcy (2d) of US Airways

I. Introduction

On August 11, 2002, following a sharp decline in air travel, US Airways became the first major airline to file for bankruptcy protection after the terrorist attacks of September 11, 2001. Under the direction of its new CEO, David N. Siegel, US Airways emerged from bankruptcy on schedule in March 2003, only to return to bankruptcy again less than 16 months later. While the plan of reorganization from the first bankruptcy filing was ultimately unsuccessful, the plan from the second looks to be more promising despite the constant grim prognostications by "experts." While the airline continues to struggle early after its emergence from bankruptcy, the merger with America West should bring clear skies to the future of the new airline.

There is now way to know for sure the implications of the second bankruptcy filing, but with the recent Delta bankruptcy, it is reasonable to believe other airlines will soon use the protections of bankruptcy to renegotiate burdensome contracts with labor unions and to refinance outstanding loans in order to stay afloat and prevent a total liquidation. US Airways may have been on the brink of insolvency when it filed on September 12, 2004, but the process became the airline's most important bargaining tool which ultimately led to the creation of the 5th largest domestic airline after merging with America West.

II. US Airways and the Airline Industry

A. US Airways

US Airways began in 1939 as All American Aviation providing airmail service to Pennsylvania and the Ohio Valley.[1] All American Aviation later became All American Airways and began passenger service in 1949. In 1953 All American Aviation became Alleghany Airlines.[2] At the same time, the airline expanded its routes into the Midwest and East Coast.[3] Alleghany changed its name to US Air in 1979 and began adding flights to the South and California.[4] In the largest U.S. Airline merger of its time, US Air acquired Piedmont Airlines and Pacific Southwest Airlines in 1987.[5]

In 1988, shortly after the merger with Piedmont Airlines, US Air began to experience losses due to the high cost of fuel and the increase of fare competition.[6] Nevertheless, US Air continued to add routes and expand its international service.[7] In 1996, as the airline began to return to profitability, its CEO, Seth E. Schofield, was retiring.[8] Stephen Wolf would take over as CEO and began an immediate transformation of US Air. The airline ordered 400 new Airbus aircraft for delivery from 1998 through

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[1] US Airways History, *available at* http://www.usairways.com/about/corporate/profile/history/company_history.htm; *Key Dates in history of US Airways*, USA TODAY, Sept. 13, 2004.
[2] *Id.*
[3] *Id.*
[4] *Key Dates in history of US Airways*, USA TODAY, Sept. 13, 2004.
[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*

2009 and then severed its relationship with British Airways.[9] The name US Airways and new logo were officially put to use Feb. 27, 1997.[10]

In May 2000, US Airways announced a merger with United Airlines that would provide US Airways strong East Coast presence with United's broad international routes. However, the merger required approval by the Department of Justice. Because of concerns about the impact on competition in the industry, the Department of Justice decided to disallow the proposed merger.[11]

By its own admission, 2001 was a turning point for US Airways (and the airline industry).[12] In April, it announced services to Amsterdam; in May, it added its ninth European destination and four new Caribbean destinations.[13] However, after September 11, 2001 US Airways was forced to reduce its workforce by 11,000. David Siegel took over as president and CEO in March 2002 and began undertaking a comprehensive restructuring that took the airline to its first bankruptcy on August 11, 2002.

B. The Financial Woes of the Airline Industry

While economic downturns in the airline industry have in the past led to liquidation, the most recent, and most severe, downturn has not yet resulted in a single liquidation.[14] Low-cost carriers have begun to compete with the major full-service airlines, and have done so profitably.[15] However, this competition created record losses

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[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] Rollman, Daniel P., Comment: Flying Low: Chapter 11's Contribution to the Self-Destructive Nature of Airline Industry Economics, 21 BANKR. DEV. J. 381 (2004).
[15] *Id.*

for traditional carriers.[16] As a result, the major carriers must find ways to cut costs if they are to survive in the increasingly competitive airline industry. Because labor is the largest expense of airlines, it is expected that labor expenses are the first to be cut.

In addition to cutting labor expenses, major airlines will need to adjust their current hub-and-spoke route system in order to provide stability.[17] Many carriers, including US Airways, are in the process of reducing the number of hubs and providing more direct flights. Because of the increased costs of using the hub-and-spoke system[18], more direct flights also means a more efficient airline and also more satisfied passengers willing to fly with the same airline again.

While stiff competition from low-cost carriers provides an obstacle to profitability for major airlines, all airlines share equally in the burden of increasing fuel costs.[19] In addition, one of the strongest contributing factors to the entire airline industry's financial problems is certainly the terrorist attacks of September 11, 2001. According to at least one study of the effects of September 11th, the impact on airline demand was so severe that demand was still well below pre-attack levels two years later.[20] The initial effect of the attacks resulted in a 30% decrease in demand and an ongoing decrease in demand of

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[16] *Id.*
[17] *Id.* A hub-and-spoke system is one in which passengers are flown from many small cities (the spokes) to a central city (the hub) where they are then routed to their final destination. This increases the number of cities to which an airline can provide travel, although it is more costly than a direct flight.
[18] *Id.*
[19] For an in depth analysis of the rising cost of jet fuel, see Appendix A, The Higher Cost of Fuel.
[20] Lee, Darin, Harumi Ito, Assessing the Impact of the September 11 Terrorist Attacks on U.S. Airline Demand at 3, *available at* http://www.brown.edu/Departments/Economics/Papers/2003/2003-16_paper.pdf.

7.4%.[21] This same study concludes that "this structural demand shock accounts for over 90% of the current weakness in domestic airline demand relative to its pre-September 11th Peak."[22] While the initial panic following September 11th has faded away, the residual effects of that panic – strict security screening and perceived risks of flying – have likely contributed to the current decrease demand.[23] As a result, no less than ten major airlines have filed for bankruptcy since 2001;[24] US Airways has now filed twice.

C. The First Bankruptcy

By its own reports, US Airways was hit the hardest by September 11th.[25] The reason US Airways took such a hard hit was because of the prolonged closure of Washington Reagan National Airport, higher security costs, the recession, and an overall decrease in travel along the east coast.[26] In order to save the airline, US Airways brought in David Siegel as its new CEO to reverse the losses and return the airline to prosperity.[27]

US Airways had a prepackaged restructuring plan put together before it ever filed for bankruptcy. That plan included $500 million in debtor-in-possession (DIP) financing from Credit Suisse First Boston and Bank of America.[28] In addition, the airline received a $1 billion collateralized loan backed by a federal guarantee that was conditionally

[21] *Id* at 4.
[22] *Id* at 22.
[23] *Id.*
[24] Based on an independent study conducted at lopucki.law.ucla.edu. The ten airlines that have filed since 2001 are Midway Airlines Corp. (2001), Trans World Airlines (2001), United Airlines (2002), US Airways (2002), Hawaiin Airlines (2003), ATA Holdings Corp. (2004), US Airways (2004), Delta Air Lines (2005), FLYi (2005), and Northwest Airlines (2005).
[25] US Airways Press Release: US Airways to Complete Restructuring Plan in Chapter 11 Reorganization, *available at* http://www.americawest.com/awa/content/aboutawa/pressroom/pressreleases.aspx
[26] *Id.*
[27] *Id.*
[28] *Id.*

approved by the Air Transportation Stabilization Board (ATSB).[29] According to the Press Release coinciding with the First bankruptcy Filing, the $1 billion ATSB loan coupled with cost reductions and revenue enhancements will improve cash flow as it implements the remainder of the restructuring plan.[30] In addition to the ATSB loan, on the effective date of the plan the Retirement Systems Alabama Holdings LLC invested $240 million in cash in exchange for a 36.2% equity interest in US Airways.[31]

Another important part of the plan was the cancellation of US Airways' prior common stock.[32] New stock was distributed in accordance with post-petition agreements, namely to satisfy general unsecured claims.[33] The cancellation and then distribution of new common stock would prove to have serious implications for some employees and investors in the 2004 bankruptcy case.[34] US Airways also began negotiations with Embraer and Bombardier for regional jets, with MidAtlantic Airways, the new regional carrier for US Airways, taking the first deliveries in the fall of 2003.[35] In addition, the plan called for the previous Board of Directors to be replaced by a Board selected under the plan. [36]

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[29] *Id.*
[30] *Id.*
[31] Motion for Order Pursuant to 11 U.S.C. §§ 105, 362 and 363 and Rules 4001 and 6004 of the Federal Rules of Bankruptcy Procedure Authorizing the Debtors to Enter Into a Sale and Lease Agreement and related Transactions with the City of Philadelphia, No. 04-13819, 1660 at 5 (Jan. 24, 2005).
[32] *Id.*
[33] *Id.*
[34] *See infra* note ?? *In re US Airways, Inc., et al.,* No. 04-13819-SSM, 2005 Bankr. LEXIS 2828 (Bankr. E.D. VA Dec. 29, 2005)
[35] *See supra* note 30. US Airways would eventually close MidAtlantic and cut 368 jobs as a result of the second bankruptcy. *US Airways to close MidAtlantic, cut 368 jobs,* CHARLOTTE BUSINESS JOURNAL, *available at* http://charlotte.bizjournals.com/charlotte/stories/2006/03/27/daily57.html.
[36] *See supra* note 30.

Because of its prepackaged plan, US Airways was able to emerge from bankruptcy on schedule, March 31,2003, less than nine months after it filed.[37] In total, the bankruptcy process involved over 700 transactions governing all aspects of the operations of US Airways providing $1.24 billion of additional capital and a $240 equity investment.[38] US Airways reduced its costs by more than $2 billion annually, including $1.2 billion in labor costs, [39] initiated a plan to use more regional jets and procured financing to acquire the new regional aircraft[40], and expanded alliances with other carriers.[41] On August 20, 2004, the Bankruptcy Court for the Easter District of Virginia entered an order closing all but one of the 2002 bankruptcy cases.[42]

III. What Went Wrong

A. Why the Plan Didn't Work

US Airways emerged from its first chapter 11 case with what appeared to be a sound business plan based on its continued operation as a traditional hub-and-spoke carrier.[43] As evidence of the success of the 2003 plan, US Airways prepared a chart comparing the plan projections for 2004 and the actual status in 2004.[44]

[37] US Airways Press Release: US Airways Completes Restructuring; Secures $1.24 Billion in New Financing and Investment As It Emerges from Chapter 11, *available at* http://www.americawest.com/awa/content/aboutawa/pressroom/pressreleases.aspx.
[38] *Id.*
[39] *See supra* note 16.
[40] *See supra* note 30.
[41] *See supra* note 30
[42] According to the Court entering the order, the only purpose of the one remaining open case is to complete the administration of 70 disputed claims.
[43] *In re US Airways, Inc.*, 329 B.R. 793, 795 (Bankr. E.D. VA 2005)
[44] *See In re US Airways, Inc.*, Motion for Bridge, Interim, and Final Orders (1) Authorizing The Debtors To Use Cash Collateral; (2) Providing Adequate Protection; (3)

	Plan Projections for 2004	Current Status
Fleet Size	279	282
Capacity (available seat miles) (millions)	53.7	53.6
Revenue passenger miles (millions)	39.4	39.9
Cities Served	87	86
Labor cost (per available seat mile)	4.2 ¢	4.1 ¢
Load Factor (main line)	73.3%	74.4%
Total cost (per available seat mile) (excl. fuel)	10.1¢	10.0¢
Total operating expenses (excl. fuel) (millions)	$5,237	$5,183

While it had achieved substantially all of the objectives of its 2003 plan, it continued to experience operating losses after emerging from bankruptcy. For the nine-month period ending December 31, 2003, the airline had an operating loss of $44 million and a net loss of $174 million.[45] The primary factors cited for these losses include "an unprecedented reduction in domestic industry unit revenue and unprecedented increases in fuel prices."[46] Notably, the plan projections and current status exclude fuel costs, demonstrating the enormous impact of high fuel costs on the airline. In addition to rising fuel costs, all of the previous cited reasons for the industry's financial problems

Scheduling A Final Hearing; (4) Approving Form And Manner Of Notice; And (5) Granting Related Relief, No. 4 (E.D. VA Sept. 12, 2004).
[45] *See supra* note 30
[46] *Id.*

(competition from low-cost carriers, the design of the route system, and current fare structure of traditional carriers[47]) hit US Airways hard.

Many analysts believe that US Airways underestimated the level of concessions needed in the first restructuring to remain viable and competitive.[48] Even though it was able to secure more concessions from its workers than it had initially anticipated, it was still not enough.[49] While cutting was in line with projections, the airline failed to produce enough revenue to make it profitable again.[50]

The increase in low-cost carriers has continued to take its toll on the legacy carriers such as US Airways. These carriers are able to price their services substantially lower than large carriers and can therefore draw a significant market share.[51] At the lower price levels, low-cost carriers are able to make a profit while legacy carriers continue to lose.[52] While this fact should have been apparent to US Airways in the first bankruptcy case, it failed to acknowledge the emergence and enormous impact of these discount carriers and continued to struggle financially as a result. To exacerbate the effect of low-cost carriers on US Airways, Southwest Airlines announced in October 2003 that it would begin flying out of Philadelphia, one of US Airways' most important

[47] *See* Rollman, *supra*, note 14, at 388-393.
[48] Alexander, Kieth L., Plan to Save US Airways Falls Apart, WASHINGTON POST, Feb. 2, 2004, at E01.
[49] *Id.*
[50] *Id.*
[51] *Id.* As of February 2004, low-cost carriers have increased their market share to 20% of the aviation market, compared with 5% in the 1980's and are expected to have 40% by 2006. The growth of low-cost carriers has come mostly on shorter routes in the Northeast, where US Airways operates most of its flights.
[52] *Id.*

hubs.[53] In order to be competitive in the industry US Airways would have to reduce its costs or it would face another bankruptcy proceeding from which it may not emerge.

B. How US Airways Attempted to Prevent A Second Bankruptcy

Since emerging from its first bankruptcy in March 2003, US Airways cut more than 500 jobs.[54] Despite criticism that it may have exited bankruptcy too soon, US Airways claims it had no choice but to take it out when it did since many of its lenders had tied approval of loans to a March 31 emergence.[55] However, many employees and union leaders blame the airline's failures on the executives, including then-CEO David Siegel.[56]

In order to reduce its costs and compete with the low-cost carriers, US Airways began by asking employees for more concessions and considered selling off some of its

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[53] *See* Alexander *supra* note 46.
[54] *Id.*
[55] *See* Alexander, *supra* note 46. While US Airways claims that it had no choice, it is reasonable to believe that they would have agreed to a later emergence if US Airways had shown that it needed to remain in bankruptcy longer in order to ensure financial success after emerging. Because, if US Airways is not successful after emerging, then its lenders will have a much smaller chance of being paid back in full – or at all.
[56] Ramstack, Tom, Unions slam US Airways sell-off plan, THE WASHINGTON TIMES, Jan. 9, 2004. ("[T]he pilots' union called for the resignation of David Siegel, US Airways' chief executive officer, saying he mismanaged the airline and lost support of employees.")

assets.[57] Management looked first to the pilots to take a pay cut[58], and then sought more concessions from the flight attendants and mechanics[59].

1. Pilot's Union

New CEO Bruce Lakefield met with a group of 11 pilots to discuss possible concessions. In a "work more, pay less" plan, management's first proposal was for a 16.5% pay cut with an increase in flying hours per month from 80-85.[60] However, the pilots' governing board was not satisfied with the offer.[61] The pilots had previously given up $565 million in annual concessions in the first bankruptcy and were now being asked to give up another $295 million.[62] Therefore, the pilots' union countered with a proposal for a 12.5% cut and an increase in flying hours per month to 90 rather than 85.[63]

In addition to wage cuts, negotiators for US Airways proposed changes in the pilots' vacation and sick time policies. The company based the proposed changes on JetBlue airways – a low-cost carrier rival – indicating the airline now saw the impact that low-cost carriers were having on its financial problems. Not surprisingly, the controlling factions of the pilots' union rejected this proposal, too, and countered with their own:

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[57] Analysts estimate that the traditional airlines, such as US Airways, must cut their costs by at least 25% in order to survive. Because labor is the largest operating expense, airlines typically begin by looking for significant concessions from unions. *See* Alexander, *supra* note 44.
[58] De Lollis, Barbara, US Airways asks pilots for 16.5% cut in pay, USA TODAY, Aug. 20, 2004, at B1.
[59] Fitzpatrick, Dan, US Airways/ Behind the Scenes: Machinists, PITTSBURGH POST-GAZETTE, Aug. 1, 2004, *available at* http://www.post-gazette.com/pg/pp/04214/354993.stm.
[60] *See* De Lollis, *supra*, note 58.
[61] Fitzpatrick, Dan, US Airways/ Behind the Scenes: Pilots, PITTSBURGH POST-GAZETTE, Aug. 1, 2004, *available at* http://www.post-gazette.com/pg/pp/04214/354994.stm.
[62] *Id.*
[63] *Id.*

- Keep the pilots' defined contribution retirement plan in place,
- Remove the policy that penalizes pilots for calling in sick,
- Provide profit haring, stock or premium pay in exchange for concessions,
- Tie the pilot concessions to participation by all groups, and
- Tie pilot concessions to sacrifices from management.[64]

The gist of the pilots' suggestions: if we are going to make concessions and take cuts, then so will everyone else. The union was willing to concede more points but wanted to ensure that everyone at US Airways would share equally in the financial struggles and that management – who, to the pilots, was responsible for the current problems[65] – should not be rewarded.[66]

The Company's main bargaining tool was the threat of liquidation if it did not receive the concessions it was seeking. However, the pilots' representative on the US Airways board of directors saw this threat for what it was – a threat to force negotiations.[67] While union officials believed that the airline's executives were trying to intimidate them to make more concessions by threatening to sell parts of the company, they also recognized that it could be real.[68]

The airline lost some credibility with the union leaders when, at the same time that it was threatening liquidation, its CEO was declaring that it is "not inevitable" that it would have to sell assets.[69] Siegel also declared that he did not anticipate filing for

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[64] *See* Fitzpatrick, *supra* note 57.
[65] *See* Alexander, *supra* note 44.
[66] The pilots union later filed suit to prevent the management compensation package that was proposed in bankruptcy. *See In re US Airways, Inc., et al., infra* note ?.
[67] *See* Ramstack, *supra*, note 54.
[68] *Id.*
[69] Fitzpatrick, Dan, Selling Assets not inevitable at US Airways, PITTSBURGH POST-GAZETTE, Jan. 31, 2004, *available at* http://www.post-gazette.com/pg/pp/04031/267671.stm.

chapter 11 bankruptcy protection.[70] Either the company was suddenly improving or it realized its threat was having no effect on negotiations and sought a new strategy of optimism to sway the pilots.[71]

2. *"The concession stand is closed"*[72] *– The Machinists' Union*

While the pilots' union was willing to make some concessions, the machinists took a hard line and would not concede on its contracts any further than it already had.[73] US Airways was seeking $263 million in annual cuts from the International Association of Machinists (IAM).[74] In US Airways' first bankruptcy, the machinists union rejected $152 million in cuts. It accepted the deal three weeks later, upsetting many of the union's members.[75] There was no second vote this time as the union held its line and refused to make any additional concessions.

C. On the Brink of Bankruptcy

In March 2004, David Siegel announced that he was willing to walk away from an agreement that would pay him millions if he left his job; Less than a month later, on April 19, 2004, in perhaps a sign of things to come, Siegel resigned his position as

[70] *Id.*
[71] One analyst suggests that the reason for this change of approach is that if the employees are to agree to more concessions, Siegel would have to convince them that he does not plan to sell the airline. While Siegel would ultimately not see the airline into bankruptcy, he did his best at this point to convince his workers that he intended to revive the airline.
[72] *See* Fitzpatrick, *supra* note 57. The union representing the mechanics coined the phrase in the fall of 2003 when negotiations began.
[73] *Id.*
[74] *Id.*
[75] *Id.*

President and CEO and was replaced by Bruce Lakefield.[76] Lakefield continued negotiations with the labor unions to no avail. As of August 2004 US Airways had failed to reach a deal with its pilots' union and its machinists' union. Nevertheless, both sides expressed optimism that they would reach a deal soon.[77] However, describing the airline's September 8 deadline as "artificial," the Air Line Pilots Association was skeptical of the company's analysts that said it would go bankrupt within a month.[78] This skepticism likely stemmed from its recent reversals, including threats of liquidation (followed shortly by promises of not liquidating) and the use of deadlines previously as a bargaining tool.[79] With this type of history, it is no wonder that the labor unions were unwilling to concede further.

US Airways was in dire need of $800 million in labor concessions by September 30 or it risked defaulting on the federally guaranteed loan from its first bankruptcy.[80] In addition, it was facing $130 million in obligations to union pension funds on September 15.[81] After pilots' union leaders blocked a vote on US Airways latest proposal, bankruptcy was inevitable, despite the assertions by Lakefield that a last-minute deal could be struck.[82] The company indicated to the union that it needed to reach an

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[76] Press Release: Us Airways Announces The Resignation Of David Siegel As President And Chief Executive Officer, Apr. 19, 2004, *available at* http://www.usairways.com/about/press_2004/nw_04_0419.htm.
[77] Halvonik, Steve, Airline, pilots trying for deal, PITTSBURGH TRIBUNE-REVIEW, Aug. 21, 2004, *available at* http://www.pittsburghlive.com/x/tribune-review/business/print_234095.html.
[78] *Id.*
[79] *Id.* One leader of the Air Line Pilots Association noted that "the company has used deadlines to their advantage for as long as I've been here."
[80] *See* Halvonik, *supra*, note 74
[81] *Id.*
[82] Fitzpatrick, Dan, US Airways nears bankruptcy, PITTSBURGH POST-GAZETTE, Sept. 8, 2004, *available at* http://www.post-gazette.com/pg/pp/04252/375273.stm. While

agreement or it would file for bankruptcy by September 12.[83] Again, the union ignored the threat and proceeded to block a vote on the most recent proposal from US Airways.

The implications of not reaching new agreements were serious. If US Airways' cash were to fall below $850 million, its credit card processor, American Express, could demand as much as $55 million in cash collateral.[84] Furthermore, if its cash were to fall below $725 million, then it would default on the federally guaranteed loans from its first bankruptcy.[85] Holding only $925 million at the end of June and pension payments coming due, US Airways had one option left to save the airline.

IV. Bankruptcy

A. Filing, First Day Motions, and Orders

Failing to receive any concessions from its labor unions, US Airways filed for bankruptcy on September 12, 2004, in the Bankruptcy Court for the Eastern District of Virginia. Judge Stephen S. Mitchell would preside over the case. It is the second time the airline has filed for bankruptcy in two years and it is less than 18 months since the airline emerged from its first bankruptcy case. It cited high oil process and low domestic yields as its reasons for filing.[86] In support of its filing and to demonstrate what went

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Lakefield was claiming that he was not ready to throw in the towel on September 8, it is likely that the company had already prepared the bankruptcy petition that it would file 4 days later on September 12.

[83] *Id.*

[84] *Id.*

[85] *Id.*

[86] US Airways Pulls the Plug, Airfinance Journal, Sept. 2004, Issue 273, p.18-20.

wrong with the 2003 plan, US Airways included a chart comparing certain projections from that plan and the actual status as of filing.[87]

	Plan Projections for 2004	Current Status
Fuel Price (per gallon)	80.5¢	110.5¢ (net of hedging)
Passenger revenue (per available seat mile)	10.4¢	9.5¢
Yield	14.1¢	12.8
Total passenger revenue (in millions):		
Domestic	$4,974	$4,472
International	$593	$642

Bankruptcy would provide the opportunity for the US Airways to preserve cash and implement what it called its "Transformation Plan" built on lower costs, simplified fare structure, and expanded service areas – much like those of low-cost carriers.[88] Joining US Airways, Inc. in bankruptcy are its parent holding company, US Airways Group, Inc., and 3 subsidiaries, PSA Airlines, Inc., Piedmont Airlines, Inc., and Material

[87] *See In re US Airways, Inc.*, Motion for Bridge, Interim, and Final Orders, *supra*, note 43, at p. 5.

[88] Press Release: US Airways To Seek Court Supervision To Complete Restructuring and Implement Transformation Plan, Sept. 12, 2004, *available at* http://www.usairways.com/about/press/nw_04_0912.htm. These proposed goals of the Transformation Plan are the first visible recognition of US Airways of its need to mimic low-cost carriers if it is to survive. In fact, in the press release announcing that it had filed for bankruptcy, the airline specifically announces that the reason its previous plan failed was because of the dramatic growth of low-cost carriers. In addition to stating its goals, CEO Bruce Lakefield acknowledged that because it was unable to implement new labor agreements that bankruptcy was the only way it could preserve cash resources necessary to implement the plan.

Services Company, Inc.[89] By ordered entered the same day, all five companies would be jointly administered. US Airways petition lists a little more than $8.8 billion in assets and $8.7 billion in liabilities.[90] Also, Group was listed as the sole stockholder of US Airways common stock.[91]

The Air Transportation Stabilization Board ("ATSB"), which guaranteed $900 million of a $1 billion loan from the first bankruptcy, and other lenders[92] agreed to allow US Airways continued use of that cash.[93] Because it was able to continue using cash from the ATSB loan[94], it did not need to seek immediate DIP financing. Also, the Bankruptcy Court entered bridge orders immediately, allowing the company to continue operations while the case proceeded.[95]

In a statement after filing the petition, Lakefield made it clear that if agreements were not reached (read: if the unions didn't agree to more concessions), then the

[89] *See In re US Airways, Inc.*, Voluntary Petition Under Chapter 11, Annex A – Affiliate Debtors, No. 1 (E.D. VA Sept. 12, 2004).
[90] *In re US Airways Inc.,* Voluntary Petition Under Chapter 11, (E.D. VA Sept. 12, 2004). The liabilities listed on the petition filed with the court do not include future aircraft purchase obligations of $2.6 billion or future lease obligations of $4.9 billion. *See In re US Airways*, Motion for Bridge, Interim, and Final Orders, *supra,* note 44.
[91] *In re US Airways, Inc.*, Voluntary Petition Under Chapter 11, *supra,* note 87, Attachment 1.
[92] Retirement Systems of Alabama Holdings LLS and Bank of America, N.A.
[93] *See* Press Information, *supra,* note 86. This agreement was later extended until January 15, 2005, and eventually until June 30, 2005, coinciding with th airline's planned exit from bankruptcy.
[94] The court authorized the use of this cash collateral in a bridge order entered the day of filing. *US Airways, Inc.,* Bridge Order Granting Motion to (A) Use of Cash Collateral, (B) Provide Adequate Protection and (C) Schedule Interim Hearing, No. 31, (Sept. 12, 2004).
[95] Those orders allowed US Airways to pay wages and benefits, honor pre-petition obligations to customers (such as frequent flyer program obligations), pay for fuel, and continue maintenance of its bank accounts. *See US Airways, Inc.*, Bridge Order[s] Granting Motion[s] to Authorize, Nos. 19-25, 27 (Sept. 12, 2004);

company would use the powers of the bankruptcy court to get what they want while also not ruling out liquidation as an alternative.[96]

The initial Transformation Plan appeared to address each of the issues causing financial problems in the airline industry. First, it aims to offer lower, simplified pricing and lower distribution costs. Second, it aims for enhanced low-cost product offering. Third, the airline will enhance its network and route structure. Finally, the Transformation Plan aims to lower operating costs.[97] While all of these goals sounds good for US Airways, in order to implement the plan it would still need to reduce labor costs significantly.

B. Saved By GE

In October 2004 US Airways reached an agreement for aircraft leasing and financing with GE Capital Aviation Services ("GECAS") and GE Engine Services ("GEES"), the airline's two largest creditors[98], that would provide short-term liquidity, reduce debt, and preserve a majority of the US Airways' fleet owned by GECAS.[99] In exchange for the lease commitments from GECAS and GEES, US Airways would issue a 15-year convertible note for at least $125 million.[100]

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[96] *See* Press Information, *supra*, note 86. Lakefield commented that employees would have to make concessions, and if not, the alternative is to have their jobs exported to low-cost airlines, where employees would start over at entry-level wages and without seniority.
[97] The first prong addresses the complex fare structure cited as a problem for the legacy airlines. The second prong will maintain the benefits of flying on a legacy airline but also cuts costs to compete with low-cost carriers. By adding more direct flights under the third prong, US Airways continues to move away from the hub-and-spoke system. And finally, the fourth prong calls for more time in the air and less time sitting idle at the hubs waiting for passengers.
[98] *In re US Airways, Inc.*, List of Creditors Holding 20 Largest Unsecured Claims
[99] GECAS helps US Airways out, Airfinance Journal, Dec2004/Jan2005, Issue 276, p. 14.
[100] *Id.*

C. Labor Cost Cuts

1. Interim Relief Under § 1113(e) of the Bankruptcy Code

Senior Management again warned the various labor unions that if they did not agree to concessions within a week, it would turn to the court to make the necessary cuts.[101] US Airways did in fact have to turn to the courts, and on September 24, 2004, it filed a motion under section 1113(e) of the bankruptcy code[102] for interim relief from collective bargaining agreements with (1) The Airline Pilots Association, Association of Flight Attendants, Communications Workers of America, and the International Association of Machinists and Aerospace Workers.[103] The Airline's stated reason for seeking this relief was to maintain the company as a going concern and to preserve 34,000 jobs and preserve air service to hundreds of communities.[104] On October 15, 2004, after arguments and objections from various individuals and union representatives, Judge Stephen Mitchell authorized interim relief for US Airways to make across-the-board wage cuts.[105] Lakefield quickly declared that the relief was necessary to continue

[101] De Lollis, Barbara, US Airways may ask for OK to cut wages, USA TODAY, Sept. 16, 2004, at B04. The pilots union should have seen this as a credible threat. In the first bankruptcy, many pilots had their pensions modified by the bankruptcy court after they refused to concede anymore. For more on those cuts and pending pension reform, see Appendix B: US Airways Terminates its Pensions.
[102] Section 1113 applies to the rejection of collective bargaining agreements. Subsection (e) states: If during a period when the collective bargaining agreement continues in effect, and if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court, after notice and hearing, may authorize the trustee to implement interim changes in the terms, conditions, wages, benefits, or work rules provided by a collective bargaining agreement. 11 U.S.C. § 1113(e) (2005).
[103] *In re US Airways, Inc.*, Motion to Authorize Interim Relief Pursuant to Section 1113(e) of the Bankruptcy Code, No. 225 (Sept. 24, 2004). *See also* Press Information, US Airways Files Motion for Interim Relief Under Section 1113(e) Sept. 24, 2004.
[104] *Id.* at p. 2.
[105] *In re US Airways, Inc.*, Order Authorizing Interim Relief pursuant to section 1113(3) of the Bankruptcy Code, No. 502, (Oct. 15, 2004).

operations.[106] He also noted that the cuts were not permanent and that the company would continue negotiations with the various unions.

2. Finally, A Concensus

The pilots proved to be the most cooperative of any labor group, as they ratified a new contract in mid-October of 2004 – just after interim relief was granted – agreeing to more than $300 million in cuts a year.[107] The Communications Workers of America (Dec. 2, 2004) and the Association of Flight Attendants (Dec. 16, 2004) were the next to come around and agree to major concessions. Finally, the International Association of Machinists, despite their hard-line position prior to bankruptcy, agreed to cuts of more than $353 million annually over five years.[108] As a result of all the cost-saving agreements that US Airways made with its unions, it will save over $1.1 billion annually.[109]

D. Sale/Leaseback Transactions

US Airways increased its available cash even more through a series of sale and leaseback transactions. The largest sale and lease back agreement, with Republic Airways, resulted in US Airways realizing an additional $120 million in liquidity.[110] However, the most important aspect of the agreement is an option, the effect of which,

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[106] Press Information: US Airways Statement Regarding Interim Relief Approval, Oct. 15, 2004, *available at* http://www.usairways/com/about/press/nw_04_1015.
[107] *See* Halvonik, Steve, US Airways skids toward liquidation, PITTSBURGH TRIBUNE-REVIEW, Oct. 29, 2004, *availavle at* http://www.pittsburghlive.com/x/tribune-review/trib/regional/print_267107.html.
[108] Press Information, US Airways' Three IAM Units Ratify Agreements On More Than $353 Million in Annual Cost Savings, Jan. 21, 2005, *available at* http://www.usairways.com/about/press/nw_05_0121.htm.
[109] *Id.*
[110] Press Information: US Airways to Improve Cash Position Through Bankruptcy Court Approval of Airline Sale/Leaseback Transaction, Sept. 2, 2005, *available at* http://www.usairways.com/about/press/nw_05_0902a.htm.

results in the sale of US Airways' MidAtlantic aircraft to Republic.[111] All together, the liquidity generated from these aircraft transactions is about $300 million, bringing the airlines total cash to nearly $2.5 billion, compared to less than $1.5 billion when it entered bankruptcy.

V. The Plan

After the court had extended the exclusivity period four times for US Airways to file its Plan of Reorganization, the airline finally filed its plan on June 30, 2005, the date on which it had originally intended to exit bankruptcy. The highlights of the cumbersome 83-page plan include:

- The Merger with America West.[112]
- Unsecured creditors with claims of $50,000 or less will receive 10 cents on the dollar for their claims.
- Other unsecured creditors will receive stock in the reorganized US Airways after it emerges.
- All existing common stock will be cancelled.
- Reinstatement of the ATSB loan from the first bankruptcy, amortized through 2010.

In addition, the plan provides that the Merger with America West will close 11 days after the order confirming the plan. The Plan was overwhelmingly confirmed by creditors,

[111] Press Information: US Airways Obtains Second $125 Million Equity Commitment for Plan of Reorganization, March 14, 2005, *available at* http://www.usairways.com/about/press/nw_05_0314.htm.

[112] The merger has proved to be more difficult than anticipated by either of the airlines. Since the plan became effective and the merger began, they have been unable to agree on anything from what soda to serve on flights, to which union will represent the mechanics. For more on the merger itself and the difficulties that came from it, see Appendix C: East Meets West: The Merger.

with 90% in amount of all claims and 80% in number of all creditors voting to confirm the plan.[113]

VI. Conclusion

A. The Case of Philip Garland: An Example

In 1991, Philip A. Garland obtained a judgment against US Airways for racial discrimination.[114] The judgment enjoined US Airways from any further discriminatory conduct.[115] After his employment was terminated on December 4, 2001, he filed another complaint against US Airways.[116] After US Airways filed for Bankruptcy the first time, Garland filed a proof of claim for $17 million.[117] An arbitration board eventually upheld Garland's termination, and he filed a motion for reconsideration.[118] Under the plan in the first bankruptcy case, all outstanding common stock was cancelled.[119]

After US Airways filed for bankruptcy in 2004, Garland again filed a proof of claim for $17 million.[120] The confirmed plan in second case again cancelled all existing shares of common stock, including the pool of shares issued to pay claims under the first

[113] Press Information, US Airways Plan of Reorganization Receives U.S. Bankruptcy Court Approval, Sept. 16, 2005, *available at* *http://www.usairways.com/about/press/nw_05_0916*.htm.
[114] *In re US Airways, Inc.*, 2006 Bankr. LEXIS 352, at *3, (E.D. VA March 6, 2006).
[115] *Id.*
[116] *Id.* at *4.
[117] *Id.* at *5.
[118] *Id.* at *5-6.
[119] *Id.* at *8.
[120] *Id.* at *7.

plan.[121] The court held that because Garland's claim arose pre-petition in the first case, it was a general unsecured claim for that case and was discharged.[122]

The confirmed plan in the first bankruptcy case provides holders of general unsecured claims to a pro rata distribution of common stock in US Airways. Therefore, whatever claim Garland did have was discharged and replaced with an equity interest in the company. However, because the plan in the second bankruptcy case cancelled all existing stock and did not entitle equity holders to any payment, the combined result of the first and second plans renders Garland's claims moot. Whatever claim he had was discharged by bankruptcy #1 when his class was provided common stock. Then in bankruptcy #2, whatever equity interest he received on account of his claim in bankruptcy #1 was extinguished by bankruptcy #2.

This case demonstrates the inherent risk of owning stock in a struggling company – or the risk of being an unsecured creditor in general. Garland could have protected himself by obtaining some sort of property interest that would elevate him to secured creditor status *before* bankruptcy or by cashing in his stock and reinvesting in a more stable company.

B. The Lasting Effects of Bankruptcy on the Airline Industry

US Airways Transformation Plan, if successfully implemented, would make it a highly competitive airline. By the stated goals of the Transformation Plan, it would reduce costs significantly while operating more efficiently as it moved away from the hub-and-spoke route system. While the plan after merger is to create a competitive low-cost carrier, there is no indication that the actual effect of the merger will do any such

[121] *Id.* at *8.
[122] *Id.* a *11.

thing. In fact, the only goal of the Transformation Plan that US Airways was able to complete by the middle of 2006 was cutting labor costs, as it had done previously. However, the reorganized US Airways predicts that it will see its first profit in early 2007.

While bankruptcy effectively saved US Airways, as well as the jobs of over 34,000 of its employees, it may have saved a business that would have been better off liquidated. The airline industry is full of competition that is driving prices down and forcing out legacy carriers. This amount of competition may mean that fares and wages are artificially low. Unfortunately, the bankruptcy code makes no allusion to industry health and it is not a prime consideration in chapter 11 reorganizations.[123] As such, the availability of chapter 11 may ensure increased competition, much to the benefit of the consumer who benefits from falling prices.

[123] Rollman, Daniel P., Comment: Flying Low: Chapter 11's Contribution to the Self-Destructive Nature of Airline Industry Economics, 21 BANK. DEV. J. 381, 415 (2004).

APPENDIX A

The Higher Cost of Fuel

Jet fuel, a by-product of crude oil, accounts for 15% of the industries cost. According to J.P. Morgan airline analyst Jamie Baker, industry adaptation is helped by higher crude, insomuch as fares will continue moving higher, labor costs lower, and at some point even the most stubborn growth names may see need to decelerate. Unfortunately, the airline industry has historically chosen to order airplanes whenever economic times are good. Because the orders take years to fill, a cyclical world basically assures that bad times become worse. When airlines take delivery of new planes, they flood weak markets with new capacity.[1]

After Hurricane Katrina interrupted domestic supply lines, crude oil prices, already high, reached record levels. On August 30, 2005, the price of crude oil reached an all-time high of $69.91 per barrel. During the ten-year period from 1992-2001, the median price per barrel of crude oil was just under $20. The median price subsequently climbed to $41.44 per barrel in 2004 and $54.03 per barrel in 2005, representing a seismic, structural change in airline costs over a very short period of time.

As shown in the chart below, this represents roughly a doubling in fuel costs compared to recent years:

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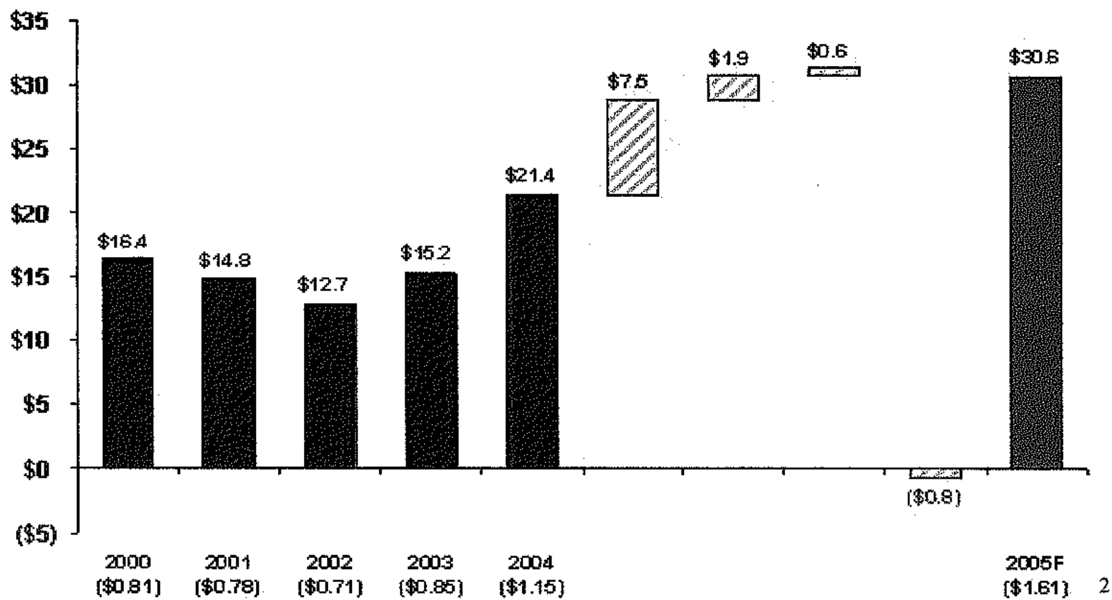
[1] "Let Us Now Praise Pricey Airline Fuel," *TheStreet.com* (Jan. 25, 2006).



[2]

Compounding the overall problem is the widening gap between the price of crude oil and the price of jet fuel, known as the "crack spread." In the days immediately following Hurricane Katrina, the crack spread for jet fuel reached almost $30 per barrel. It has since declined, but it relatively high with the year-to-date through August 2005 is $13.40 per barrel. The ATA has estimated that the average cost per barrel of jet fuel will reach $70 in 2006, significantly higher than in previous years.[3]

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[2] Mark Kiefer, "Subcommittee on Aviation Hearing on Current Situation and Future Outlook of U.S. Commercial Airline Industry," Accessed April 10, 2006 at http://www.house.gov/transportation/aviation/09-28-05/09-28-05memo.html

[3] *Id.*

APPENDIX B

U.S. Airways Terminates Its Pension Plans

In March 2003, U.S. Airways filed a motion seeking to terminate its airline pilot pension plans in order to emerge successfully from bankruptcy. U.S. Airways argued that, absent termination of the plan, they would be unable to obtain confirmation of the plan of reorganization that they proposed, while the objecting parties asserted that the debtors did not make an adequate showing that reasonable alternatives to the plan were contemplated or explored. In re: U.S. Airways Group, Inc., 296 B.R. 734 (2003). For a Chapter 11 debtor, the standards for a distress termination under 29 U.S.C.S. § 1341 require that four condition be met: (1) As of the proposed termination date, the employer has filed, or has had filed against it, a petition for reorganization under the Bankruptcy Code; (2) The case has not, as of the proposed termination date, been dismissed; (3) The employer has provided the entity responsible for paying insured benefits any request for Bankruptcy Court approval of the termination; and (4) The bankruptcy court determines that, unless the plan is terminated, the employer will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the Chapter 11 reorganization process and the court approves the termination. 29 U.S.C.S. § 1341(c)(2)(B)(ii)(I) - (IV).

The pivotal issue for the court was whether the financial requirements for distress termination had been met. The court noted that terminating any of the other defined benefit plans would not solve the cash flow obstacles to the debtor's reorganization and subsequently determined that the debtor had carried its burden of proof of showing that, short of the termination of the plan, the business could not continue its business outside

of the Chapter 11 reorganization process. The only condition attached to the court's decision was that the termination of the pension plan did not violate the terms of the collective bargaining agreement between the debtor and the pilots' union. In re: U.S. Airways Group, Inc., 296 B.R. 734 (2003).

U.S. Airways' $2.1 billion in unfunded pilot pension obligations were given to the Pension Benefit Guarantee Corporation ("PBGC") after the plans' termination in 2003. This decision came after the pilots had already agreed to $565 million in annual concessions in order to aid the company in its reorganization and prevent pension termination. On a personal level, the cost of broken retirement promises are often steep. Captain Tim Baker, a 19-year veteran of U.S. Airways, was one of many union representatives sorting through the airline's complicated bankruptcy proceedings in March 2003. In his position, Baker reluctantly agreed to support U.S. Airways' proposal to dump the pilots' pension plan on the PBGC, the government agency that is the insurer of last resort for hopelessly underfunded plans. The decision practically guarantees that retirees will receive less than they were initially promised, in many cases less than 50 cents on the dollar. According to Baker, "it was the pension underfunding and its future requirements that were going to put in jeopardy the airline's ability to get out of bankruptcy. At some point you have to look around and say that is all there is." Baker paid dearly for his decision and was subsequently voted out of his union position by angry fellow pilots. Instead of the six-figure annual pension he was promised in his contract, when he retires in 15 years he'll get just $28,585 a year from the PBGC plus whatever he can save in his 401(k). At the same time that they slashed the pilots' pension funds, U.S. Airways honored employments with its top three executives by paying them

$35 million in lump-sum retirement benefits. Stories like Baker's are becoming horrifically common in today's economy as employers faced with mounting retiree costs look to get out from under and struggle to compete with younger companies that have little or no retiree costs.

In November of 2004, U.S. Airways brought a comprehensive motion in court seeking, among other things, termination of the defined-benefit pension plans currently in place for employees in addition to the defined-benefit plan frozen in the early 1990s that covered employees in management, administrative, airport customer service and reservations, ramp, crew scheduling, dispatch, flight crew training instructors, and flight simulator engineers workgroups. The company indicated that following the termination of the plans, it would then work with the PBGC in the administration of plans and benefits. These plans cover 53,000 active and retired workers and would bring an additional $2.1 billion in unfunded pension obligations to the PBGC. After the plans are submitted to the PBGC, all of the other airline employees will find themselves in the same position as Captain Baker, receiving only a mere fraction of what they were initially promised. The airline expects to save $1 billion over five years by getting rid of the pension plans.

A. ERISA: A Brief Background

In the days before the passage of the Employee Retirement Income Security Act ("ERISA"), the bill's proponents had high hopes that the legislation would provide much-needed security to the nation's ailing pension plans. At the time, no laws existed to govern pension plans, so consequently, the plans remained severely underfunded. Thirty years after its passage, however, many would argue that pension plans today are almost

as insecure as they were in the 1960s and 1970s when major companies like Studebaker declared bankruptcy and ended their pension plans.

In this context, Congress enacted ERISA to accomplish three distinct goals: (1) To encourage the growth of defined benefit pension plans, (2) To provide timely and uninterrupted payment of pensions benefits, and (3) To keep pension insurance premiums at a minimum. ERISA basically aims to accomplish these goals by requiring plans to provide participants with plan information including important information about plan features and funding, providing fiduciary responsibilities for those who manage and control plan assets, requiring plans to establish a grievance and appeals process for participants to get benefits from their plans, and giving participants the right to sue for benefits and breaches of fiduciary duty. Perhaps the most significant component of ERISA is the fiduciary duty requirement, which makes the primary responsibility of fiduciaries to run the plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. They are required to act prudently and must diversify the plan's investments in order to minimize the risk of large losses. Additionally, they must follow the terms of plan documents to the extent that the plan terms are consistent with ERISA. Fiduciaries who do not follow these principles of conduct may even be personally liable to restore any losses to the plan or to restore any profits made through improper use of plan assets.

B. The Necessity of ERISA Reform

Because of the increased strain on the PBGC caused by bankrupt companies dumping their pension plans and the PBGC's already staggering liabilities in excess of $9.7 billion dollars, experts agree that ERISA reform is long overdue. As responsibilities

quickly shift from the private to the public sector, most analysts feel that ERISA must be reformed in such a manner that taxpayers do not end up with the burden of funding the owed pensions. In July 2003, the Government Accountability Office "placed the PBGC single-employer pension program on [its] 'high risk' list of troubled federal programs."

Some experts urge an increase in the variable-rate premiums that some employers are required to pay to the PBGC. Many, like President George W. Bush, feel that the premium rate structure should more accurately reflect the risk that a financially unstable company with an underfunded plan poses to the PBGC. Many analysts, however, fear that the PBGC is not collecting enough from its premium structure to cover its cost, especially in light of the benefits experts are projecting the PBGC will owe in light of both United's and U.S. Airways's bankruptcies and other large pension plans that the PBGC assumed control of in the 1990s. Increasing premiums would better allow the PBGC to meets its obligations if companies terminate their defined benefit plans, and the threat of increased premiums might encourage companies to manage their pension plans properly so as to avoid pay higher premiums if they underfund their pension plan. Still, some argue that the premiums, at best, provide limited security that the government will provide some benefit payment. At the same time, increased premiums could adversely affect solvent companies who are playing by the rules or even discourage companies from offering defined benefit plans at all.

DePaul Law student Christine Stinson Matott advocates that the best solution to PBGC's financial woes is to raise the PBGC's status in Bankruptcy from that of an unsecured creditor to priority status. Because of its current low status, the PBGC recovers only about twelve percent of its claims from bankrupt corporations. This is due,

in large part, to the Bankruptcy Code limiting the PBGC to asserting either a lien for unfunded benefit liabilities or for unpaid minimum contributions. A lien for unfunded benefit liabilities is for "the amount of the excess of the present value of the plan's benefit liabilities over the fair market value of its assets." The PBGC can only assert this lien after it has made a demand on the plan sponsor, and the agency is limited in asserting this lien because the lien amount cannot exceed thirty percent of the aggregate net worth of the employer's control group. In terms of unpaid minimum contributions, even if an employer has filed Chapter 11 bankruptcy and has not terminated its defined benefit plan, the employer must still make its minimum contribution payments. Pursuant to current Bankruptcy law, the only way the PBGC can be classified as a secured creditor is if the employer terminates the plan before filing Chapter 11 bankruptcy, and the PBGC must perfect its lien against the company before it files for bankruptcy. In all but a few cases, the PBGC cannot file a lien because the employer typically waits until bankruptcy to file a plan termination.

Matott outlines several of the benefits that would result from raising the PBGC's priority status in bankruptcy. First, other creditors would actually have an incentive to monitor the employer's pension plans because their recoveries would now be affected by the PBGC's priority status. Second, allowing the PBGC to have priority status regardless of when the lien was perfect would be consistent with ERISA's original purpose as well as the statutory scheme before the enactment of the Bankruptcy Code in 1978. Under ERISA's original language, PBGC liens perfected after a company filed for Chapter 11 bankruptcy would be afforded fourth priority status, similar to taxes owed to the United States. Finally, basic fairness demands that employee pension plans receive priority

status in a reorganizing bankruptcy. Many employees rely solely on their pensions for retirement and often have made substantial concessions in the form of wage reductions to preserve their pension benefits.

House Majority Leader John Boehner (R-OH), Employer-Employee Relations Committee Chairman Sam Johnson (R-TX), and Ways & Means Committee Chairman Bill Thomas (R-CA) recently drafted comprehensive legislation popularly known as the Pension & Protection Act (H.R. 2830). The entire House approved the bill in bipartisan fashion on December 15, 2005 by a margin of 294-132. The co-sponsors believe that the PBGC's deficit is closer to $23 billion and fear the prospect of a costly multi-billion dollar taxpayer bailout. At the same time, they worry that more companies will stop providing defined benefit pension plans entirely if comprehensive reform is not passed.

The Pension & Protection Act focuses on six key reforms to "fix" outdated pension laws, including certainty, common sense, stability, transparency, honesty, and portability. Certainty means that H.R 2830 establishes a permanent interest rate to more accurately calculate employers' pension liabilities to ensure they fund their worker pension promises. The bill gives employers common sense incentives to help build up a cushion in their worker pension plans during good economic times, raising the maximum deductible amount for pension plans contributions. In an effort to provide stability, the measure closes funding loopholes and reduces volatility in worker pension plans by ensuring employers make adequate and consistent cash payment to their plans. The bill allows for transparency by ensuring that workers and retirees are given timely, accurate, and straightforward information about the health of their plan and their own financial future. With thousands of significantly underfunded pension plans across the country, the

measure includes reasonable restrictions to ensure employers and union leaders cannot dig the pension hole even deeper by promising extra benefits if a plan is less than 80 percent funded. Finally, the bill resolve legal uncertainty to ensure hybrid plans such as cash balance pensions, which offer portable benefits that allow workers to earn more generous benefits steadily throughout their careers, remain a viable part of the defined benefit system.

On March 3, H.R. 2830 passed the Senate by unanimous consent. Although the language of the bill says nothing about bankruptcy per se, or giving the PBGC higher priority status in bankruptcy, an administration proposal recently released by the Department of Justice advocates notifying participants when plan sponsors file for bankruptcy including its effect on plans. Additionally, the proposal suggests allowing the PBGC to perfect its lien against missed contributions while the plan sponsor is in bankruptcy. The plan suggests that the PBGC's standing to enforce contributions on firms in bankruptcy, but falls short of actually stating that the PBGC's status should be raised from that of an unsecured creditor.

APPENDIX C

East Meets West: The Merger

On June 23, 2005, the Justice Department cleared the proposed merger of U.S. Airways and America West, finding that any overlap between the two carrier's routes would not hamper competition in the hyper-competitive budget airline industry. Notably, the decision was issued by outgoing Assistant Attorney General R. Hewitt Pate of the department's antitrust division, the same attorney who led the opposition to U.S. Airways's previous merger attempt with United Airlines in 2001. At that time, U.S. Airways was forced to pare down costs in a final effort to survive on its own, but this time, the merger appeared to be a keystone of the airline's exit strategy from Chapter 11 Bankruptcy.

While the ruling removed a clear hurdle before the merger, U.S. Airways was still faced with gaining approval from America West's sharedholders, its creditors, the U.S. Bankruptcy Court, the Securities and Exchange Commission, and the Air Transportation Stabilization Board, which granted both airlines' federal loan guarantees in the amount of $1 billion.

Financing sources for deal

The proposed merger of America West and US Airways will be financed with $1.5 billion of new capital along with loans.

Where the money comes from:

$350 million in new equity.
•$125 million; Eastshore Holdings, owned by Air Wisconsin Airlines.
•$100 million; PAR Investment Partners, Boston investment firm.
•$75 million; ACE Aviation Holdings, owner of Air Canada.
•$50 million; Peninsula Investment Partners, Virginia investment firm.

$1.1 billion in cash contributions, mainly from partners and suppliers.
•$675 million; from refunded deposits, refinanced debt and signing bonuses from companies interested in long-term business relationships with merged company.
•More than $425 million; from partners and vendors, including more than $300 million in signing bonus and loan from prospective affinity credit card providers for merged company.

Airbus loan.
•$250 million; The merged company will be a launch customer for Airbus A350, with deliveries starting in 2011.[1]

At America West's annual shareholder's meeting in May 2005, CEO Doug Parker escaped the wrath of employees and shareholders relatively unscathed. A notable exception was Phoenix shareholder Seymour Licht, who holds more than 60,000 shares of America West stock. Licht confronted Parker several times and reproached him for the lack of information disclosed about the upcoming merger. Finally, he left the crowd with what his straightforward analysis of the merger: "What I see is two weak sisters merging together to form a terminally ill patient."[2]

By all outside appearances, the merger seemed to move forward in a relatively smooth fashion. At the core, however, many of the same labor disputes that plagued U.S. Airways pre-bankruptcy reared their ugly heads, this time at America West. America West pilots started a public campaign to bring attention to their fight for seniority fairness and were expected to request an arbitrator to settle controversial issue of who ranks where in the pilot pecking order. Simultaneously, the flight attendants planned a picket at Phoenix's Sky Harbor International Airport to protest what they characterize as empty

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[1] Dan Reed and De Lollis, Barbara, "America West, U.S. Airways merger goes for a tight fit," USA TODAY (May 19, 2005).

[2] Dan Fitzpatrick, "America West chief grilled over U.S. Airways merger," PITTSBURGH POST-GAZETTE (May 18, 2005).

promises from management and stalled contract negotiations. Unionized mechanics and ramp agents, fearing pay or benefit cuts to match what their U.S. Airways counterparts received after bankruptcy, began to escalate their campaign to retain a separate union and their own contracts. Ironically and perhaps strategically, the stakes were especially high in this case because smooth combination and unification of the labor force would prove to be critical to the success of the merger. With reports of physical fights breaking out between newly minted rivals in key cities like Phoenix and Philadelphia, the merger began with a substantial measure of turbulence.

To add to employee anxiety, America West had been negotiating with flight attendants for nearly two years before the merger and had yet to reach any agreement. Newly installed CEO Doug Parker continued to stress that no money existed for new raises. Compounding labor disputes was the added tension between America West and U.S. Airways unions, most notably the mechanics' unions. Because the International Association of Machinists, which represents U.S. Airways mechanics, was three times the size of the America West union, it was widely expected to emerge as the leader in the new airline. Among flight attendants and pilots, seniority disputes increased between the two workforces, with some U.S. Airways staff boasting over forty years of tenure versus a maximum of twenty or so for America West staff.[3]

Two forces ultimately collided on the morning of February 8, 2006 in Philadelphia hotel meeting room with a bloody, bare-fisted brawl between rival baggage-handling unions. The dispute had been in the works for nearly six months, the time of the

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[3] Dawn Gilbertson, "U.S. Airways' merger glow dims amid labor tension," THE ARIZONA REPUBLIC (December 5, 2005).

actual merger, and physically involved as many as thirty men and landed two in a hospital emergency room. Some America West employees actually described the fight as a direct result of "typical East Coast mentality," while outside analysts described the events as a culture clash between two very different coastal carriers, "one sunnier and more Western in outlook (America West) and the other hardened by East Coast turmoil and long periods of financial distress (U.S. Airways)."[4]

While U.S. Airways public relations workers pointed to an alliance between two unions representing more than 7,000 gate workers as an early victory, several significant cultural differences still exist. For example, pilots at the old U.S. Airways and old America West still have not worked out critical issues of seniority, pay and work rules, and strains are growing between the two groups. In a similar vein, flight attendants still do not have a single contract governing all employees, and like the U.S. Airways pilots, many flight attendants are hoping to recover much of what they sacrificed in the previous two bankruptcies. As of now, the National Mediation Board is presiding over the debate for which union, the much larger International Association of Mechanics or the Teamsters Union, will represent mechanics and work toward a new contract with the merged carrier. Similarly, baggage handlers still do not know whether the International Association of Mechanics or the Transport Workers Union will represent them, a dispute that contributed to much of the violence in Philadelphia.

Another more subtle dispute even exists as to how the new airline will award empty seats for free. America West's faithful want to retain the first come, first served system as a way of ensuring fairness, while the U.S. Airways employees wish to retain a

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[4] Dan Fitzpatrick, "Cultures actually clash in U.S. Airways-America West merger," PITTSBURGH POST-GAZETTE (April 2, 2006).

system by which free travel is awarded based on seniority. Even whether to serve Coke, as U.S. Airways did, or Pepsi, as America West served has come up for possible debate. Still, fortunately no dispute has yet reached the seriousness of the Philadelphia brawl, which left one man from the Transport Workers Union convinced that his attackers were trying to kill him and caused twenty-two workers to lose their jobs.[5]

In spite of the obvious setbacks, many within the airline feel that the merger has moved along surprisingly well for an airline merger. Surprisingly, higher fuel prices are causing many U.S. Airways rivals to reduce the number of seats flying, allowing airlines to charge more and increase revenue. In fact, U.S. Airways has increased revenue, on a percentage basis, more than all other major airlines, compared to a year ago. For the final three months of 2005, U.S. Airways lost $138 million, much of which was due to the company paying $197 million more for fuel than a year earlier. The company is also benefiting from a $1-plus billion in pre-merger pay givebacks by employee and expense cuts, aircraft returns and renegotiated leases, in addition to a very healthy flying climate.

Ultimately, in the first six months, CEO Doug Parker has possibly succeeded in bringing together two very different cultures in a relatively smooth process. Many analysts have lavished praise on Parker to his slow, methodical approach in melding the laid-back, casual style of America West with the button-down collar, suit-and-tie ways of U.S. Airways. Some experts have even hailed the U.S. Airways as possibly the best merger in the airline industry, managing the airlines as well as any airline has done in recent history. The airline finally has begun to hedge against the cost of fuel, striving to always maintain at least half its fuel hedged against higher fuel prices six months into the

[5] *Id.*

future. Using this strategy, the airline hopes to absorb unforeseen fuel price spikes, something the airline had never done before the merger.[6]

[6] Rick Stouffer, "After America West merger, U.S. Airways flying right," PITTSBURGH TRIBUNE-REVIEW (March 19, 2006).