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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	**Chapter 11 Case No.**
AMR CORPORATION, *et al.*,	:	**11-15463 (SHL)**
Debtors.	:	**(Jointly Administered)**

MEMORANDUM IN SUPPORT OF DEBTORS' MOTION TO REJECT COLLECTIVE BARGAINING AGREEMENTS PURSUANT TO 11 U.S.C. § 1113

PART ONE: PRINCIPAL MEMORANDUM OF LAW

* admitted *pro hac vice*
** *pro hac vice* admission pending

TABLE OF CONTENTS

I. INTRODUCTION AND SUMMARY OF ARGUMENT 1

II. OVERVIEW OF AMERICAN AIRLINES 7

III. AMERICAN'S CURRENT FINANCIAL CRISIS HAS INDUSTRY-WIDE HISTORICAL ANTECEDENTS 8

A. Airline Deregulation 8

B. Pricing Transparency Via the Internet 10

C. September 11 And Its Aftermath 10

D. Steep Increases In The Price Of Fuel.. 11

E. Explosive Growth Of Low Cost Carrier Competition 12

F. American's Major Competitors Filed For Bankruptcy 20

G. American Avoided Bankruptcy In 2003 But Remains At A Disadvantage......... 22

IV. AMERICAN CONTINUES TO LOSE GROUND TO RESTRUCTURED AND MERGED NETWORK COMPETITORS 24

A. Battered By Exogenous Events, American's Financial Performance Has Deteriorated... 24

B. American's Historic Network Strength Has Been Overcome 31

C. American Struggles With Higher Labor Costs Than Its Restructured Network Competitors 34

V. AMERICAN CAN SURVIVE—AND THRIVE—BUT IT NEEDS TO BECOME FAR MORE PRODUCTIVE AND FAR MORE EFFICIENT 36

A. American's Business Plan Shows That The Company Can Succeed 36

B. American's Business Plan Calls For Significant Investments in the Fleet and the Product 39

VI. AMERICAN'S SUCCESSFUL REORGANIZATION REQUIRES $1.25 BILLION PER YEAR IN LABOR COST REDUCTIONS 42

A. American Has The Highest Labor Costs In The Industry.................................. 43

B. American's Non-Union Employees Will Shoulder Their Fair Share Of The Burden 51

1. Non-Union Cost Reductions 2002-2011 ... 52

2. Further Cost Reductions As Part Of Plan For Success ... 53

a. Management and Support Staff: $165 Million Per Year ... 53

b. ARP Employees: $95 Million Per Year ... 54

C. American Has Tried To Negotiate Needed Changes With Its Unions ... 55

D. American Has Made Proposals That Are Necessary For Reorganization ... 60

1. Cost Reductions Have Been Fairly And Equitably Allocated ... 61

2. Viewed As a Whole, The Changes Proposed By American Are Necessary For Reorganization ... 61

a. Universal Benefits Changes ... 62

b. The Remaining Changes Proposed By American Are Intended Simultaneously To Save Money And Make The Company Competitive ... 69

c. Changing Work Rules To Enhance Productivity ... 69

d. Eliminating Restrictions On Entrepreneurial Opportunities ... 72

VII. AMERICAN HAS SATISFIED THE REQUIREMENTS OF SECTION 1113 ... 74

A. American's Proposed Terms Are Necessary For Successful Reorganization ... 75

B. American's Proposals Provide Fair And Equitable Treatment For All Stakeholders. ... 81

C. American Shared The Information On Which Its Proposals Were Based With The Unions, And Conferred With Them In Good Faith ... 83

1. American Answered All Relevant Union Questions, Fulfilled All Data Requests, And Shared Even Its Most Sensitive Information On Request From Each Union ... 84

2. American Has Conferred In Good Faith ... 87

D. The Failure Of Each Union To Agree To American's Proposals Is Without Good Cause ... 93

E. The Balance Of The Equities Favors American ... 95

VIII. CONCLUSION 99

TABLE OF AUTHORITIES

Page(s)

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AFA v. Horizon Air Indus.,
976 F.2d 541, 545 (9th Cir. 1992) 91

Chicago & N.W. T. Co. v. UTU,
402 U.S. 570 (1971)...97

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682 F. Supp. 1003 (W.D. Mo. 1988) 91

In re Allied Delivery Sys. Co.,
49 B.R. 700 (Bankr. N.D. Ohio 1985) 81, 94

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75 B.R. 847 (Bankr. N.D. Ohio 1987) 94

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155 B.R. 431 (S.D. Tex 1993) 75, 79, 86

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In re Bowen Enters, Inc.,
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795 F.2d 265 (2d Cir. 1986)...79, 81

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899 F.2d 887 (10th Cir. 1990) 75

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346 B.R. 307 (Bankr. S.D. N.Y. 2006)...78

In re Northwest Airlines Corp.,
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483 F.3d 160 (2d Cir. 2007)...56, 97

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848 F.2d 345 (2d Cir. 1988).. passim

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47 B.R. (Bankr. D. Wyo. 1985) 79, 92, 94

In re Sol-Sieff Produce Co.,
82 B.R. 787 (Bankr. W.D. Pa. 1988) 92, 95, 82, 87

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142 B.R. 337 (Bankr. E.D. Mo. 1992)...75, 78

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69 B.R. 967 (Bankr. E.D. Mich. 1987)...94

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474 F.2d 457 (2d Cir. 1973)....................92

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358 F. Supp. 760 (S.D.N.Y. 1973)....................91

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151 F. App'x 46 (2d Cir. 2005) 76

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816 F.2d 82 (2d Cir. 1987).................... passim

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

This Motion to Reject Collective Bargaining Agreements rests on three unpleasant but undeniable facts:

First, American Airlines, Inc., ("**American**" or "**the Company**") will not survive if it does not restructure. American lost $1.06 billion in 2011, bringing its cumulative losses since 2001 to more than $10 billion. Declaration of Beverly K. Goulet ("Goulet Decl.") ¶ 7. American has financed these persistent losses by borrowing money—accumulating a total of $16.8 billion in debt as of 2011. *Id.* ¶ 39. As a member of the negotiating committee for American's pilots recently conceded:

> Given American's massive losses over the past decade, it's difficult to imagine how management could have avoided a bankruptcy filing for any length of time—with or without a new pilot contract. In many respects, it had become a question of when and not if American would file for bankruptcy and inevitably follow the rest of the industry into what has now become an industry-wide pattern of court restructuring.[1]

Second, while American has been staggering with billions in losses and a crushing debt load, its long-time competitors have reorganized in Chapter 11 and have thrived: Delta, United, and US Airways were all profitable in 2011. Mergers at Delta (with Northwest), United (with Continental) and US Airways (with America West) have expanded their networks. With those enhanced networks and the lower costs and broader entrepreneurial freedoms they obtained in their own Chapter 11 proceedings, American's principal competitors have preyed on American's market share. In 2000, American was the largest passenger airline in the world, measured by capacity; today American ranks fourth, behind post-merger, post-bankruptcy rivals United and Delta. Goulet Decl. ¶¶ 5, 8.

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[1] G. Shayman, *APA Negotiations After Action Report: The final push for a negotiated settlement*,

Third, although American's financial peril has multiple sources, the greatest single challenge is its labor agreements. Collectively, American's collective bargaining agreements ("**CBAs**") with the Unions saddle the Company with the highest labor costs in the industry. Those agreements tie the Company to compensation rules that are among the most expensive in the industry and to the richest active and retiree benefit package, by far, among American's peers. Together, these CBAs generate a competitive headwind that the Company cannot overcome. American has negotiated ***for years*** with each of its unions to remedy these structural impediments to profitability, but those negotiations have failed to produce results.

In addition to imposing higher direct labor costs, American's CBAs contain an array of archaic rules and other restrictions that constrain American's ability to generate revenues and shackle it to operations that cannot be economically justified. The peculiar difficulties presented by each contract are discussed in Union-specific materials accompanying this brief; a few examples suffice for present purposes:

- **Limits on the fleet American can use.** The pilot agreement precludes American from deploying through regional partners the fuel-efficient regional jets it needs and that American's competitors have used to serve smaller markets and extend the reach of their already-superior networks. Because American cannot match supply to demand by flying the right "gauge" of aircraft in each market it serves, it has been forced to concede markets, passengers, and precious market share to its competitors. Declaration of Dennis Newgren ("Newgren Decl."), attached as AA Ex. 900, ¶ 43.

- **Limits on Code-Sharing.** The pilot agreement also restricts American's ability to "code-share" with other airlines to the same degree as can its major competitors. This restriction prevents the Company from extending its network into markets it cannot otherwise serve and thus forces American to relinquish significant revenue-enhancing opportunities to its competitors. Newgren Decl. ¶¶ 67-87.

Flightlines Magazine, January 2012 issue, p. 8, AA Ex. 504.

- **Restrictions on the use of manpower.** The mechanics contract requires American to use its highly-paid Aircraft Maintenance Technicians ("**AMTs**") to do work that does not require employees with that degree of skill and training. For example, after a lower-paid Overhaul Support Mechanic ("**OSM**") has repaired an aircraft seat in the seat shop, American cannot have the OSM install the seat in the aircraft cabin or fix any problems that arise with the seat while the aircraft is in a maintenance "dock"—jobs the OSM is fully qualified to perform—because the docks are the exclusive preserve of the AMTs.

- **Restrictions on part-time employment.** American's agreement with its Fleet Service workers (*i.e.,* the ground employees who service aircraft at airport gates) limits the Company's use of part time employees. This means that at stations where American has only a few flights a day, it must nonetheless maintain full time employees for whom it has no full time work.

- **Part-time work; rich rewards.** The flight attendant CBA requires that flight attendants work just 420 hours per year to accrue vacation, sick time, and health benefits, and has no minimum requirement whatsoever to continue to hold their place on the seniority list. In some cases, a flight attendant who has not yet reached the top of the seniority-based pay scale can work ***zero*** hours per year and still advance a step on the scale each year; he or she can stop flying altogether for years at a time, secure in the knowledge that if he or she ever wants to return to work it will be at the same rate of pay as someone at the same seniority level who had conscientiously worked and gained experience during that same time period.

- **Extended vacations.** Currently, flight attendants can manipulate their work and vacation schedules in order to turn a two week vacation into a month off with pay. For example, if a flight attendant has scheduled a vacation from December 6-19, he or she can bid on a schedule that contains three four-day trips (a common configuration for a full month's schedule in American's international operations) on December 3-6, December 11-14, and December 19-22. Because the scheduled vacation "trumps" the work schedule on which he or she has bid, this flight attendant would be paid for all three trips without working any of them, effectively parlaying 14 days' vacation into an entire month off with pay.

If American is to survive—if it is to continue to provide its employees with good jobs—it ***must*** be allowed to deploy its people and its other assets rationally, as its competitors do now and as businesses in nearly every other industry take for granted. American's labor agreements currently burden it with operations it cannot afford, require it to perform work in irrational, inefficient ways, and obligate it to continue to do work in-house that other airlines have long ago outsourced.

These three undeniable facts yield but one irrefutable conclusion: with these CBAs in place, American cannot successfully reorganize. Thus, reluctantly, but out of necessity, American seeks an order authorizing it to reject its collective bargaining agreements with (a) the Allied Pilots Association ("**APA**"); (b) the Association of Professional Flight Attendants ("**APFA**"); and (c) the Transport Workers Union of America, AFL-CIO ("**TWU**").[2]

American takes no joy in filing this Motion. American's employees are the industry's finest. They are conscientious and professional, and they are committed to the safety and comfort of the passengers that place trust in them. Moreover, American's employees have already sacrificed much. The Company was able to avoid Chapter 11 in 2003 only because its employees agreed to significant and painful cost reductions.

Unfortunately for American and its employees, the other network carriers[3] thereafter achieved far more significant labor cost reductions and transformed their operations far more dramatically during their bankruptcies. As a result, today American faces much larger and more nimble competitors who have been able to slash their costs and eliminate operational restrictions through Chapter 11. Goulet Decl. ¶¶ 20-21. Today's brutally competitive marketplace gives no credit for sacrifices made in years gone by.

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[2] TWU represents employees in seven separate employee groups. This brief refers to APA, APFA, and TWU collectively as the "**Unions**." American's Motion relates only to the nine collective bargaining agreements covered by United States labor law; it does not extend to foreign national employees based outside the United States.

[3] The term "network carriers," as used in this brief, refers to American, Delta, Northwest, United, Continental, and US Airways. Northwest and Delta have merged, as have United and Continental. These carriers were established prior to the deregulation of the industry in 1978. These carriers operate a traditional "hub and spoke" model. *See* Kasper Decl. ¶ 6 n.7.

American has tried for years to reach agreements that acknowledge the realities facing the Company but, with a few exceptions,[4] those efforts to find common ground have been unsuccessful. Just a few weeks ago, APA's President, Captain David J. Bates, provided this window on the Union's perspective and illuminated the difference in perspectives that has prevented agreement:

> As we all know, numerous airlines have used Chapter 11 to force deep reductions in pay and benefits and to degrade the working conditions of unionized employees. The net effect of all these "pattern bankruptcies" has been to decimate decades' worth of gains that airline employees achieved. ***APA is seeking to take a step in reversing this trend***.[5]

Subsequently, APA President Bates declared that it was "time for American Airlines to ***break from the pack of*** airlines that have used bankruptcy as a blunt instrument to abrogate fair labor agreements that have stood for decades." Newgren Decl. ¶ 43; *see also* AA Ex. 921 (emphasis added).

These messages betray a fundamental, and lamentable, misunderstanding of the market in which American operates. It makes no difference to American's future whether its CBAs have been "fair" for decades, and labor's exhortation that the Company should "break from the pack" formed by its competitors is unrealistic. American cannot decide whether it should join or reject an existing "trend"; in the real world—in the world where American must compete—that decision is made by market forces. The Company cannot change that immutable fact any more than it can unilaterally return the industry to pre-deregulation market dynamics or lower the price of oil. Preparing to take on the world ***as it is***, American has made Section 1113 proposals to the

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[4] American has had some success in negotiating new agreements with the TWU. *See* Brundage Decl. ¶ 21.

[5] Newgren Decl. ¶ 42.

Unions that will allow it to compete and thrive to the benefit of its employees; in large measure, its Unions have bargained as if they can return American and the industry to a world ***that was***.[6] So long as this divide remains, agreement is not possible. That is why American has sought Court intervention.

American understands, however, that to be successful in the long run it needs ***agreements*** with its Unions. It cannot exit Chapter 11 or compete effectively without them. American's purpose in filing this Motion, then, is to foster ***agreements***; contract rejection cannot be viewed as the ultimate goal because that would be a lasting victory for no one. American hopes that the Court is never required to decide this Motion, because it hopes that the Motion will facilitate bargained-for solutions for each employee group. Negotiations continue with each Union, and it is on those negotiations that American's attention remains principally focused. Nonetheless, American's survival hinges on its success in ***promptly*** resolving this indispensable element of its reorganization. American hopes that this Motion accelerates that process.

* * * *

The materials submitted in support of American's Section 1113 Motion are organized into five parts. This part, Part One, is comprised of this brief and its supporting declarations and exhibits. It discusses American's financial and competitive challenges in broad terms, explains why alterations to American's collective bargaining agreements are necessary for the Company to exit Chapter 11 as a viable competitor, and analyzes the Section 1113 legal standards.

Each of the following parts contains a brief, at least one declaration, and exhibits that together detail the particular changes American seeks to make to specific Union agreements. Part Two deals with American's pilot agreement and Part Three with its flight attendant

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[6] The Company reiterates that not all of its Unionized employees share this perspective.

agreement. Parts Four (Fleet Service, Dispatch, Instructors and Sim Techs) and Five (Mechanics and Related Employees, Stock Clerks, and MCTs) together discuss the seven different agreements American has with TWU.

STATEMENT OF FACTS

II. OVERVIEW OF AMERICAN AIRLINES

American Airlines is the principal subsidiary of AMR Corporation. The airline was founded in 1934 and has long been a premier U.S. airline. As of November 1, 2011, American had a fleet of over 600 jet aircraft and operated approximately 1,800 scheduled daily departures to approximately 160 destinations throughout North America, the Caribbean, Latin America, Europe, and Asia.[7] First Day Declaration of AMR's Chief Financial Officer, Isabella Goren ("Goren Decl."), filed November 29, 2011 (D.I. 4) ¶ 5. Through its oneworld alliance, American provides customers with (i) a broader route network, (ii) opportunities to earn and redeem frequent flyer miles across the combined oneworld network, and (iii) access to more airport lounges and clubs. Goren Decl. ¶ 8.

American has approximately 65,000 domestic employees in the U.S., 70% of whom are represented by one of three labor unions under nine separate CBAs negotiated pursuant to the Railway Labor Act. Declaration of Jeffrey J. Brundage ("Brundage Decl."), attached as AA Ex. 500, ¶ 6. American's management and support staff (office/clerical) employees ("**Management**" and "**Support Staff**"), and its Passenger Service Agents, Representatives, and

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[7] This does not include the flights operated by AMR's other wholly-owned subsidiary, AMR Eagle Holding Airlines ("**Eagle**"), which operated approximately 1,500 scheduled daily departures to over 175 destinations in North America, Mexico, and the Caribbean. Eagle has separate unions and separate labor contracts and is expected to file a separate Section 1113 motion if it is unable to reach agreement with its unions on new contracts.

Weight and Balance Planners ("**ARP**") are not unionized; the wages, benefits and work rules for these employees are established by American.

As noted above, American is party to nine separate CBAs. American moves to reject all nine. As described below, American either has or will make changes in the wages, benefits and work rules of its non-union employees to achieve cost reductions parallel to those American has proposed for Union-represented employees. Brundage Decl. ¶¶ 5, 9; Declaration of Carolyn E. Wright ("Wright Decl."), attached as AA Ex. 600, ¶¶ 61-67.

III. AMERICAN'S CURRENT FINANCIAL CRISIS HAS INDUSTRY-WIDE HISTORICAL ANTECEDENTS

Although each Union agreement represents a different set of competitive problems—explained in detail in the Union-specific papers accompanying this Motion—the Company's financial crisis has its roots in a number of seismic changes affecting American and the airline industry as a whole. Together, these events have turned what was once a relatively sheltered, regulated industry into a brutally competitive marketplace. They have robbed American of any meaningful ability to control the prices it can charge for its product, and have skewed the competitive equation between American and its network carrier competitors in a way that have made it impossible for the Company to achieve profitability.

A. Airline Deregulation

Prior to the Airline Deregulation Act of 1978, the federal government largely controlled the routes each airline could fly and the prices it could charge for its tickets. Under this regime, when an airline's labor or other costs increased, it would ask for (and would typically receive) permission from the Civil Aeronautics Board to raise its ticket prices to recover those costs. And because the government severely limited head-to-head competition on the routes it flew, an incremental increase in ticket prices almost never had competitive consequences. Thus, the

airlines generally enjoyed predictable, healthy profit margins and significant pricing power. Declaration of Daniel M. Kasper ("Kasper Decl."), attached as AA Ex. 1, ¶¶ 11-14.

That all changed with deregulation. Almost overnight, prices became a function of market dynamics, competitors freely entered previously protected markets, and when they did, they competed directly on price. This new competition included not just the known, pre-deregulation entities but a number of voracious new market entrants, all with dramatically lower operating costs and no union contracts to encumber them. Because these new entrants (and Southwest, which went from a small regional operation to a significant player on the national stage after deregulation) had dramatically lower labor costs, more productive work rules, and less-senior employees, they were able to set market prices at dramatically lower levels. In this entirely new market, the pre-deregulation ability of the pre-deregulation "legacy" airlines' to recover increased labor costs by raising ticket prices evaporated. Kasper Decl. ¶¶ 15-17.

Although the competitive landscape changed virtually overnight, the legacy pre-deregulation carriers all continued to operate under collective bargaining agreements that had become encrusted over the decades with cumbersome, expensive and inefficient work rules and pay schedules—contract terms that may have been acceptable or even rational in the pre-deregulation era in which they were born but that had become—almost overnight—anachronistic. The dead weight of these contracts and the crushing pressure of unparalleled competition profoundly changed the face of the industry. Since deregulation, 10 U.S. air carriers have filed for bankruptcy (four more than once), and several have disappeared altogether through merger or liquidation. Once hallowed names in U.S. aviation—including Pan Am, TWA, Eastern, and Braniff—have simply disappeared. Kasper Decl. ¶ 27.

B. Pricing Transparency Via the Internet

Before the internet became a fact of American life, airline tickets typically were purchased from travel agencies or directly from the airlines themselves, either at airline ticket offices or over the phone. Even after de-regulation in 1978, finding the absolute lowest fare for any particular trip was a cumbersome process.

With the advent of the internet and the birth of websites such as Expedia, Travelocity, and Orbitz, however, it became possible for the flying public to find, instantly and effortlessly, the very cheapest price for any given route. And bitter experience quickly showed that when one ticket is even a dollar or two cheaper than another, the cheaper airline is instantly rewarded by the shopping public. Kasper Decl. ¶¶ 72-73. The airlines thus found that they had to match their competitors' lowest prices in any market, or lose the business. *Id.* ¶ 16. Put another way, large network carriers have effectively lost the ability to control the pricing of their product.

C. September 11 And Its Aftermath

No aspect of U.S. commerce was more directly or profoundly affected by the attacks of September 11, 2001, than commercial aviation. Increased security at the airport made air travel more difficult and less enjoyable (Kasper Decl. ¶¶23-24), and the government imposed massive new costs on the airlines for security measures on airplanes, in the terminal, and at the ticket counter. The combination of huge cost increases, reduced demand, and an inability to pass those costs on in the form of higher ticket prices led to cataclysmic losses for the industry. Between 2001 and 2005, the industry lost approximately $30 billion—more than the industry had made in all the preceding years since the Wright Brothers.[8]

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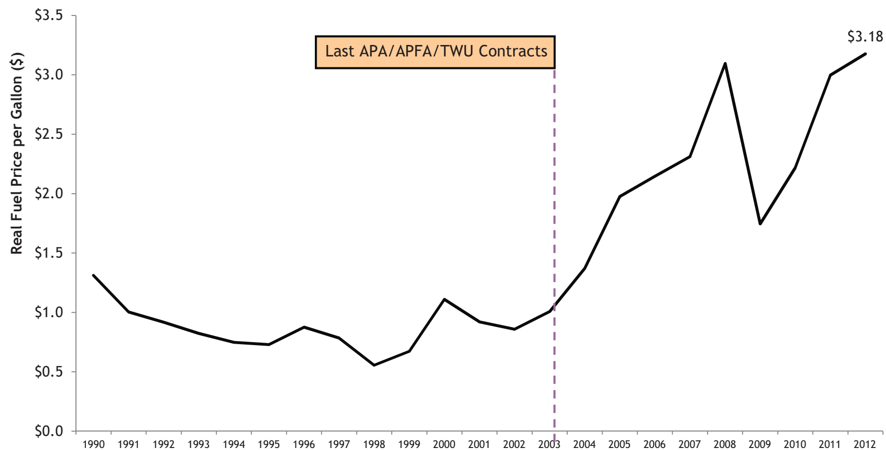
[8] U.S. DOT Form 41; Mary Gahan, Aviation's Continuing Crisis, BBC News (Aug. 13, 2002) available at http://tinyurl.com/7t379tm.

D. Steep Increases In The Price Of Fuel

American has two fixed operating costs that dwarf all others: labor and fuel. The real price of jet fuel was relatively flat throughout the 1990s, but began to rise sharply in 2003 and, with few exceptions, has remained elevated and volatile since that time:

EXHIBIT 78: ANNUAL REAL JET FUEL PRICES, 1990-2012



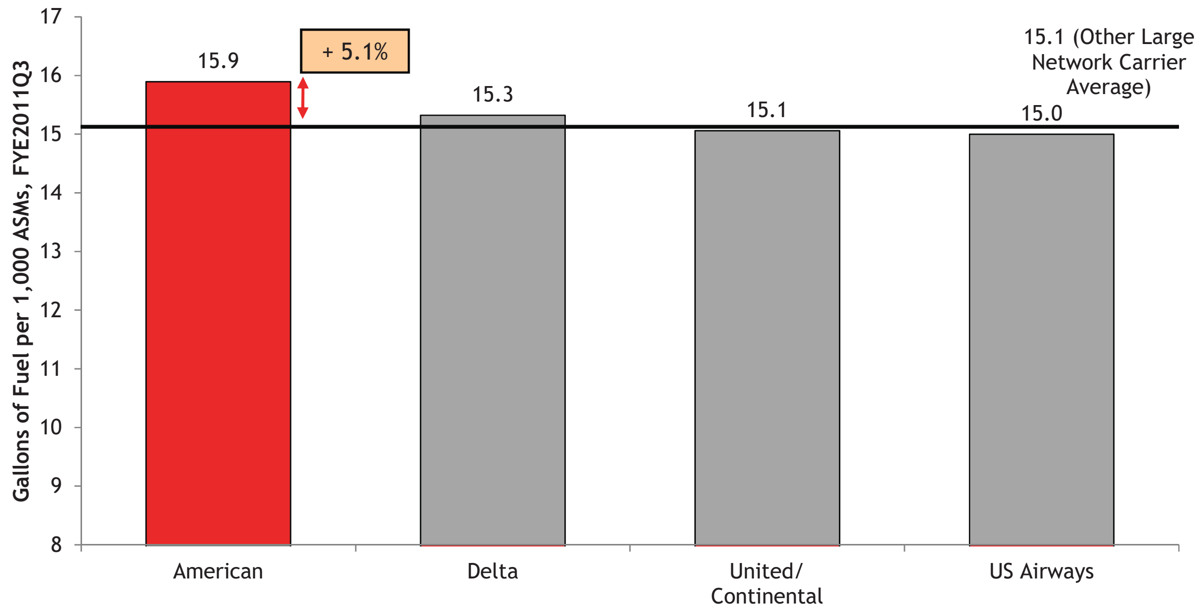
See also Goulet Decl. ¶ 17.

Accordingly, American has worked aggressively—as aggressively as it can within the context of its existing contractual commitments—to drive its operations to ever more fuel-efficient practices (collectively, American's "**Fuel Smart**" initiatives). Goulet Decl. ¶ 32 and n.13. Notwithstanding these efforts, however, the Company's fuel costs between 2000 and FYE3Q2011 ***increased*** by 211%. Kasper Decl. ¶ 134.

Although high fuel prices have affected all carriers, it has had a disproportionate impact on American for several reasons. As discussed in greater detail in the Declaration of Dennis Newgren accompanying Part Two, which deals with changes proposed to the pilot agreement, restrictions in the pilot CBA prevent the Company's regional partners from utilizing 70-seat and larger regional jets ("**RJs**") in anything like the numbers its competitors use; those jets are

substantially more fuel efficient than either the much smaller RJs in American's regional fleet or its aging fleet of narrowbody (single aisle) aircraft. Newgren Decl. ¶¶ 53-66; *see also* Declaration of Varasb Vahidi ("Vahidi Decl."), attached as AA Ex. 200, ¶¶ 16-19. Likewise, American's mainline fuel consumption per Available Seat Mile ("**ASM**," the industry's standard measure of capacity) is the highest among the network carriers and more than 5% higher than the network carrier average, primarily a reflection of the Company's aging fleet. Kasper Decl. ¶ 136.

EXHIBIT 79: GALLONS OF FUEL CONSUMED PER 1,000 ASMS, FYE 2011Q3



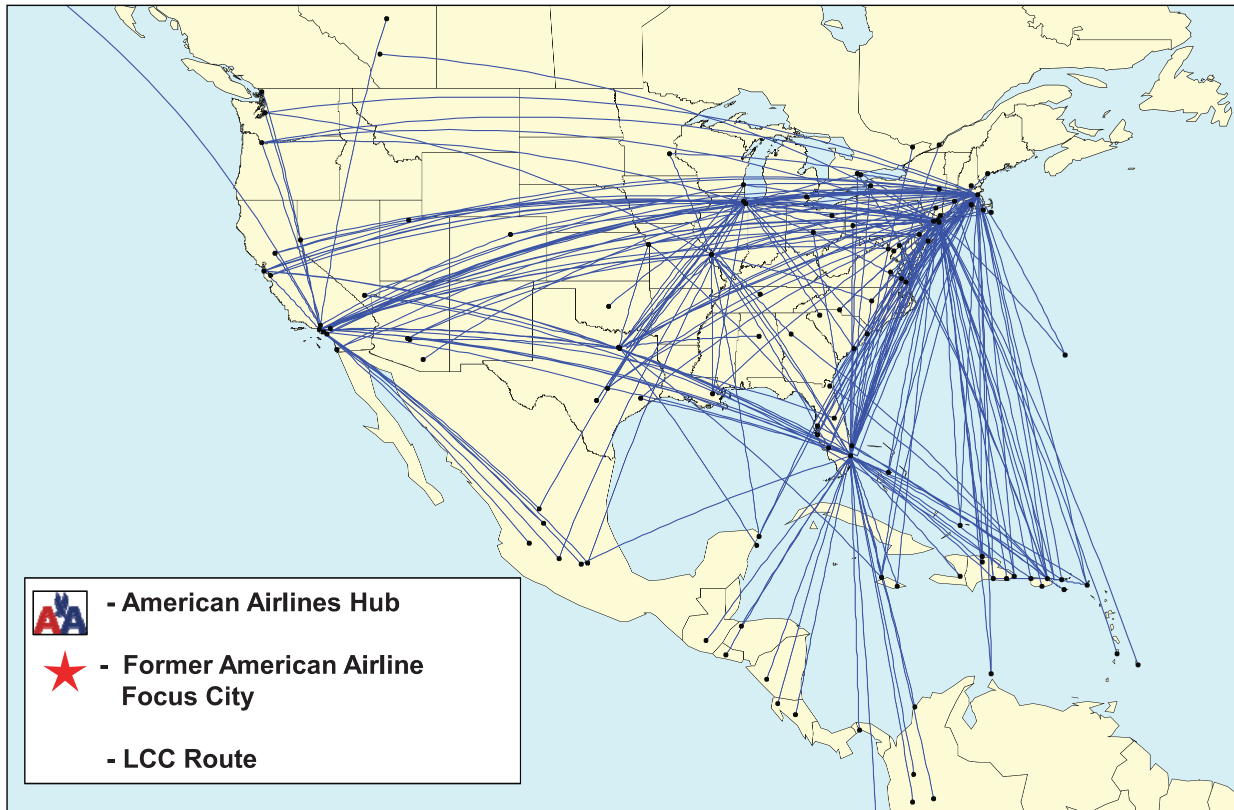
E. Explosive Growth Of Low Cost Carrier Competition

The phenomenon of no-frills, "low cost carriers" or "**LCCs**" is not new, but the LCC segment of the industry has profoundly changed the competitive landscape since American and its Unions last reached collective bargaining agreements in 2003. Since that time, LCCs have dramatically increased their market share at many of American's hubs and "focus cities."[9] As

[9] "**Focus cities**" are metropolitan areas where an airline offers service to a substantial number of

shown below, LCCs have added ***more than 250*** new non-stop routes from American's hubs and focus cities since 2003. Kasper Decl. ¶ 42.

**EXHIBIT 16: ROUTES ENTERED BY LCCS
SINCE 2003 AT AMERICAN HUB AND FORMER FOCUS CITIES**



LCCs now serve virtually all of American's largest domestic city-pair routes. Indeed, LCCs serve ***49 of American's largest 50 domestic routes***, up from 39 in 2003 and only 25 in 1998. Kasper Decl. ¶ 43.[10] As discussed below, the only remaining route among American's top-50 routes that is not currently served by LCCs (Dallas-Orange County, California) soon will be free from regulatory restrictions that have thus far prevented non-stop service by LCCs from Dallas' Love Field. *Id.*

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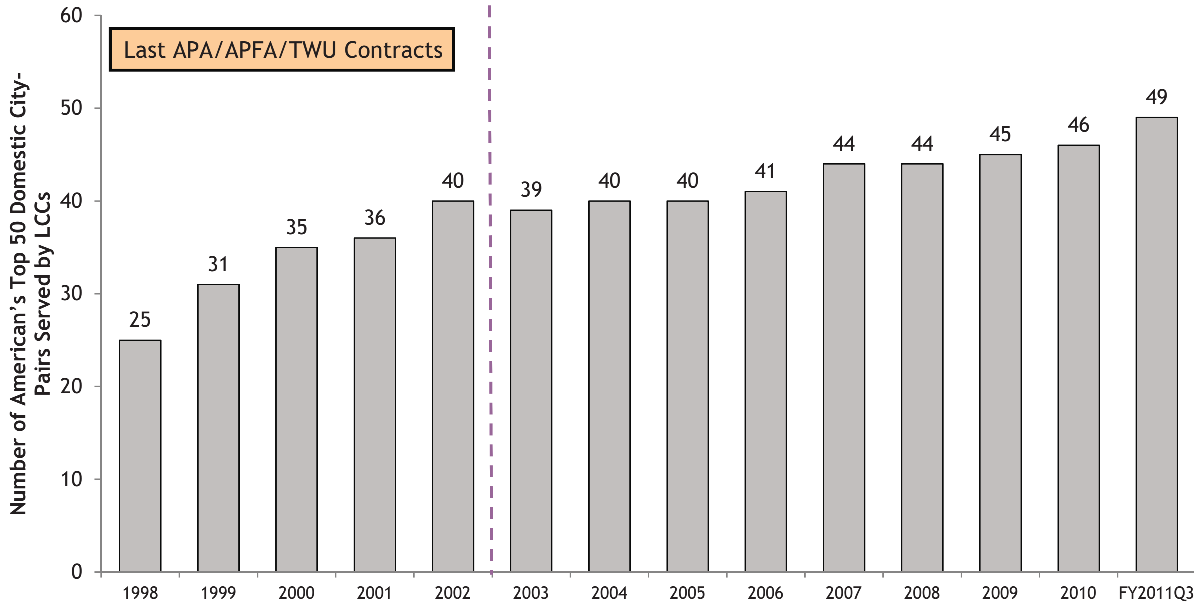
destinations targeted primarily at serving local passengers, but does not operate a traditional hub.

[10] In 2003, American's largest 50 domestic routes accounted for approximately 35% of the

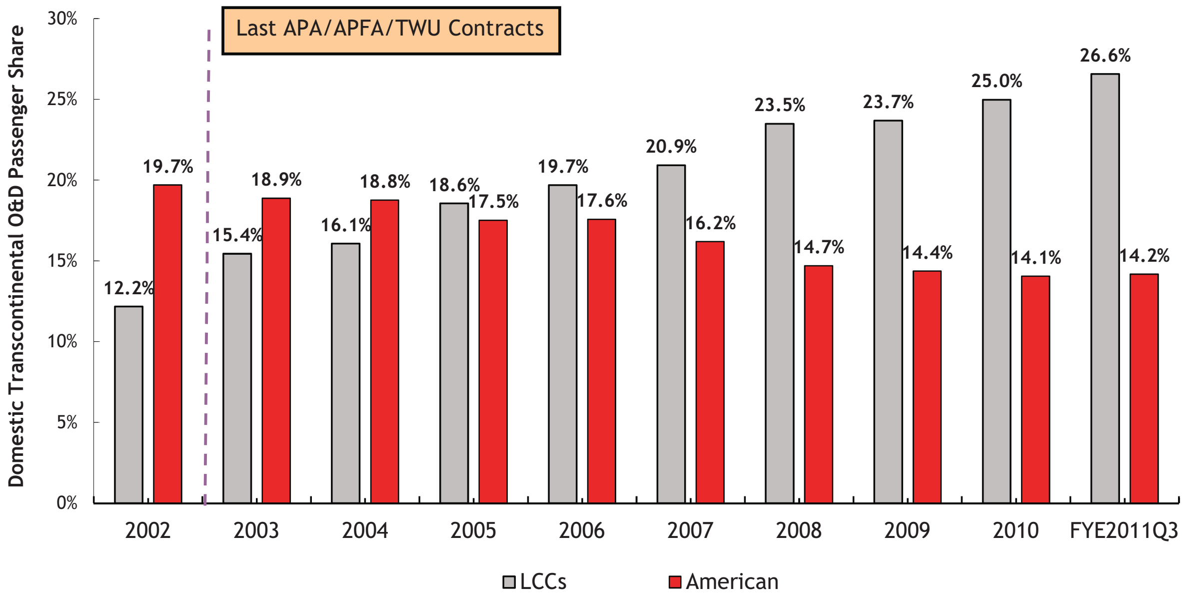
EXHIBIT 17: LCC COMPETITION ON AMERICAN'S TOP-50 ROUTES, 1998-2011Q3



American's share of passengers in transcontinental markets—once among the most lucrative for large network carriers—fell from 20% in 2002 to only 14% today, while LCCs' share more than doubled from 12% to 27%.

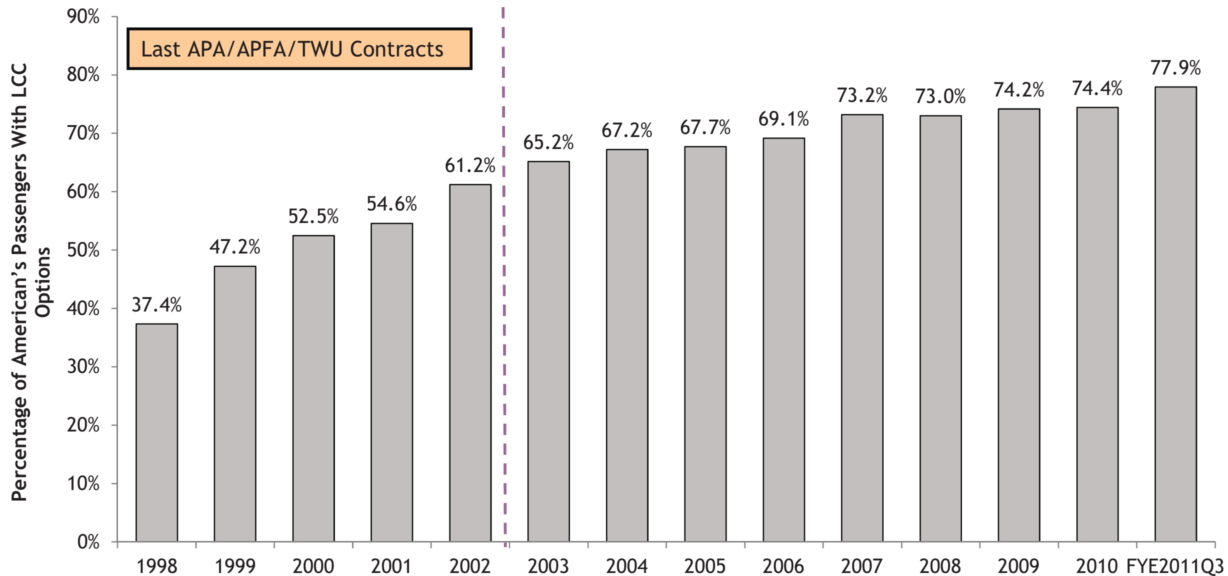
Company's domestic revenues. *Source*: U.S. DOT DB1B Survey.

EXHIBIT 19: AMERICAN VS. LCC SHARE OF DOMESTIC TRANSCONTINENTAL O&D PASSENGERS, 2002-FYE 2011Q3



American (and its network carrier peers) formerly were able to rely on a revenue premium on international operations, where LCCs did not operate. That, too, has changed. In recent years, LCCs such as JetBlue and Spirit (in addition to foreign LCCs such as Volaris) have greatly expanded services to the Caribbean and Latin America, which have long been critical markets for American. Kasper Decl. ¶ 53. The number of routes between the United States and the Caribbean/Latin America served by LCCs grew from only eight in 2003 to 96 in 2011. Overall, the percentage of American's domestic "origin and destination" (or "**O&D**") passengers flying on routes where they have at least one LCC option now stands at 77.9%, up from 65.2% in 2003 and more than twice the level the Company faced in 1998 (37.4%). Kasper Decl. ¶ 49.

EXHIBIT 22: PERCENTAGE OF AMERICAN'S DOMESTIC O&D PASSENGERS WITH LCC OPTIONS, 1998-FYE 2011Q3



The real problem with LCCs, of course, is that they are able to translate their lower costs directly into lower fares. When an LCC enters a market with lower-fare services, the network incumbent in that market is forced to match or at least approach those lower fares, unless the incumbent is able to differentiate its service sufficiently to justify charging higher fares, which has proven to be extremely difficult in the U.S. domestic market. Kasper Decl. ¶ 37 n.40. As a result, the lower fares resulting from LCC competition have eroded American's "revenue premium" *vis-à-vis* LCCs and, hence, its ability to offset higher unit costs. Vahidi Decl. ¶ 6; Kasper Decl. ¶ 63.

Although the LCCs pose a threat to all of the network carriers, as explained below, American's scale and labor cost disadvantages make the problem particularly acute for the Company. And, unfortunately, that problem is likely to get much, much worse. Southwest Airlines, the world's largest LCC, is based in Dallas—also American's home—and has firm orders for 199 new aircraft for delivery by 2017. Kasper Decl. ¶ 51. These deliveries are well-timed to take advantage of the phasing out of restrictions on the destinations that can be served

from Love Field. *Id.*[11] In addition, the full repeal of the Wright Amendment in 2014 will—for the first time—permit Southwest (and potentially other LCCs) to fly to any airport in the country non-stop from Dallas Love Field.[12] This is virtually certain to result in new non-stop service by Southwest on more of American's most important Dallas-based routes which, until now, have been shielded from non-stop competition by Southwest operating from Love Field. Kasper Decl. ¶ 52.

The problem is illustrated below. American currently serves 28 non-stop routes from Dallas/Fort Worth airport ("**DFW**") that cannot currently be served non-stop by Southwest because of Wright Amendment restrictions, but where Southwest serves the other endpoint. These are prime candidates for new non-stop service by Southwest when the Wright Amendment restrictions are lifted.[13] In total, these 28 routes accounted for close to $800 million in revenue for American in FYE2011Q3.[14] Kasper Decl. ¶ 52.

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[11]*See* "Southwest Airlines Reports Third Quarter Results," *PRNewsire*, October 20, 2011.

[12]Prior to the passage of the Wright Amendment Reform Act of 2006 (the "**Wright Amendment**"), airlines serving Dallas Love Field (Southwest's headquarters) were prohibited from flying non-stop or providing connecting service to destinations outside of Texas, New Mexico, Oklahoma, Kansas, Arkansas, Louisiana, Mississippi, Missouri, or Alabama. The Act removed ticketing restrictions in 2006, and in 2014, all restrictions regarding the domestic destinations that can be served non-stop from Love Field will also be lifted. *See* "Wright Amendment Reform Act of 2006 Enacted Into Law; Southwest Airlines Offers Customers $99 One-Way Fares and Increased Travel Options From Dallas Love Field," *Southwest Airlines Press Release*, October 17, 2006 and H.R. 6228, 109th Congress, 2D Session.

[13]Likewise, none of these 28 routes is currently served by another LCC from DFW.

[14]American will also face new LCC competition on routes to/from Hawaii starting in the summer of 2012 when Allegiant commences Hawaii service with its 757 fleet. Allegiant's entry into Hawaii will mark the first LCC service between Hawaii and the 48 contiguous states since ATA filed for bankruptcy and ceased all operations in 2008. *See* ALGT Investor Day Presentation, page 5, November 2011, available at http://files.shareholder.com/downloads/ALGT/1385773168x0x516828/b9085334-8521-40db-b66a-36545bf28ef4/Allegiant%20travel%20company%202011%20investor%20day.pdf and *see* U.S. Airline Bankruptcies and Service Cessations, *Air Transport Association*,

EXHIBIT 24: POTENTIAL NON-STOP ENTRY ROUTES FOR SOUTHWEST FROM DALLAS LOVE FIELD IN 2014 NOT ALREADY SERVED BY LCCS

	Destination	American's FY2011Q3 Non-Stop Revenue From DFW ($million)
1	Orange County, CA	$63
2	San Diego, CA	$53
3	Philadelphia, PA	$50
4	Seattle, WA	$49
5	San Jose, CA	$42
6	Tampa, FL	$41
7	Nashville, TN	$39
8	Detroit, MI	$34
9	Pittsburgh, PA	$32
10	Indianapolis, IN	$31
11	Raleigh/Durham, NC	$29
12	Columbus, OH	$28
13	Portland, OR	$27
14	Jacksonville, FL	$24
15	Hartford, CT	$24
16	Salt Lake City, UT	$24
17	Sacramento, CA	$24
18	Omaha, NE	$23
19	Ontario/San Bernardino, CA	$22
20	Cleveland, OH	$20
21	Tucson, AZ	$17
22	Louisville, KY	$17
23	Reno, NV	$13
24	West Palm Beach/Palm Beach, FL	$12
25	Norfolk, VA	$11
26	Ft. Myers, FL	$11
27	Greenville/Spartanburg, SC	$9
28	Charleston, SC	$8
	Total	**$777**

Among the few market segments in which American has traditionally been able to command a reliable revenue premium—the Latin American and Caribbean markets—has become far more competitive and is about to get even more so. In 2003, when American last reached agreements with its Unions, American faced virtually no LCC competition on its Caribbean and Latin American routes; today, that competition is pervasive. Kasper Decl. ¶ 53.

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http://www.airlines.org/Economics/DataAnalysis/Pages/USAirlineBankruptciesServiceCessations.aspx?View=%7b1CB1046D-5CDF-4B7E-87A3-85F68601F69A%7d.

EXHIBIT 25: U.S.-CARIBBEAN/LATIN AMERICA ROUTES SERVED BY LCCS, 2003 VS. FYE 2012 Q2

2003

FYE 2012-Q2

Spirit Airlines, which currently operates between its Florida hub and 20 Latin American destinations in direct competition with American's Miami hub, recently announced an order for 75 additional Airbus A320 aircraft to be delivered between 2016 and 2021, bringing Spirit's total new aircraft orders to 108 and nearly quadrupling the size of Spirit's current fleet.[15] Kasper Decl. ¶ 51. As a result of this sort of LCC expansion into Caribbean and other Latin American markets, LCCs' share of O&D passengers in these markets has risen to 16% in 2011 from only 1% in 2003. Kasper Decl. ¶ 54.[16]

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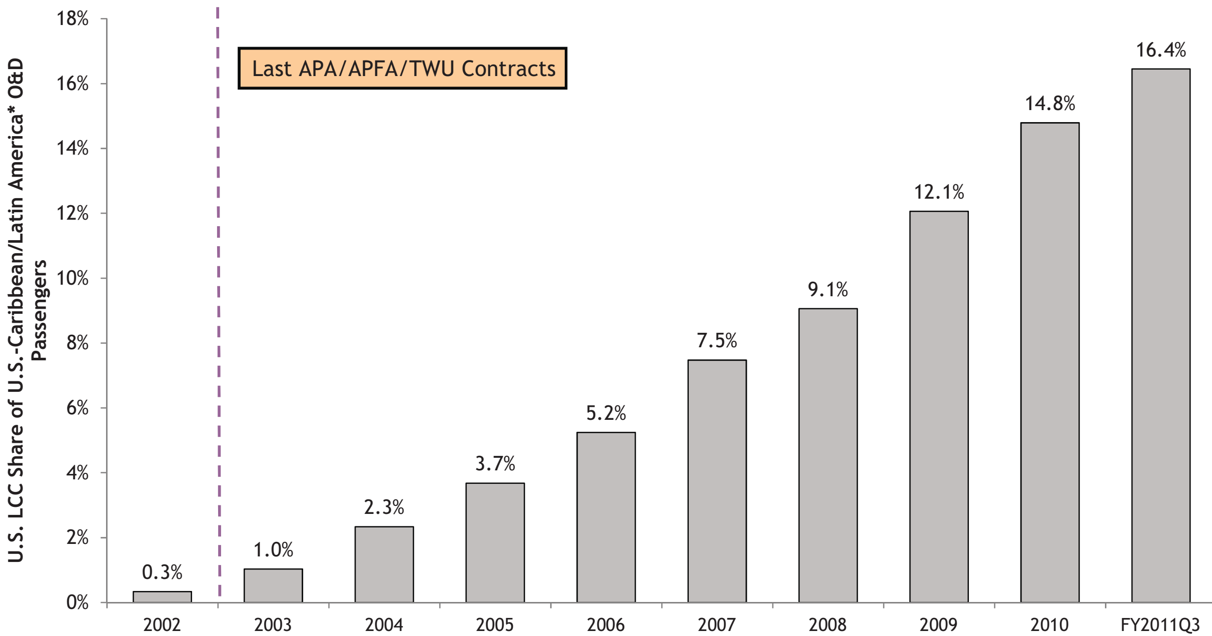
[15]*Source*: OAG. *See also* "Spirit Airlines Signs Memo of Understanding for 75 Airbus Aircraft," *Spirit Airlines press release*, November 15, 2011. As of September 2011, Spirit operated 35 aircraft. *See* "Spirit Airlines Presentation, Dahlman Rose & Company, *Global Transportation Conference*, September 7, 2011.

[16]Because the U.S. DOT's DB1B survey of international passengers does not include passengers traveling exclusively on foreign carriers (*e.g.*, Volaris), Exhibit 17 is limited only to U.S. LCCs and thus ***understates*** LCCs' actual share.

EXHIBIT 26: LCC SHARE OF U.S.-CARIBBEAN/LATIN AMERICA* O&D PASSENGERS, 2002-FYE2011Q3



F. American's Major Competitors Filed For Bankruptcy

In response to the deregulated environment in which the airlines have been forced to compete, the devastating impact of September 11 and then the wars in Iraq and Afghanistan, the weight of steadily intensifying LCC competition, and the precipitous increase in fuel prices, each of the country's network carriers has, over the years, attempted to negotiate new collective bargaining agreements with its unions to realign fundamentally its cost structure.[17] Collectively, they have failed, and in the last decade all ended up in bankruptcy, except for American and Continental (which was twice in bankruptcy—once in 1983 and a second time in 1990):

- **US Airways: four rounds of concessions and twice in bankruptcy.** The first of the legacy carriers to file for bankruptcy in the past decade was US Airways. Prior to filing in August, 2002, the Company received $722 million in voluntary concessions. Once in bankruptcy, in December of 2002, US Airways returned to

[17] *See* Declaration of Jerrold A. Glass ("Glass Decl."), attached as Ex. 800, ¶¶ 39-40.

the bargaining table and decreased its labor costs by another $200 million, largely from changes in work rules and health benefits, although pilots took another 8% reduction on top of the previous 26-37.4% reductions realized before bankruptcy. These changes, however, left the pilots' defined benefit pension plan in place. In March 2003, the company and the pilots' union agreed that the plan would be terminated.

Only 18 months after it emerged from this first Chapter 11 case, US Airways filed again. This time, it announced that it needed $900 million per year in additional cost reductions. Ultimately, the company and the unions agreed to new contracts that (a) lowered employee wages again; (b) removed many restrictions on outsourcing (leading, *inter alia*, to the elimination of half of the company's mechanics positions, nearly all of its utility worker positions, and the outsourcing of ground handling at 21 stations); (c) terminated the non-pilot defined benefit plans; and (d) resulted in fewer restrictions on regional flying, including agreement on a provision that allowed flying with regional jets of up to 97 seats. Glass Decl. ¶¶ 43-46.

- **United Airlines: three years in bankruptcy.** United Airlines filed its Chapter 11 proceeding in December, 2002, and promptly reached agreements with its unions for interim relief. Thereafter, in March of 2003, United filed a Section 1113(c) motion seeking additional per year labor cost reductions of $2.56 billion. Before the motion was decided, in June 2003, the company and its unions reached voluntary agreements worth $2.2 billion in additional annual cost reductions over 6 years, coming in the form of deep pay cuts, fundamental work rule changes and sharply reduced restrictions on regional flying.

  Later during that same bankruptcy proceeding, in late 2004, United obtained a second round of labor cost reductions, achieving another 11.8% reduction in pilot wages and further cost reductions in benefits and work rules. These direct labor cost reductions equaled $725 million, and in addition, United and its unions agreed with the Pension Benefit Guaranty Corporation to terminate all of United's defined benefit pension plans. Glass Decl. ¶¶ 47-50.

- **Northwest Airlines: savings achieved before and in bankruptcy.** Northwest suffered acute financial distress in 2004, and undertook the first step of its labor cost restructuring that December when the pilots' union agreed to a 2-year "Bridge Agreement" yielding $265 million in savings a year, primarily from a 15% pay cut. The parties had an understanding, however, that further savings would be needed once Northwest's other unions agreed to reductions (hence the title "bridge" agreement). Negotiations continued with the other unions without success. In the summer of 2005, Northwest's mechanics launched an unsuccessful strike and in response, the company contracted out the vast majority of its line and base maintenance jobs.

  In September 2005, Northwest filed Chapter 11 and a Section 1113 motion. Prior to a ruling on the company's motion, the pilots agreed to $358 million in

additional cost reductions and eliminated (with limited exceptions) the pilot agreement's ban on large regional jets and to a freeze of the pilots' defined benefit pension plan. The company also reached agreement with its agents and clerical workers, saving an additional $191 million per year. Northwest's flight attendants rejected two tentative agreements; the Company asked for and obtained relief under Section 1113 and then imposed the terms it had proposed to the flight attendants' union, resulting in savings of $195 million a year. Nearly a year later, the flight attendants ratified a new agreement. Glass Decl. ¶¶ 53-54.

- **Continental Air Lines.** Continental entered bankruptcy for the first time in 1983, and for the second time in 1991. During the first of these proceedings, Continental rejected all of its labor contracts and dramatically reduced its labor costs. These early bankruptcies did not prepare Continental for the post-9/11 world, however, and in 2003, the company sought additional labor cost reductions from its unions. On February 28, 2005, Continental's pilots union agreed to contribute $213 million per year, through an 8.9% pay cut and other contract changes over 45 months. The pilots' defined benefit pension plan was frozen, and replaced by a defined contribution plan. The mechanics agreed to a 4% wage cut and a cap on benefits. The flight attendants voted down a tentative concessionary agreement, but ratified a second agreement which provided for a four year pay freeze and saved the company $72 million per year, largely through cuts in benefits and changes in work rules. Glass Decl. ¶ 55.

- **Delta Airlines: in bankruptcy.** As Delta's economic condition began to deteriorate in early 2003, the company asked its union-represented pilots—the only unionized group of any size at Delta—for cost reductions of approximately $1 billion per year. The resulting negotiations continued until late 2004, when Delta was on the verge of bankruptcy. The parties concluded an agreement for the $1 billion in cost reductions, coming largely in the form of a 32.5% wage cut and numerous changes to pilot work rules. Nonetheless, Delta filed for bankruptcy protection in September, 2005. The company laid off between 7,000 and 9,000 of its 52,000 employees and filed a motion to reject the pilots' collective bargaining agreement. Before the motion was decided, the parties reached an agreement netting another $280 million in annual savings, based mostly on an additional 14% wage rate cut, and the termination of the pilot defined benefit plan. The agreement also included changes to the pilot scope clause that greatly increased the carrier's freedoms with respect to using large regional jets. Glass Decl. ¶¶ 51-52.

G. American Avoided Bankruptcy In 2003 But Remains At A Disadvantage

In 2003, American was also on the precipice of bankruptcy, but urgently sought to avoid that fate by, among other things, negotiating new agreements with its unions. American succeeded in reaching agreements, but, as history proved thereafter, the changes made to the

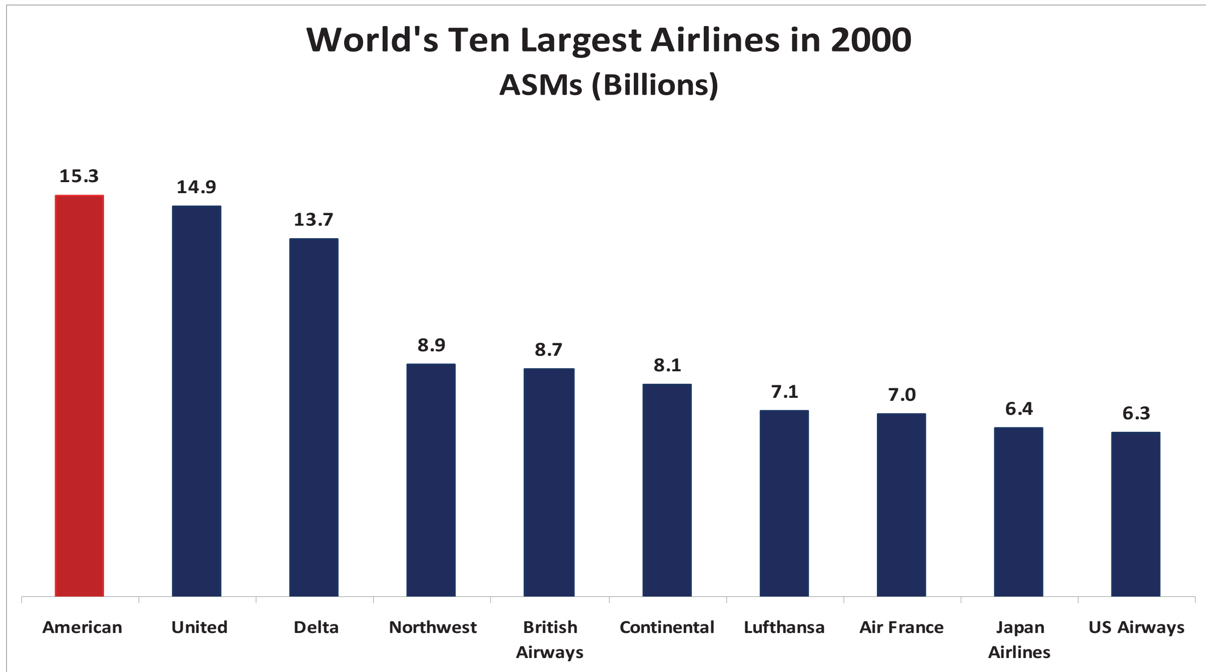
Company's CBAs paled both in scale and in character to the cost reductions and revenue-enhancing changes the other airlines would later achieve in bankruptcy. As the ink dried on American's 2003 agreements with its Unions, the Company and its employees watched as, one by one, its competitors used the bankruptcy process to do what American had been unable to do consensually: fundamentally remake their contractual arrangements in a way that would rationalize its airline operations to the new, post-9/11 world. Goulet Decl. ¶ 21; Glass Decl. ¶¶ 43-55.

Thus, until November 29, 2011, American remained the ***only*** major network carrier that had not filed for protection in Chapter 11. Although all of American's competitors either terminated or froze their defined benefit ("**DB**") pension plans in bankruptcy, American still has its DB plans, and funded them to the tune of approximately $518 million in 2011 alone, a cost unique to American—in ***addition*** to carrying an unfunded liability of $4.7 billion for those plans. Wright Decl. ¶ 44. In nearly every respect, the labor cost reductions that American's competitors achieved in bankruptcy were far deeper, and the entrepreneurial freedoms won were far greater, than those American was able to negotiate consensually with the Unions in 2003. Ultimately, the competitive landscape, and the costs and operational strictures imposed by the CBAs, ultimately required American to follow a similar path.

IV. AMERICAN CONTINUES TO LOSE GROUND TO RESTRUCTURED AND MERGED NETWORK COMPETITORS

A. Battered By Exogenous Events, American's Financial Performance Has Deteriorated

As noted above, in 2000, American was the largest passenger airline in the world, measured by capacity, or ASMs[18] and, at that time, AMR—American's parent company—was earning reasonable profits. Goulet Decl. ¶ 5.



AA Ex. 102. However, in the past decade, the Company has fallen behind. While American moved quickly to reduce its costs (including reaching consensual agreements with the Unions in 2003 to reduce annual unionized labor costs by $1.6 billion), as described above, American's major competitors then "leapfrogged" those efforts, filing for Chapter 11, repairing their balance sheets, and using the Section 1113 process to secure large labor cost reductions and operating

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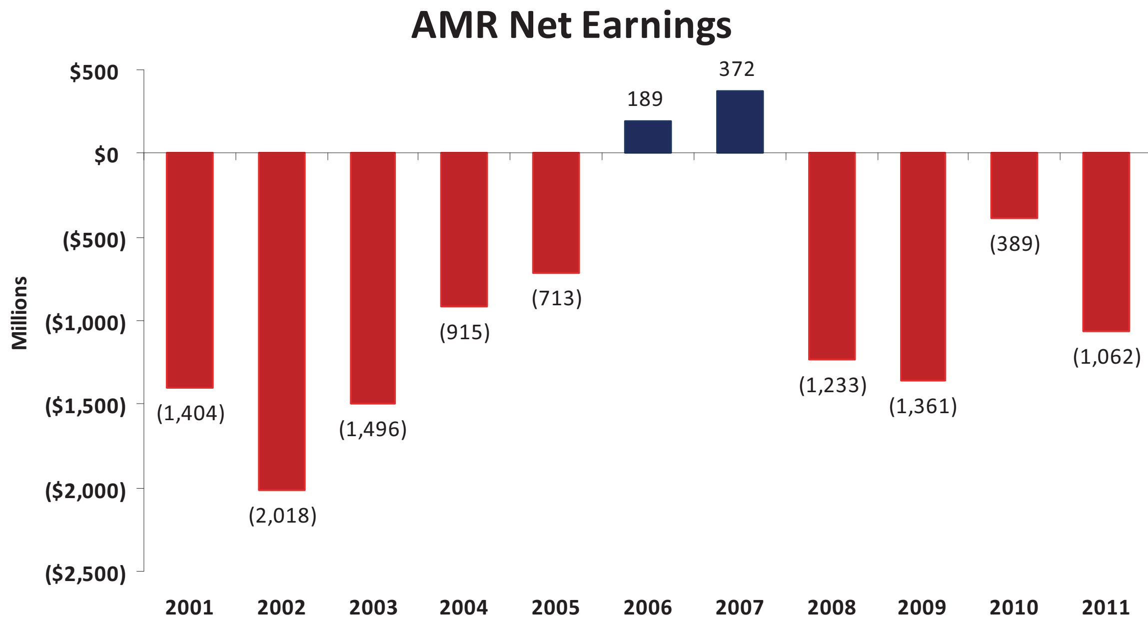
[18] This measure includes AMR's regional operations, including the operation of American Eagle, Inc. ("**American Eagle**"), AMR's regional airline.

flexibility that have now left American with the highest unit labor costs among the major network carriers. AA Ex. 103. Goulet Decl. ¶ 6.

In the years following 9/11, average fares for domestic flights fell (in large measure due to a dramatic rise in price competition driven by lower cost carriers) while fuel costs rose dramatically, and American's losses mounted. Meanwhile, its network competitors took advantage of their post-bankruptcy restructured balance sheets and reduced labor costs to merge, creating two mega-carriers (United and Delta) with networks larger than American's. These newly-merged network carriers have been able to reverse their losses and earn profits. Although American redoubled efforts from 2003 to 2011 to reduce costs even further and, in fact, has maintained non-labor costs in line with its network competitors, it could not—without agreement from the Unions—address its largest barrier to profitability: the terms and scope of its collective bargaining agreements. Between 2001 and 2011, American's parent company, AMR, incurred losses of more than ***$10 billion***, on a cumulative basis. AMR was modestly profitable in only two of those 11 years and borrowed heavily to fund its losses, debt obligations and pension liabilities. Goulet Decl. ¶ 7.



AA Ex.104; Goulet Decl. ¶ 7.

With those insurmountable burdens on its business, AMR has been unable to re-invest and grow the airline to be competitive. The results on American's industry standing have been dramatic. Today, American, including all regional capacity, ranks fourth in overall capacity (ASMs) among passenger carriers worldwide—and third (behind Delta and United) among U.S. carriers.[19] Goulet ¶ 8; Kasper Decl. ¶ 16.

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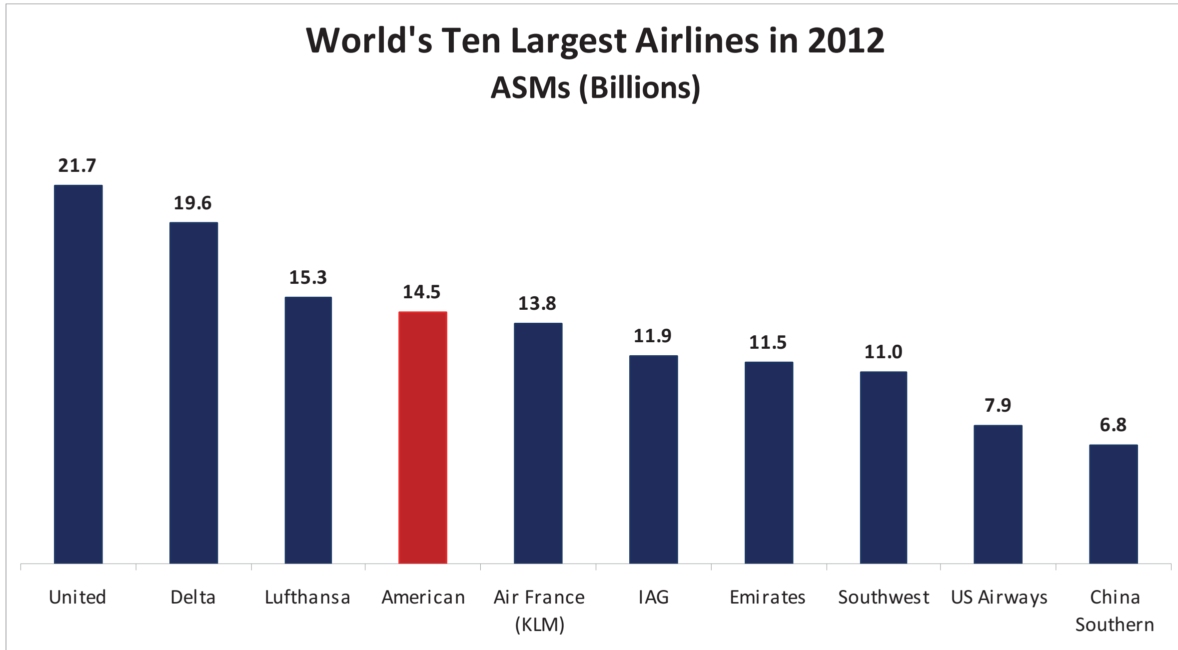
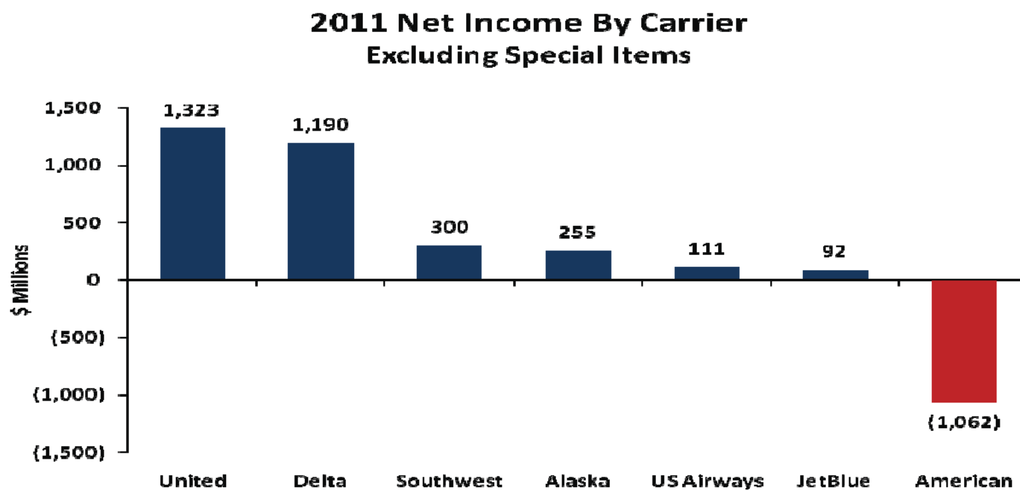
[19] *See* OAG May 2012 schedule.



AA Ex. 105.

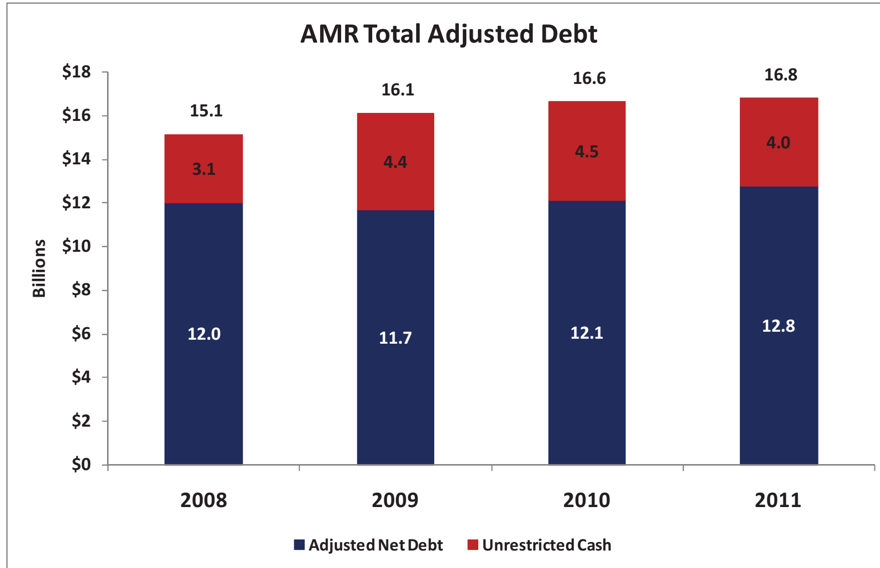
In 2011, AMR was the ***only major carrier to lose money***, and its losses were more than ***$1 billion***. Goulet Decl. ¶ 9.



AA Ex. 106.

The impact on AMR of its relative cost and operational disadvantages has been dramatic. As illustrated above, AMR has experienced cumulative losses of over $10 billion since the beginning of 2001, with losses of more than $1 billion in three out of the last four years. During

the period from 2008-2011, AMR borrowed heavily to cover its losses, fund its pension plans, and meet its debt obligations. Adjusted debt climbed to $16.8 billion in 2011, as AMR encumbered virtually all of its assets. Goulet Decl. ¶ 39.



AA Ex. 124.

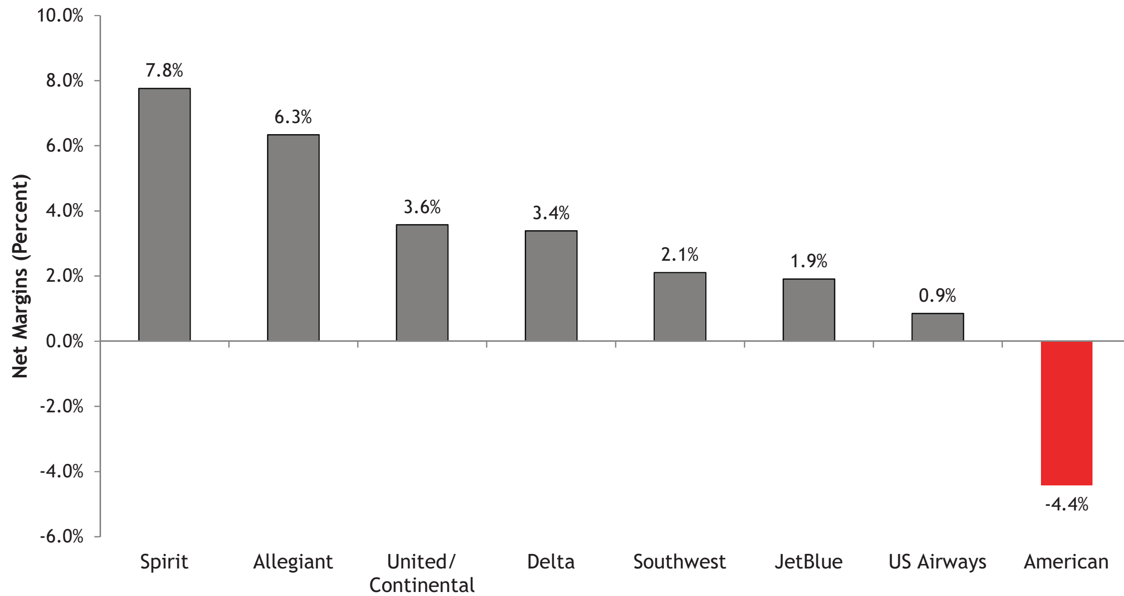
At the heart of American's deteriorating position is the fact that its net margins (its net income/loss as a percentage of its operating revenues) have been negative, averaging 3.6% since 2003, the year the Company signed its last collective bargaining agreements. Kasper Decl. ¶ 30.

EXHIBIT 9: AMR'S NET MARGINS, 2003-2011

AA Ex. 9.

American's financial performance over the past few years compares poorly not just to the fortunes of the LCCs like AirTran, Spirit, and JetBlue, which generally have much lower cost structures, but also to the performance of other network carriers that, notwithstanding high fuel prices, intense competition, and significant economic uncertainty, have managed to return to profitability. American was also the only large U.S. passenger carrier to experience negative net margins during each quarter in 2011. Goulet Decl. ¶ 9; Kasper Decl. ¶ 31.

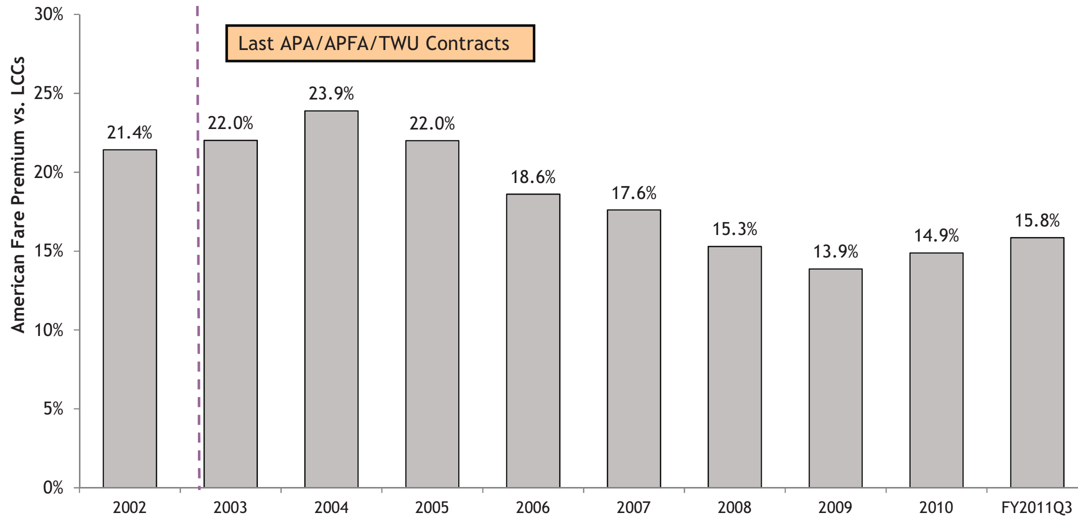
U.S. AIRLINE NET MARGINS, 2011



AA Ex. 10.

Likewise, since 2007, American's net margins have lagged behind those of both the LCCs and the other network carriers by a wide margin. While United/Continental, Delta/Northwest, and US Airways/America West have all been able to use the increased network scale created by their mergers to maintain a healthy premium over fares charged by lower cost carriers, American's revenue premium over the lower cost carriers has shrunk dramatically since 2005:

EXHIBIT 32: AMERICAN'S DECLINING FARE PREMIUM VERSUS LCCS, 2002-FYE 2011Q3



AA Ex. 32; Kasper Decl. ¶ 63.

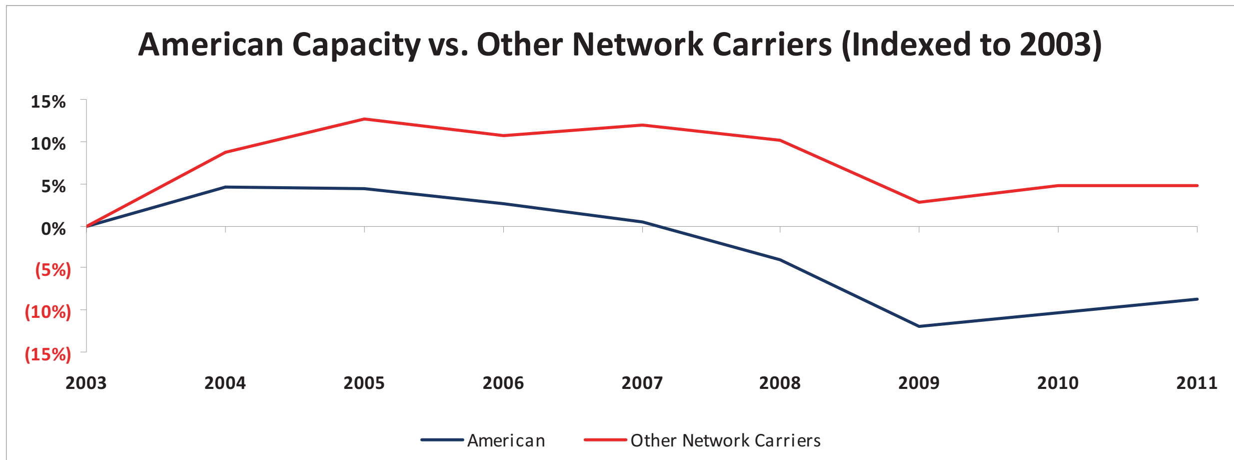
Faced with mounting losses and liabilities, having leveraged nearly all of its assets, and with no agreements on its unionized labor costs in sight, AMR sought relief under Chapter 11 as the only reasonable alternative to implement a cost and capital structure necessary to preserve value for its economic stakeholders and to assure long term viability. AMR needs a cost and capital structure that provides the Company with the flexibility to secure its competitive position. American's success, therefore, will require that American obtain relief from its collective bargaining agreements as requested in this Section 1113 Motion so that its cost structure is rational and its revenue generating capacity is no longer subject to the severe operational constraints imposed by the terms of such agreements.

B. <u>American's Historic Network Strength Has Been Overcome</u>

Historically, American, with key market positions in five hub cities—Dallas/Fort Worth, Miami, Chicago, Los Angeles, and New York City—has been well-positioned to attract a large share of high-value customers for whom the convenience of a vast network and world-class service warrants a revenue premium. Until the early part of the last decade (*i.e.,* before 2005),

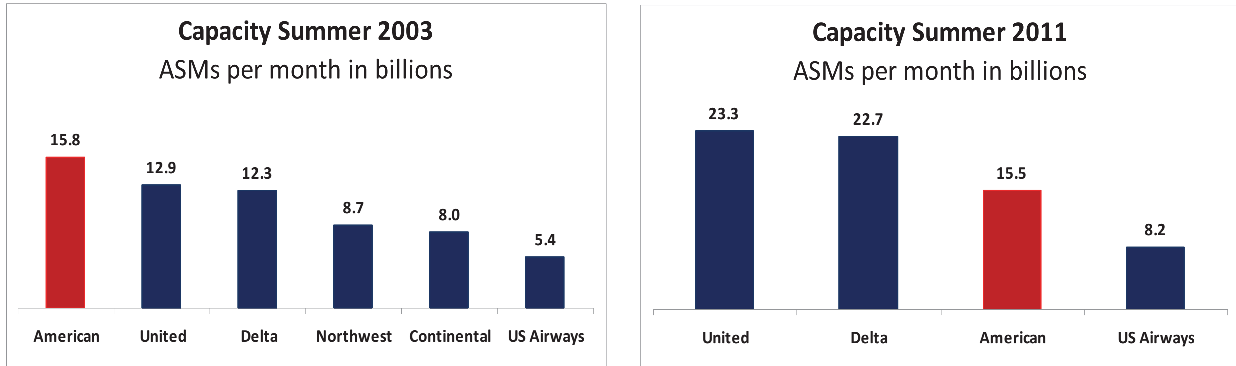
American was able to drive and maintain a healthy revenue premium by providing the largest network and developing customer loyalty through its frequent flier program, products, and branding. Vahidi Decl. ¶ 13.

American, however, has seen its revenue premium share erode not only due to rising LCC competition, but also because the other large network carriers have restructured in bankruptcy and then consolidated their networks, using their new financial strength, increased operational flexibility and expanded networks to invest in their service offerings. Goulet Decl. ¶ 34. While the other major network carriers were expanding and improving their service, American struggled with disproportionately high debt and costs and mounting losses, leaving it no choice but to under-invest in its fleet and its service, and reduce capacity. Kasper Decl. ¶ 132; Vahidi Decl. ¶ 38. Since 2003, American's capacity versus the other network carriers has shrunk:



AA Ex. 202; Vahidi Decl. ¶ 14.

As a result, American's network is now smaller than that of its two largest competitors:

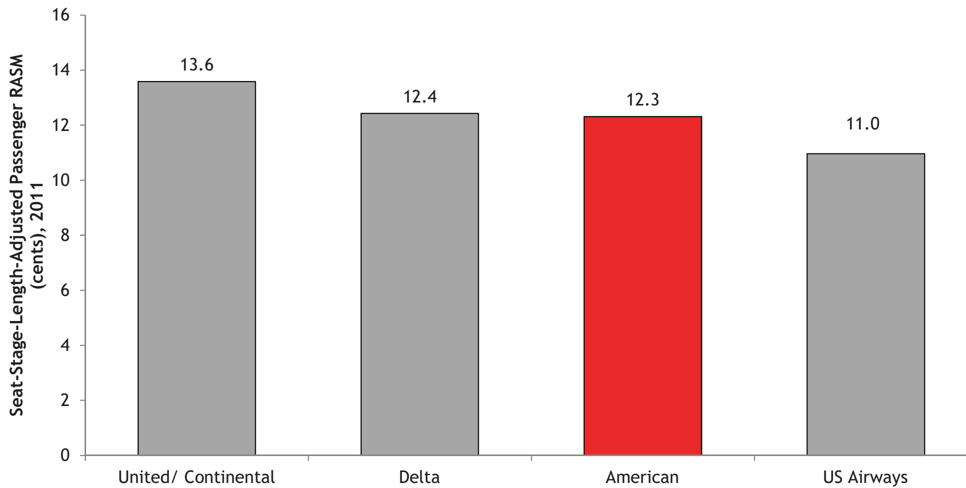


Source: Diio

AA Ex. 123.

American's unit revenues (expressed as passenger revenue per available seat mile, or "PRASM") now lag United/Continental's by a wide margin and are also lower than Delta's. Kasper Decl. ¶ 62.

LARGE NETWORK CARRIER STAGE-LENGTH-ADJUSTED PRASMS, 2011



AA Ex. 31.

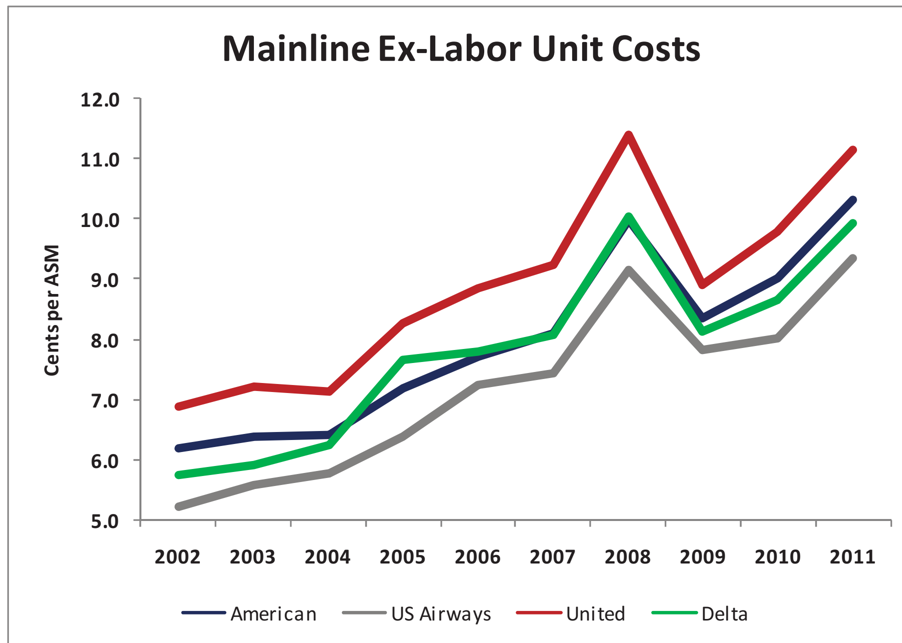
C. **American Struggles With Higher Labor Costs Than Its Restructured Network Competitors**

Having witnessed its competitors restructure their businesses through the Chapter 11 process, leaving American with a decided labor cost disadvantage, after 2003, the Company focused on reducing costs at every level possible, while striving to grow revenues. By the end of 2004, AMR (which includes both American and American Eagle) had achieved a total of approximately $4 billion in annual cost reductions. This sum included the $1.8 billion in consensual labor cost reductions, supplier concessions of approximately $200 million, and strategic initiatives accounting for approximately $2 billion in annual savings (such as reductions in food and beverage service ($250 million), reductions in travel agency commissions ($180 million) and booking fees ($60 million), reduced fuel consumption as a result of the American's "Fuel Smart" initiative ($50 million), productivity enhancements ($170 million) and fleet simplification ($200 million)). Goulet Decl. ¶ 23. During this process, AMR scrutinized its costs at every level and in every department of the Company, including such major actions as diminishing the scope of its unprofitable St. Louis hub, withdrawing from its hub in San Juan, Puerto Rico, and the closing of numerous surplus facilities, and other, more modest initiatives such as limiting the use of cell phones by management employees at Company expense. *Id.*

These initiatives continued throughout the decade, and are ongoing. In 2011, AMR targeted an additional $300 million in annual budgeted savings through (among other things) implementing maintenance efficiencies, utilizing a new aircraft route analysis system to lower air traffic control expenses, and implementing a checked bag scanning program to reduce mishandled baggage costs. Goulet Decl. ¶ 24.

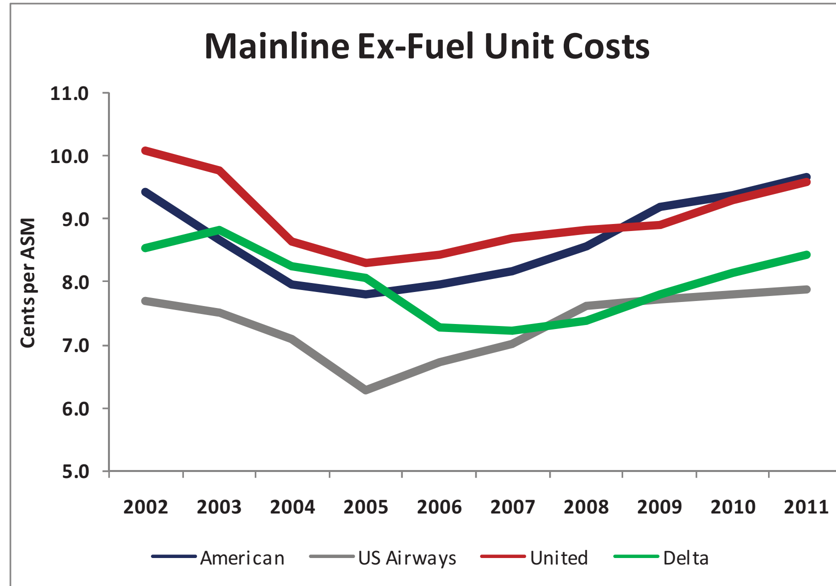
In summary, during the period 2002-2011, AMR was able to identify approximately $4.75 billion in annual budgeted savings from sources other than its collective bargaining

agreements with the Unions. Goulet Decl. ¶ 25. As a result of these efforts, American's non-labor costs are competitive with the other network carriers.



AA Ex. 114; Goulet Decl. ¶ 25.

However, American has been unable to overcome the advantage the restructured network carriers have achieved by reducing their labor costs and freeing themselves from operational strictures through Chapter 11. By 2009, American became the network carrier with the highest overall costs per available seat mile (excluding fuel), on a stage-length adjusted basis (*i.e.,* correcting for the fact that due to differing route lengths and aircraft sizes, some carriers are able to spread their costs per available seat mile over longer distances). American remains in this position today:



AA Ex. 121; Goulet Decl. ¶ 34.

V. AMERICAN CAN SURVIVE—AND THRIVE—BUT IT NEEDS TO BECOME FAR MORE PRODUCTIVE AND FAR MORE EFFICIENT

A. American's Business Plan Shows That The Company Can Succeed

On February 1, 2012, AMR announced its business plan for a reorganized American Airlines—the "Plan for Success"—in a presentation to its Union leaders. As AMR CEO Tom Horton stated in a letter to employees on that date:

> The key to [American's] successful restructuring is a business plan with a clear objective. And that is to make American a world-class global airline – America's flag carrier – that is competitive, profitable, and growing. To do this, we must consistently deliver: [1] A superior customer experience that earns loyalty and drives revenue [2] A work environment that recognizes excellence and rewards success [3] Attractive financial returns for our investors and stakeholders.

AA Ex. 126.

In building the Plan for Success, AMR understood that to survive in the current competitive environment, it would need a strategy and a plan that would enable the airline not just to meet its obligations, but to generate sufficient profits and other financial results to invest

in its future and attract capital to the Company. In other words, AMR knew it could not afford to limp out of bankruptcy with continuing losses, depleting liquidity, soaring debts and mounting liabilities.

Working intensively with an independent advisor (McKinsey), AMR conducted a comprehensive analysis of the markets in which it operates in order to better develop, refine and model its strategy for optimizing its network operations to maximize revenue. Goulet Decl. ¶ 44; Declaration of Alexander Dichter ("Dichter Decl.") ¶ 7. AMR also scoured the Company for additional savings by (i) identifying vendor and other third-party contracts that could be renegotiated or rejected (including unfavorable aircraft and facilities leases); (ii) further reducing budgeted operational expenses; (iii) identifying unsecured debt that could be compromised in the Chapter 11 process; and (iv) setting cost reduction targets for its management and non-union employees. Finally, AMR developed and presented proposals to the Unions to address the barriers to success imposed by the uncompetitive costs and operational restrictions reflected in the terms of its CBAs, as discussed below.

The resulting Plan for Success calls for AMR to strengthen its network and realize revenue improvements by:

a. Increasing the footprint of AMR's network and the volume of its operations through (i) increased focus on AMR's five key domestic hubs (Dallas/Fort Worth, Miami, Chicago, Los Angeles, and New York) (ii) expansion (through both organic growth and increased collaboration with international partners) from those hubs into international markets, with the largest expected growth in business travel; (iii) expansion of codeshare relationships with domestic air carriers to increase the breadth of AMR's network and, especially, to increase

the volume of traffic flow into the five key hubs; and (iv) greater use of large regional jet flying by regional partners to increase destinations, and frequencies in existing destinations;

b. Making significant investments in new aircraft to replace older, less fuel-efficient aircraft (resulting in a reduction in operating expenses associated with fuel and maintenance requirements) and to support growth plans; and

c. Making targeted investments in American's brand and its product.

Vahidi Decl. ¶ 21.

Revenue improvements that will be realized from AMR's business strategy are projected to reach $1.0 billion annually by 2017. Goulet Decl. ¶ 54.

AMR must also create a capital structure that allows the Company to make the investments needed to grow and compete, attract capital at favorable rates and withstand exogenous shocks to the business, and set in place a sustainable cost structure to drive profitable growth and assure long-term viability. Even with the additional $1.0 billion in annual projected revenue improvements by 2017, to achieve the financial performance required by AMR's Business Plan, the Company is required to reduce annual costs by 2017 by $2.1 billion. Goulet Decl. ¶ 54. AMR has projected that it can achieve $600 million in annual savings through the Chapter 11 restructuring process. *Id.* The remaining $1.5 billion in annual savings must come from reducing employee costs, including $990 million in annual costs arising from the terms of the CBAs that are the subject of this motion. *Id.*[20]

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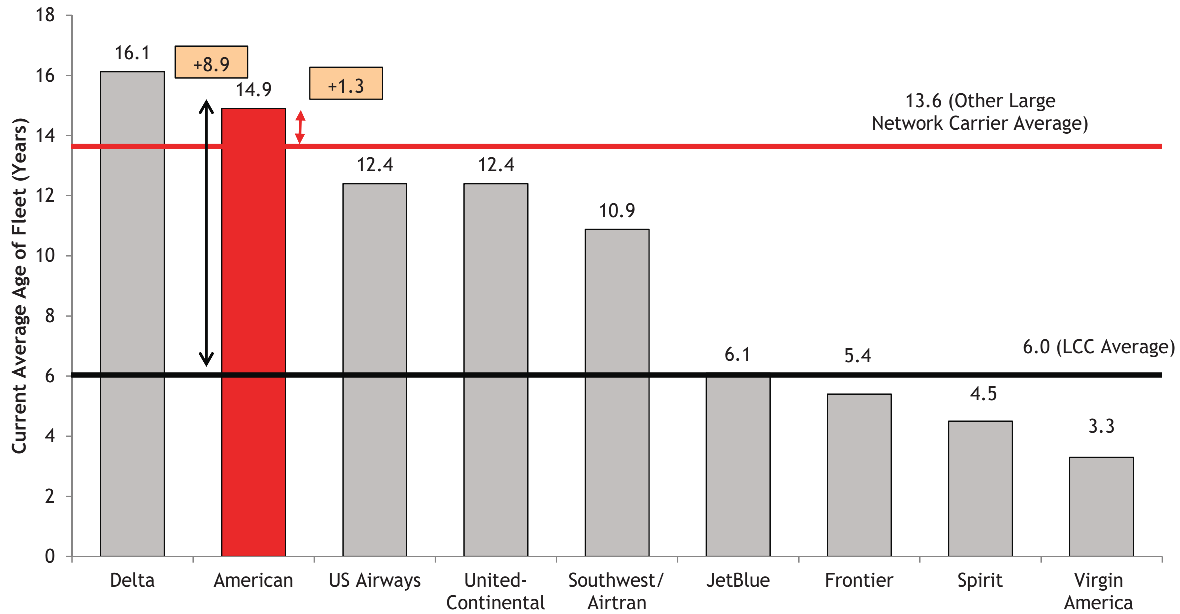
[20] This $1.5 billion represents the amount of annual cash savings over current annual costs, to be achieved by 2017, and includes retiree medical cost reductions, as well as labor cost savings at American Eagle. The figure, excluding retiree medical costs, translates to $1.25 billion in average (six-year) annual direct labor cost reductions at American, including $990 million in annual direct labor cost reductions sought in this motion from the unionized employees represented by APA, APFA and TWU. In addition, in a separate motion under Section 1114 of the Code, American will ask the Court for permission to eliminate company-paid retiree medical

B. American's Business Plan Calls For Significant Investments in the Fleet and the Product

As noted, the Plan for Success is expected to result in significant growth in AMR's unit revenue over the next six years. Goulet Decl. ¶ 47. This growth will require significant investments. After years of under-investing in new aircraft, the average age of American's mainline fleet at year-end 2011 was 14.9 years. As a result, American currently has one of the oldest average mainline fleets in the industry. Kasper Decl. ¶ 132.

AVERAGE MAINLINE FLEET AGE



AA Ex. 76.

American began to address this disparity through renewal efforts for its widebody fleet in October 2008 by placing orders for 42 aircraft and acquiring 58 options for Boeing's B787, subject to an agreement with APA.[21] Vahidi Decl. ¶ 39. The B787 will replace the B767-

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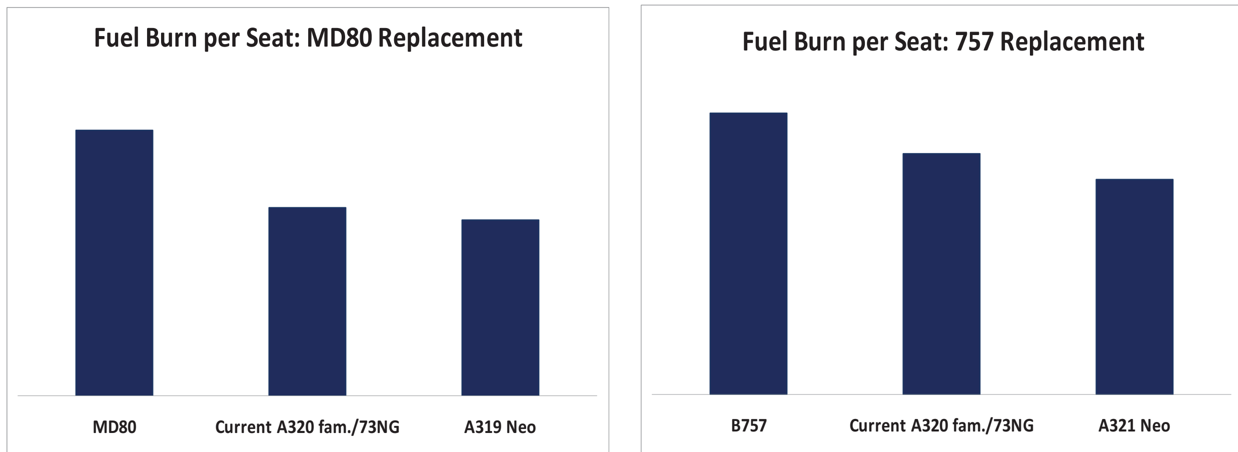
benefits for former employees who retired prior to the Petition Date.

[21] APA has taken the position that under the current pilot Agreement, American cannot operate a new piece of aircraft until the Union has agreed to a pay rate for the pilot crews that will operate

300ERs, offering superior customer comfort and fuel economics. American also has 16 firm orders for Boeing's B777 family, and expects to take the first of these deliveries, a B777-300ER, in November 2012. In July 2011 American placed the largest commercial aircraft order in history when it entered into agreements with Airbus and Boeing to acquire 460 aircraft in the Boeing 737 and Airbus A320 families, much of it through manufacturer financing. American also obtained 465 options on future deliveries. Vahidi Decl. ¶ 40. The orders include 230 next-generation aircraft, and the options include 340 next-generation aircraft. Increasing American's investments in newer, more efficient aircraft will allow American to provide a superior in-flight experience to its customers and will generate significant fuel and maintenance savings by allowing American to replace its aging MD80 and B757 aircraft. *Id.*



Source: AMR Fleet Planning based on Boeing and Airbus Data

AA Ex. 211.

In addition, re-gauging its aircraft fleet will enable American to better match supply with demand, as described above. American lacks a diverse fleet, which often prevents American

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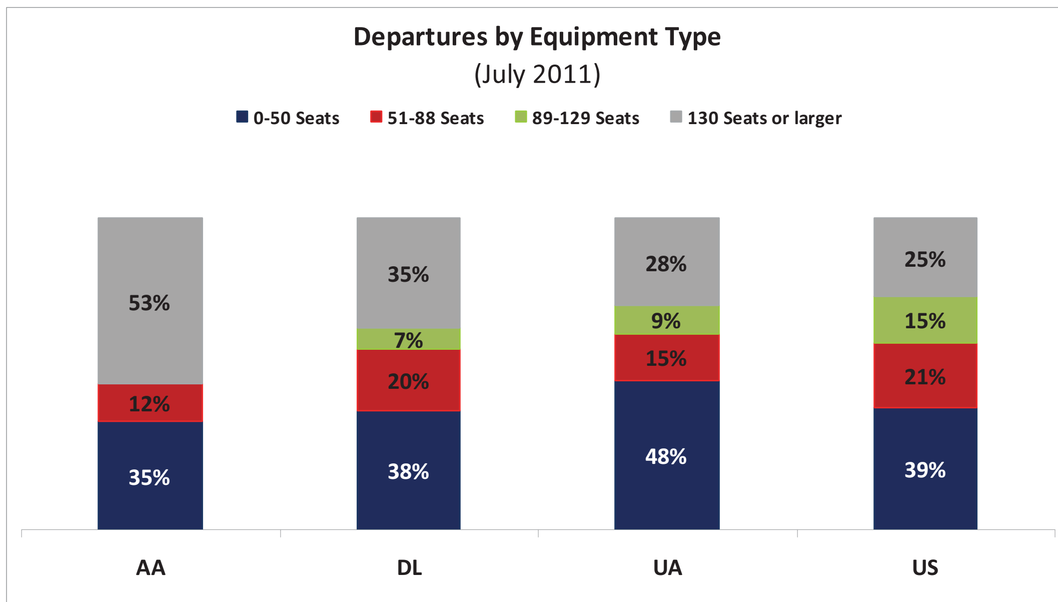
it. Accordingly, American cannot order new aircraft types until (a) it has gained APA's permission or (b) it changes the Agreement in ways that allow it to place an aircraft in service without being held hostage to pay rate negotiations. American has proposed a new pay structure

from flying the most appropriate aircraft for a given route. For example, American, through its regional affiliate Eagle, currently operates only 47 jets between 51 and 88 seats (called "large RJs" in the industry), a far lower percentage than its network competitors. As a result, American generally must employ jets that are either too large or too small for the routes that they are flying. This is inefficient, and puts downward pressure on American's unit revenue performance. Vahidi Decl. ¶ 41.



Source: Diio July 2011

AA Ex. 212.

Through the investments contemplated under the Plan for Success, by 2017 American will transform the composition of its fleet in order to more efficiently accommodate its passengers. Vahidi Decl. ¶¶ 38-42.

American has been forced to under-invest in its product and brand for the better part of a decade. Goulet Decl. ¶¶ 26-27. Meanwhile its competitors, using increased profits and

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to accomplish this in its Section 1113 proposals. Newgren Decl. ¶¶ 90-95.

enhanced revenues borne out of their Chapter 11 restructurings and mergers, have been moving forward aggressively. Both United and Delta have announced significant investments in on-board product and service improvements, including installing lie-flat seating, adding additional high value seating, and providing more in-flight services such as on-board Wi-Fi and personal entertainment centers. This, combined with the growth of our competitor networks, has helped our competitors compete for "high value" customers in the face of ever-increasing LCC competition, and thus continue to maintain a healthy premium over low fares charged by this competition, while American's revenue premium has been falling. Vahidi Decl. ¶ 43.

American's Plan for Success calls for investments to refresh and modernize the American Airlines brand with a newer fleet and best-in-class products. These efforts will help ensure that its customers have a premium experience that is fully on par (if not superior to) its network competitors. Vahidi Decl. ¶ 44.

By executing its Business Plan, AMR expects to return to profitability and to realize earnings and positive margins necessary for a successful and sustainable operation. Goulet Decl. ¶ 62. American is confident that it can achieve these results if granted the relief sought in this Motion, and if it succeeds, the Company's employees (including its unionized employees) will share in that success with a first dollar profit sharing plan (described below). The value of this profit sharing is projected to begin immediately, and climb to hundreds of millions of dollars per year by 2014. Goulet Decl. ¶ 53.

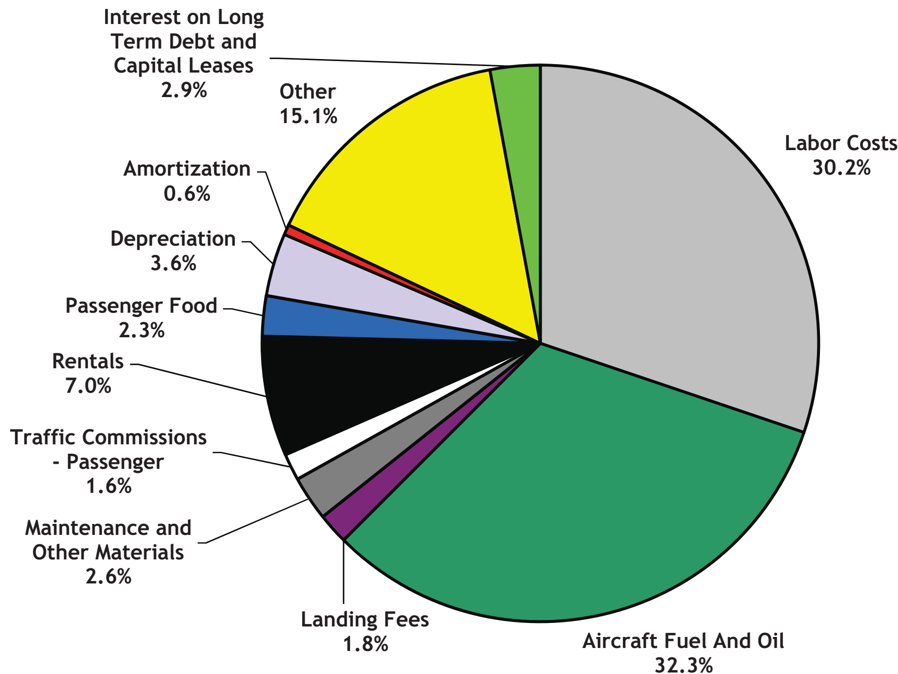
VI. AMERICAN'S SUCCESSFUL REORGANIZATION REQUIRES $1.25 BILLION PER YEAR IN LABOR COST REDUCTIONS

As the foregoing makes plain, American has made herculean efforts to remake its operations into a streamlined, ***profitable*** enterprise. More is needed.

A. American Has The Highest Labor Costs In The Industry

Labor is, by a wide margin, American's single largest ***controllable*** cost; successful reorganization is not possible unless the issue is addressed. Although fuel and labor account for a similar share of American's total costs, there is little that American can do to reduce its fuel costs for a given level of flying outside of upgrading its aircraft fleet (a step it is already taking).

EXHIBIT 41: AMERICAN AIRLINES FYE2011Q3 OPERATING COSTS

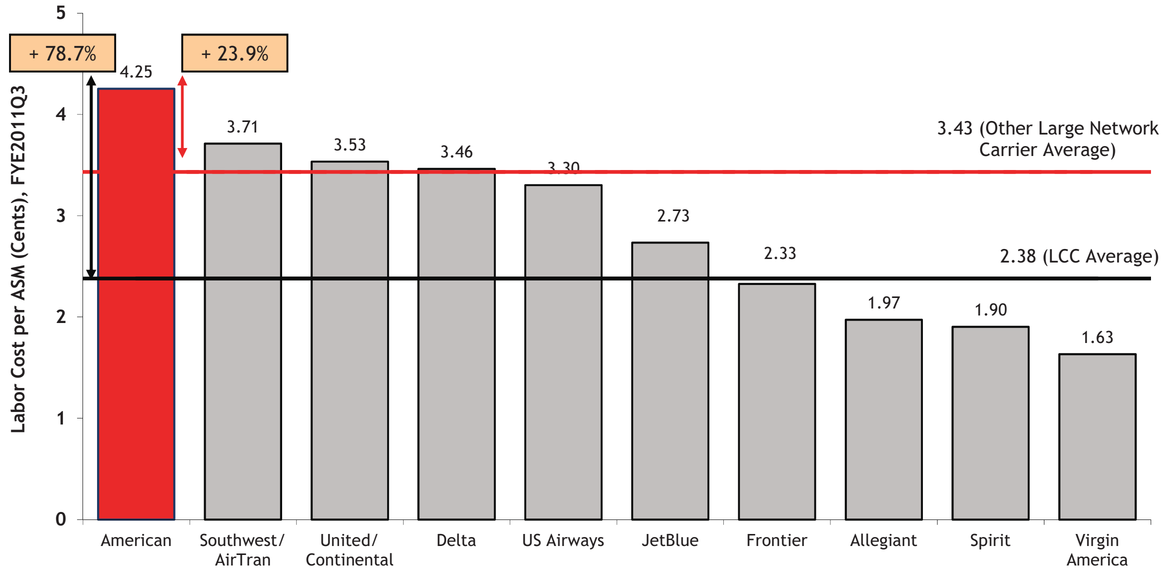


By virtually every standard metric, American's current labor costs are among the highest in the industry. Not only are they well above those of the LCCs (which dictate pricing on routes accounting for more than 75% of American's domestic passengers), but they are also well above the average costs of the other network carriers. American's labor costs per ASM (*i.e.*, its labor CASM)—a standard industry measure of unit labor costs—were the highest in the industry for the end of the 3rd quarter of 2011.[22] Kasper Decl. ¶ 79. Indeed, American's labor CASM for the

[22]Labor CASM is computed as labor costs divided by ASMs. ASMs are calculated by

FYE2011Q3 was ***24% higher*** than the average of the other large network carriers (*i.e.*, Delta, United, and US Airways) and 79% higher than the LCC average. *Id.*

EXHIBIT 42: FYE 2011Q3 LABOR COSTS PER ASM



American has not always been at such a significant labor cost disadvantage *vis-à-vis* its network carrier competitors. Until its major competitors filed for Chapter 11, American's labor CASM in 2002 was *below* those of United and US Airways:

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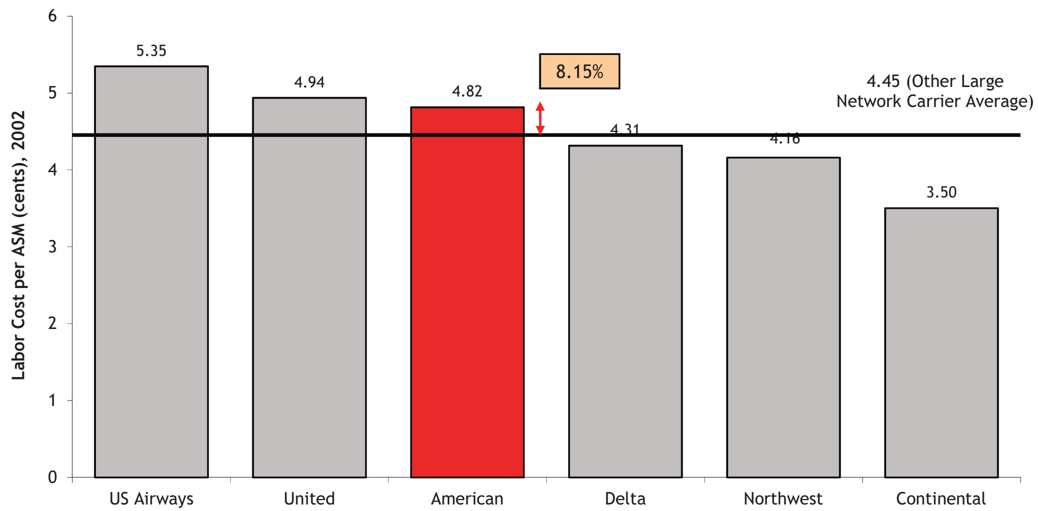
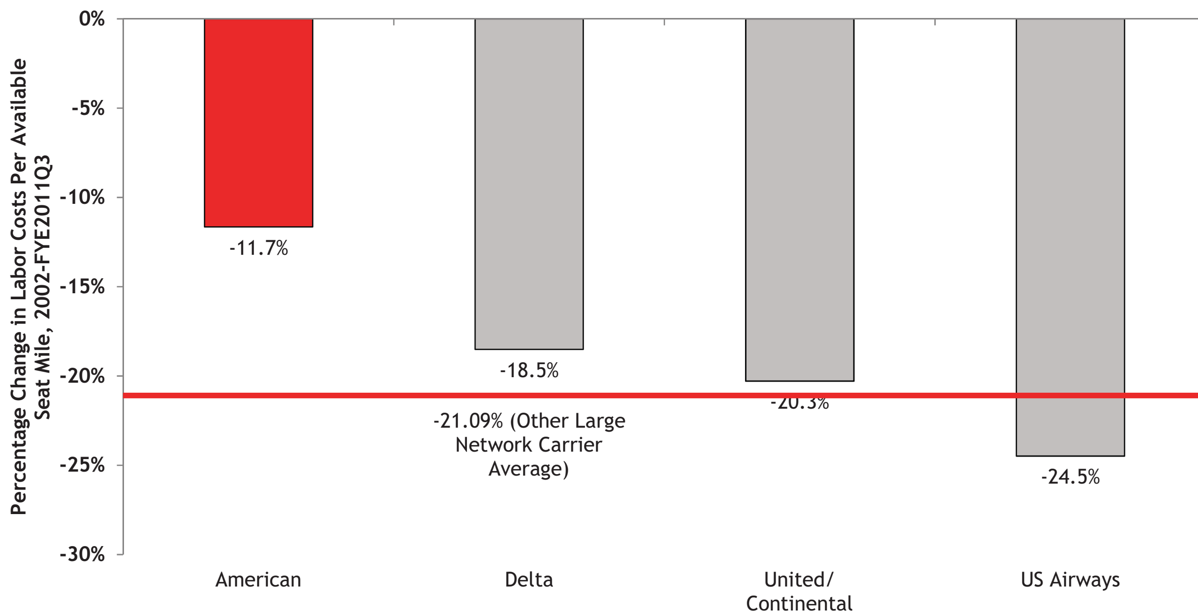
multiplying the number of seats on a flight by the distance flown and are a standard measure of airline capacity or size. Thus, a 250-seat aircraft flown 1,000 miles generates 250,000 ASMs. In 2010, American flew approximately 153 billion mainline ASMs. *See* AMR Corporation Reports Q4, 2010 Earnings Release, January 19, 2011.

**EXHIBIT 43: LABOR COSTS PER ASM,
AMERICAN VS. OTHER LARGE NETWORK CARRIERS, 2002**



The chart below shows the change in each large network carrier's labor CASM since 2002. American's costs have fallen by 12%, but costs at Delta, United and US Airways have declined by an average of over ***21%***.

EXHIBIT 44: CHANGE IN LARGE NETWORK CARRIER LABOR CASM, 2002 VS. FYE2011Q3



As detailed above, American's current unit labor cost disadvantage is the result of several factors including relatively high wage scales, vastly more generous benefits including defined benefit pension plans, a more senior workforce (*i.e.*, American has a greater proportion of employees earning the highest seniority-linked rates of pay) and restrictions in its collective bargaining agreements that prevent the Company from using its workforce as productively as its competitors. Kasper Decl. ¶ 82.

American's average compensation (*i.e.*, wages plus benefits) per employee for the year ending 2011Q3 was higher than all but Southwest.[23] At the end of last year, American's average compensation per employee was 20% higher than the average of other network carriers, and 36% higher than the average of the LCCs. Kasper Decl. ¶ 83.

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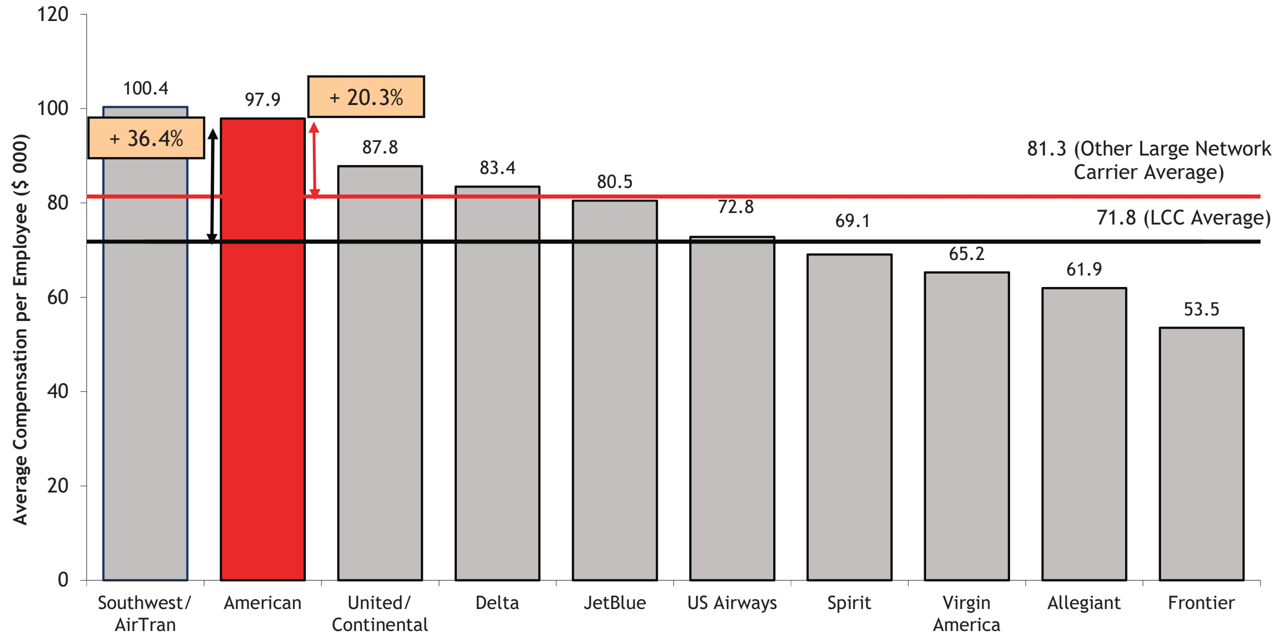
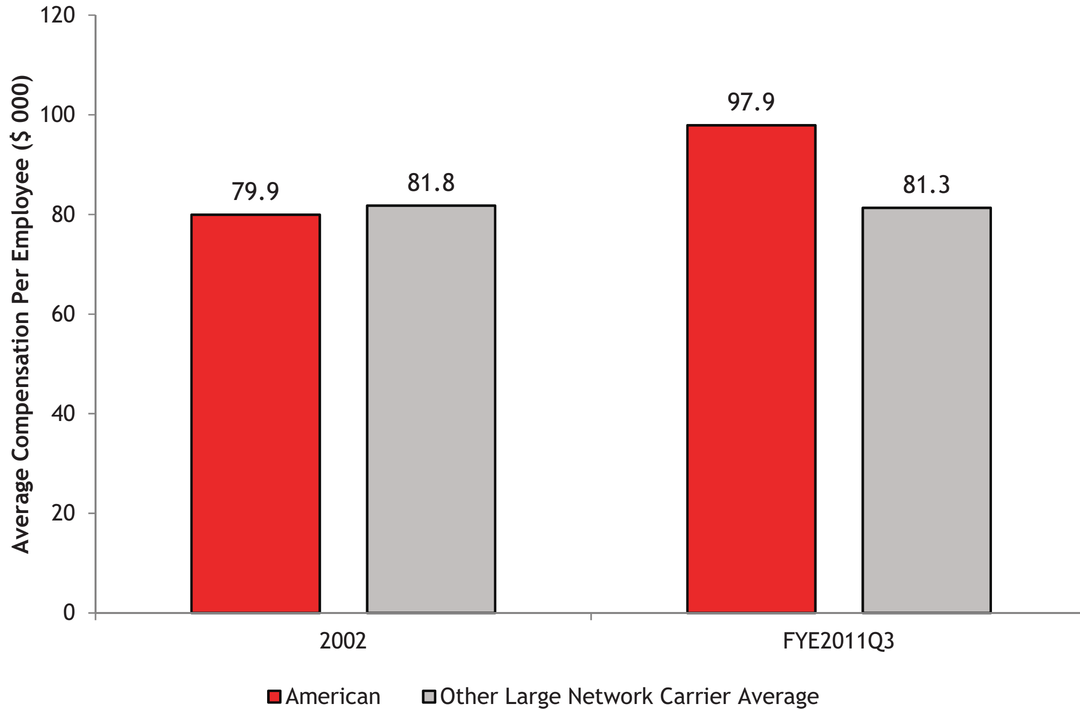
[23] Southwest has structural advantages not available to American that enables it to earn profits while still maintaining higher average employee compensation. For example, Southwest operates a single-fleet type (Boeing B737s); this dramatically reduces pilot training and spare parts inventory costs, and, as discussed below, a significant proportion of total compensation comes in the form of profit sharing. Kasper Decl. ¶ 83 n. 99.

EXHIBIT 45: FYE2011Q3 AVERAGE COMPENSATION PER EMPLOYEE



Moreover, the gap between American's average compensation per employee and the average of the other network carriers has grown ***more than seven-fold*** since 2002 (from $1,800 to $16,600), a reflection of the fact that most other network carriers have restructured their labor costs under Chapter 11 since that time. Kasper Decl. ¶ 84.

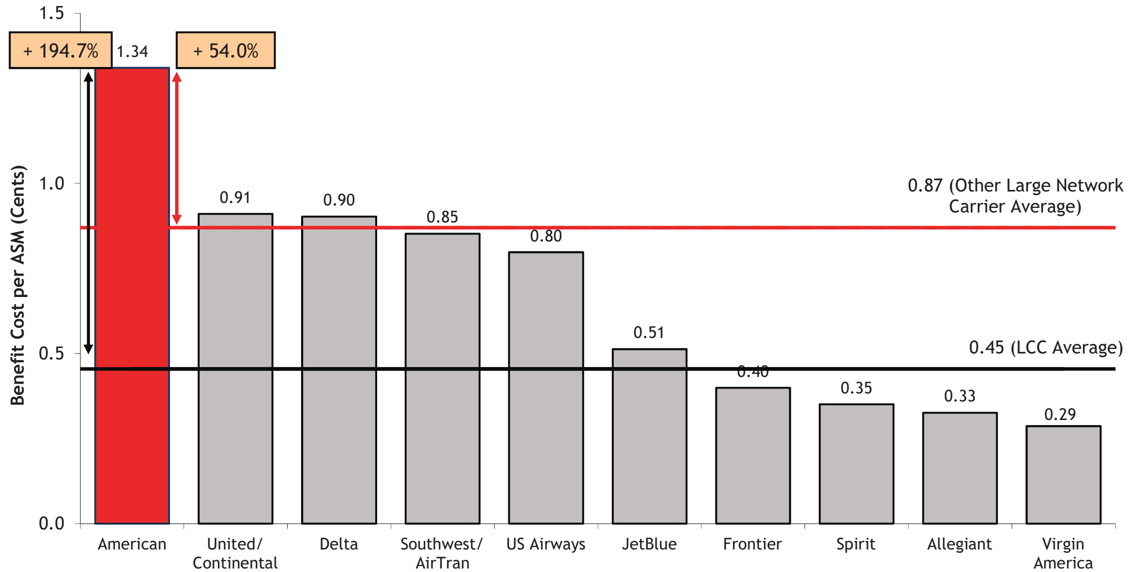
EXHIBIT 46: AVERAGE COMPENSATION PER EMPLOYEE, AMERICAN VS. OTHER NETWORK CARRIER AVERAGE, FYE2011Q3 VS. 2002



American's benefit costs per ASM are also the highest in industry, a reflection of the fact that, unlike its large network competitors, American still offers most of its employees both a defined benefit pension plan and retiree medical benefits.[24] Kasper Decl. ¶ 85. American also asks its employees to contribute less as a percentage of monthly premiums to their own health care coverage than its competitors, and far less than employees at companies of similar size in the economy as a whole. *See* Wright Decl. ¶ 20; Glass Decl. ¶¶ 35, 274. American's benefit costs per ASM were 54% higher than the average of the other large network carriers and 195% higher than the LCC average. Kasper Decl. ¶ 85.

[24] *See* American Airlines Retiree Benefits Guide, available at http://www.aacareers.com/ebg/smm2011/12275_retirees_american_airlines_jan_2011.pdf.

EXHIBIT 47: FYE2011Q3 BENEFIT COSTS PER ASM



When they restructured in Chapter 11, each of American's large network carrier competitors (except Continental) either terminated or froze its defined benefit pension plans.[25] And none of the LCCs (including Southwest) offer its employees a defined benefit pension plan.[26] As a result, American's pension accounting costs per ASM in FYE2011Q2 were by far the highest in the industry:

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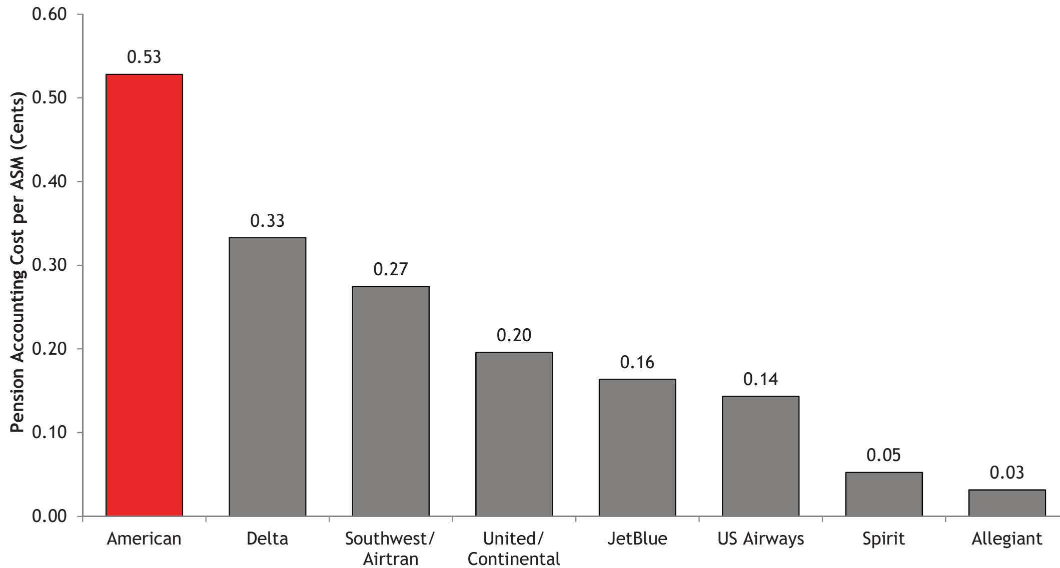
[25] For example, as part of their restructurings under Chapter 11, United and US Airways terminated all of their defined benefit pension plans. *See* http://www.pbgc.gov/wr/large/united/index.html and http://www.pbgc.gov/wr/bulletin/info/usairways/usair-assets.html. Likewise, Delta terminated its pilot pension plan. *See* "Delta, PBGC Reach Agreement on Delta Pilot Pension Plan", Delta Press Release, December 4, 2006 and "PBGC Becomes Trustee of Delta Pilots Pension Plan", PBGC Press Release, January 5, 2007.

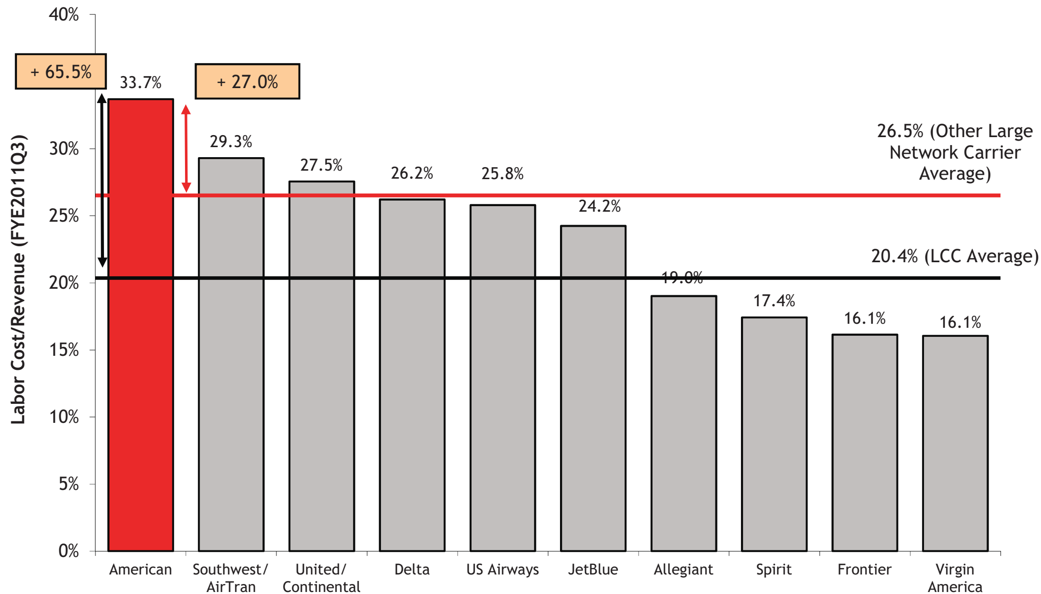
[26] *See* Kasper Decl. ¶¶ 85-86; http://www.southwestonereport.com/people_em_ben.php; Kasper Decl. ¶ 86.

EXHIBIT 48: 2011 PENSION ACCOUNTING COSTS PER ASM



As noted, some carriers (like Southwest) are able to support higher-than-average labor costs through far more productive work rules, which in turn enable them to generate higher levels of revenue per employee and thus remain profitable notwithstanding their relatively high unit labor costs. One straightforward way to measure this is by comparing carriers' labor costs (excluding maintenance) as a proportion of revenue. The chart below demonstrates that American's labor costs as a proportion of revenue are the highest in the industry, 27% higher than the average of the other large network carriers and 66% higher than the LCC average. Kasper Decl. ¶ 87:

EXHIBIT 49: FYE2011Q2 LABOR COSTS AS A PROPORTION OF REVENUE



In sum, American's labor costs are uncompetitive with both the other post-bankruptcy network carriers ***and*** with low cost carriers like Southwest and JetBlue. Despite the contributions and ingenuity of American's employees, the Company faces unrelenting competition from airlines that operate at substantially lower costs. With no pricing power, a diminished network and vastly higher costs, American cannot survive any longer with this ***status quo***. Without contributions from all corners, American cannot profit, and if it cannot profit, it cannot survive.

B. <u>American's Non-Union Employees Will Shoulder Their Fair Share Of The Burden</u>

American's unionized employees will not be asked to carry the load alone; the Company's management and non-union employees have shared and will share in the sacrifices that must be made to make American viable. Indeed, since 2002, management and non-union employees have been asked to do more ***with*** less, and more ***for*** less.

1. Non-Union Cost Reductions 2002-2011

In addition to the roughly 33% reduction in non-unionized headcount since 2002, American has implemented many cost-reduction measures, including some of the Universal Benefit Changes (described in detail in Section VI.D.2 below and the Declaration of Carolyn E. Wright) for its Management and Support Staff and Agents, Representatives, and Planners "ARP") employees. For example, American:

- Excluded new-hire ARP and Management and Support Staff from participating in American's defined benefit plans;
- Eliminated pre-funding for Management and Support Staff and ARP retiree medical coverage;
- Required Management and Support Staff and ARP retirees to contribute to the cost of pre-65 retiree medical coverage;
- Eliminated 65 and over retiree medical coverage for Management and Support Staff and ARP retirees; and
- Currently charges Management and Support Staff and ARP approximately 18% toward their active employee medical coverage, but on average only charges pilots and flight attendants about 13% and 8%, respectively.

Wright Decl. ¶¶ 20, 52-55.

American's Management and Support Staff have helped to further ameliorate the burden of American's worsening financial condition and competitive position by accepting significantly below-market compensation. Internal and external compensation assessments demonstrate just how large a burden Management and Support Staff have carried: As a whole, Management's base pay is 12% below the market median and their total cash compensation is 17% below the market median, placing Management below the 25th percentile (market is 50th percentile) in both compensation measures. Support Staff's base pay is similarly 23% below the market median, placing their compensation below the 25th percentile. Wright Decl. ¶¶ 56-59.

Although undeniably significant and contributing mightily to the Company's restructuring prospects, the non-union groups are not receiving credit for these historical sacrifices toward their current 20% cost reduction requirement. Wright Decl. ¶ 52.

2. Further Cost Reductions As Part Of Plan For Success

American's Business Plan requires that each workgroup—including its non-union workgroups—reduce their direct labor costs by approximately 20%. As a result, American's ARP and Management and Support Staff face additional significant reductions to their benefits as well as other headcount, wage, and work rule changes in order to ensure that American achieves the cost reductions necessary to emerge successfully from restructuring. Accordingly, American will reduce its annual direct labor costs for Management and Support Staff by an average of $165 million and its direct labor costs for ARP by an average of $95 million. Wright Decl. ¶ 61.

a. Management and Support Staff: $165 Million Per Year

Achieving the $165 million goal for Management and Support Staff begins with implementing the Universal Benefits Changes discussed below in Section VI.D.2[27] This will contribute $58 million in average annual labor cost reductions. McMenamy Decl. ¶ 93.

In determining how to allocate the remaining $107 million in cost reductions, American examined its staffing needs for Management and Support Staff, compensation structure, benefits programs, as well as analyses comparing their compensation with that of other Fortune 500 companies. Wright Decl. ¶ 62. Because American competes for the same management and support staff talent sought by other Fortune 500 Companies, its below-market compensation has put the Company in a vulnerable employee recruiting and retention position, which has only

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[27] The "**Universal Benefit Changes**" are further described in the Section 1113 Proposals and the

been intensified by American's repeated requests that Management and Support Staff do more with less staffing. American simply cannot reduce significantly Management and Support Staff's compensation below their already uncompetitive levels and hope to attract and retain the talent necessary to allow it to successfully emerge from restructuring. Wright Decl. ¶60.

On January 24, 2012, American's CEO, Tom Horton, announced a review and restructuring of American's management workforce that is intended to reduce the total direct cost attributable to management and support staff by at least 15% through reductions in headcount. The reductions began at the top—at the Senior Officer level. They included four Executive and Senior Vice Presidents and the consolidation of their responsibilities with those of other executives. These reductions will continue progressively down through the Management and Support Staff ranks and are anticipated to account for the remaining $107 million in Management and Support Staff labor cost reductions. To the extent, however, that these headcount reductions fall short of that number, additional labor cost reductions will be achieved through other means in order to ensure that Management and Support Staff contribute fairly and equitably to the overall direct labor cost reductions. Wright Decl. ¶ 64.

b. ARP Employees: $95 Million Per Year

American will reduce direct labor costs attributable to ARP by an average of $95 million per year over six years. Wright Decl. ¶ 61. Implementing the Universal Benefit Changes alone will reduce ARP's direct labor costs by $40 million.[28] McMenamy Decl. ¶ 91.

Declaration of Carolyn E. Wright.

[28] Although the various job categories within ARP share some commonalities as a result of their non-unionized status, unique features of each determine their individual cost structures and shape the way in which cost reductions can be achieved. Thus, while the Business Plan contemplates an overall cost reduction goal for ARP within each subgroup, the required cost reduction measures differ based on the intricacies of the particular workgroup.

American is currently engaged in the process of determining the most effective changes to achieve the necessary cost reductions called for in the Business Plan without crippling its ability to provide high-quality customer service and essential organizational support for the airline and without harming American's ability to operate as an efficient, safe, and viable enterprise. It is doing so by considering comments and concerns from the various ARP workgroups and individual ARP workers[29] and by examining how other airlines provide similar services in order to identify industry trends and common practices. Wright Decl. ¶¶ 65-67. Therefore, the remaining $55 million in cost reductions will be realized through a combination of other changes that will be determined as American finalizes its internal evaluation process. Regardless of how these cost reductions are achieved, ARP will contribute $95 million in direct labor cost reductions. Wright Decl. ¶ 67.

C. American Has Tried To Negotiate Needed Changes With Its Unions

After taking all of the painful steps described above, American is left with one remaining impediment to a successful reorganization. The Company's labor agreements result in the highest labor costs in the industry and erect the industry's most implacable barriers to success. Thus, the only way to bring American's costs into line with its competitive need is through labor cost reductions.

As explained in detail in the Brundage Declaration and the Union-specific Declarations of its Negotiating Team leaders, American has negotiated with APA, APFA, and TWU since (or

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[29] Some of American's Unions have expressed frustrations over the "failure" of the Company to announce precisely how it will achieve the 20% labor cost reductions with respect to the management and non-union portions of its workforce, but the process of eliciting feedback from those employees as to how best to accomplish that goal is no less important that the negotiations underway with each of the Unions.

in some cases before) their respective agreements became "amendable."[30] *See generally* Brundage Decl. ¶¶ 11-22. During these negotiations, American has tried to achieve long-lasting changes to its cost structure and entrepreneurial freedoms that would put it on par with its competition. *Id*. ¶ 13. For the most part, however, American's Unions made clear from the outset that they had no interest in addressing American's competitive disadvantage through pay or benefit cuts or through fundamental changes to work rules. *Id*. ¶¶ 14-15. Rather, they sought to restore the pay and benefits concessions they made in 2003. *See generally* Newgren Decl. ¶¶ 21-26. As the APA representative for the pilot group at Dallas-Fort Worth Airport put it during negotiations just last year, the employees have asked for "restoration [of the concessions given in 2003] and [in every respect] to be industry-leading . . . better than the best that anyone else has in their contract. Period."[31] In the June/July 2011 edition of *Turning Final*, the APA Communications Committee stated:

> We . . . have already sacrificed. That awareness should be the catalyst toward the drive for a truly restorative contract that reflects the worth of APA pilot professional services.[32]

AA Ex. 502.

Similarly, APFA President Laura Glading laid out the union's bargaining strategy in an April 1, 2008 letter to the membership: "We will be asking management to restore, with interest, all that we gave [in 2003]. It is imperative we send the message that we have sacrificed enough."[33]

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[30] "[O]nce a CBA becomes 'amendable' under the RLA,] the carrier and the union are bound by the status quo to embark upon an 'almost interminable' renegotiation process." *In re Northwest Airlines Corp.*, 483 F.3d 160, 167 (2d Cir. 2007).

[31] DFW Base Blast On Negotiations, February 26, 2011. AA Ex. 501 (Brundage Decl. ¶ 14).

[32] APA *Turning Final*, June/July 2011, AA Ex. 502 (Brundage Decl. ¶ 14). .

[33] *See* Declaration of Taylor M. Vaughn ("Vaughn Decl."), attached as AA Ex. 1000, ¶ 31.

Because the parties were working from fundamentally incompatible perspectives, American tried first to educate its employees on the dire circumstances facing the Company, providing to each employee group the very same monthly information and quarterly financial presentations that American's management gives to the Company's Board of Directors.[34] American then tried tailoring its bargaining proposals in a way that would at least acknowledge the disparate objectives the parties had—offering relatively small, incremental pay increases over the term of the proposed agreements and/or lump sum signing bonuses, while simultaneously seeking long-term cost reductions through enhanced productivity and other changes in work rules and benefits.[35] Brundage Decl. ¶ 20.

When viewed with the benefit of hindsight, and from the perspective of a debtor-in-possession, American's pre-petition proposals to its Unions would have been inadequate to address its needs even if they had been accepted.[36] Brundage Decl. ¶¶ 29-36. From the outset, American's pre-petition proposals were premised on hopeful assumptions: that the economy would improve (or, after the economic collapse of 2008, recover steadily); that the price of fuel would stabilize; and that American's competitors would, in relatively short order, agree to substantial increases in the wage rates they pay and the benefits they provide to their unionized

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[34] *See* Brundage Decl. ¶ 16.

[35] By October 2011, these negotiations resulted in tentative agreements for each of the TWU-represented groups; only two of them (Maintenance Control Technicians and Instructors) were ratified prior to the Company's filing for Chapter 11. Weel Decl. ¶ 13. Pilots, flight attendants, mechanics, and the remaining TWU-represented groups did not agree to American's proposals.

[36] Moreover, the viability of American's approach to pre-petition bargaining has to be assessed in the context in which it was first formed, in 2006-08. What American anticipated happening in the industry and the broader economy made sense at the time, but became less viable once the recession hit in late 2008 and thereafter, and as its major network competitors merged to form vastly expanded networks and achieved better financial performance.

employees.[37] Throughout this period, American made proposals that it believed could be accepted by the Unions (rather than proposals that might finally address its financial issues), and it was willing to assume the risk of the unknown future in exchange for consensual agreements, labor peace, and a possible future outside of bankruptcy. In the meantime, however, American's management was keenly aware of American's deteriorating financial and competitive position, and knew that Chapter 11 filings were a real risk. *Id*. ¶¶ 29-36.

American's Unions rejected these pre-petition proposals that, at the time, the Company thought were the most generous possible but, in retrospect, were far too generous. For the most part, "convergence" did not occur, the economy has remained weak and at risk, and fuel has reached and remained at historically high levels.[38] *Id.* In the current environment—for a Company in Chapter 11, with more than $10 billion in losses since 2001 and a diminished network facing larger, stronger rivals—the risks associated with those pre-bankruptcy proposals are no longer tenable. Brundage Decl. ¶35; Goulet Decl. ¶ 7, 9. If the changes American makes while in Chapter 11 are insufficient to allow it to compete against larger, profitable competitors and to withstand the impact of external events over which it has no control—whether a collapse of the Eurozone or a military confrontation in the Strait of Hormuz—the result would be catastrophic for American and all of its employees. Brundage Decl. ¶35. American no longer has the option to assume the risks of hopeful projections. With the perspective of hindsight, it is

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[37] American's then-CEO, Mr. Gerard Arpey, made public statements that he believed American's long-term labor cost differential would narrow as other carriers' labor costs increased through new collective bargaining agreements. This analysis was criticized by the financial community and it became clear to AMR's Board that it could not wait for this hoped-for convergence. Brundage Decl. ¶ 33 n.23.

[38] American's competitors, no doubt, anticipate that the Company's costs will be reduced in Chapter 11, and they would naturally be reluctant to agree to higher wages and benefits for their own employees while the bankruptcy process is underway.

clear that American today cannot agree to terms which are not supported by a hard, dispassionate look at the Company's finances, the economic and geopolitical risks that abound, and an increasingly unforgiving competitive landscape. *Id.* As another court noted in dealing with an airline bankruptcy:

> [I]n emerging from Chapter 11 into an intensely competitive market, a debtor should come forward ***close to the top of the heap in strength***, rather than at the bottom. Otherwise, it will not have the flexibility to remain competitive, or present the general attraction of future stability to future . . . partners. And a lack of those qualities may well lead to a second financial failure.[39]

Each of the Unions was well aware of the Company's increasingly precarious position, because, as noted above, each had access to the same financial performance data that management provided to American's own Board of Directors. Although American's Unions knew that the Company's management has always believed bankruptcy to be repugnant,[40] each was also aware that, as far back as 2005, market analysts had begun predicting that bankruptcy was almost inevitable, and was likely imminent, for the Company.[41] More than two years ago, one APA Union Officer thoughtfully cautioned his colleagues about the dangers of discounting the unpleasant facts regarding American's precarious position:

> In order for good decisions to be made that serve the interests of the membership, it is essential for the APA leadership to have facts, data and analysis as the starting points of any debate. In my view, we have done a poor job of this over the past two years. Far too often, we have started with a pre-determined desired outcome (which often hardens into an ideological position), then worked backward from that goal to find facts upon which we can base our arguments.

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[39] *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 738-39 (Bankr. D. Minn. 2006) (emphasis added) (referring with approval to the testimony of Mercer consultant Peter Walsh).

[40] *See* AA Ex. 910.

[41] AA Ex. 911-912.

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> Inconvenient facts that diverge from that viewpoint are repudiated or ignored, usually along with the individuals who point them out. Don't get me wrong—I'm in favor of major contractual improvements as much as the next guy. But one doesn't have to be a financial analyst to understand that the company's willingness to agree to such improvements is linked to their financial position. APA can certainly choose to ignore the reality of the current competitive and economic environment, but that doesn't mean the company and the National Mediation Board are going to do so. . . . To make matters worse, I believe that many of us are laboring under a misimpression of AMR's position and capabilities at this point in time . . . Because of misconceptions over AMR's financial strength, I believe we too easily discount the "downsides" to many of our positions and actions.[42]

As American had previously advised the Unions, in light of this Chapter 11 proceeding, American's need for labor cost reductions is now even greater. Bankruptcy diminishes American's ability to rely upon optimistic assumptions and take other business risks that the Company was willing to take in its efforts to avoid this day. Brundage Decl ¶ 35. In bankruptcy, the consequence of being too optimistic may well be liquidation.

D. American Has Made Proposals That Are Necessary For Reorganization

To reorganize, American has made proposals that are critical to both sides of its "labor balance sheet"—cost reductions that will bring its unit costs into line with the airlines against which it must compete and changes that will permit it to earn revenue it currently cannot capture. These changes will no doubt be painful for all constituencies, as changes in Chapter 11 invariably are, but they are both necessary for a successful reorganization and fairly allocated across all of those with a stake in American's future.

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[42] AA Ex. 505.

1. Cost Reductions Have Been Fairly And Equitably Allocated

American's proposals allocate the savings fairly across the different employee groups and CBAs. Specifically, American asks that each employee group—management, non-union, and unionized—bear an equal share of the necessary reductions. Each will be asked to take an approximate 20% reduction in their current total labor costs. Because the various groups account for different shares of American's current labor costs, they are being asked to contribute different sums to the total needed for a successful reorganization:

	Pilots	FAs	TWU	ARPs	Mgmt/ Support staff	Total
Total Employee Cost ($ billions)	1.8	1.1	1.9	0.5	0.8	6.1
Group's % of Total Employee Cost	29%	18%	31%	8%	13%	100%
Targeted Cost Reductions ($ millions)	370	230	390	95	165	1,250
Group's % of Total Cost Reductions	29%	18%	31%	8%	13%	100%
% Reduction of Six-Year Average Employee Costs	20%	20%	20%	20%	20%	20%

AA Ex. 507.

2. Viewed As a Whole, The Changes Proposed By American Are Necessary For Reorganization

American's proposals (other than the Universal Benefit Changes) are discussed in detail in the Union-specific briefs and accompanying declarations. Those proposals are extensive, detailed, and Union-specific, and American does not discuss them in this omnibus brief. Nonetheless, the Company's proposals generally include elements to fix the following problems.

a. Universal Benefits Changes

As discussed above in Section VI.A, American has a benefits CASM that is far higher than the average not just for the LCCs, but for the other large network carriers as well. Given its relatively high benefits costs, American recognized that it could achieve a significant share of its total cost reduction goal by implementing a package of benefit plan changes that generally would transition all of its active employees to a common active medical plan, a common retiree medical plan, and a common approach to employee pensions—the Universal Benefit Changes.[43] Providing the same benefits to all of its employees is not only fair and equitable, it also will allow American to preserve jobs and wages for many of its union and non-union employees. Implementing the Universal Benefit Changes across workgroups will account for almost half ($563 million) of the direct labor cost reductions required by American's Business Plan.[44] McMenamy Decl. ¶¶ 13, 22.

(1) Common Active Employee Medical Benefits

American provides its employees with rich medical benefits under its active employee medical plan.[45] The extraordinary value of that plan is underscored by a recent study showing that the gross cost of healthcare under the self-insured components of American's active

[43]These are referred to as the Universal Benefit Changes because with minor exceptions discussed in this Motion and the Declaration of Carolyn E. Wright, they will offer the same active medical, retiree medical and pension plan benefits to all employee groups, unionized and non-unionized alike.

[44] A detailed overview of American's proposed benefit plan designs is provided in the Wright Declaration.

[45] American's medical plan is complex with fifteen healthcare options, seven of which are self-insured, with a variety of CBA-mandated employee contribution levels further complicating medical plan administration. Wright Decl. ¶20.

employee medical plan[46] is approximately $2,000 more per year than the average employer with 20,000 plus employees. Wright Decl. ¶ 14.

In 2011, American spent approximately $544 million per year (net of employee premium payments) to provide these rich medical and prescription drug benefits and, although it has tried to contain costs, American has watched those costs almost triple since 1994. Wright Decl. ¶¶ 17, 21. Mercer, American's medical plan actuary, estimates that if action is not taken to control this growing cost, American's annual medical plan costs will balloon to [redacted] by 2018. McMenamy Decl. ¶ 23.

American simply cannot afford to continue its current active employee medical plan without significant change.[47] In order to address this ever-escalating cost, the Company's Section 1113 proposals ask its employees to contribute more and seek to make a uniform medical plan available to all of its employees, union and non-union alike.[48] Under the proposals, employees will be able to select from three medical plan options: The Standard Option, the Core Option, and the Value Option.[49] Wright Decl. ¶¶ 28-29. Employee monthly premiums under the Standard Option and the Core Option will be set actuarially at 21%, with a 17% employee only

[46] The cost reductions and changes related to American's medical plan discussed in this Motion all are attributable to the self-insured component of its medical plan. *See* the Wright Declaration for a description of the term "premium" as used in this brief. Wright Decl. ¶17, n.11.

[47] As described in the Wright Declaration, American's medical plan is unsustainable in part because of relatively low employee contributions, low deductibles, low out of pocket maximums, and because American is unable to negotiate with network providers for discounted rates under all of the plan's options. Wright Decl. ¶¶ 22-24.

[48] ARP's Home Based Representative and a sub-group of Premium Service employees will be offered participation only in the Core Option. Additionally, part-time employees will have a higher family coverage cost share. Wright Decl. ¶ 28.

[49]For unionized employees, the Standard Option and the Core Option will be included in the CBAs and any future changes to the Standard Option will be accomplished through collective bargaining. Wright Decl. ¶ 29.

cost share and a 22% employee plus family cost share. Wright Decl. ¶ 27. In other words, the Company will subsidize 79% of the aggregate premium under the Standard and Core Options.[50] The contribution rates for these two contractually-based options compare very favorably with the up to 28.4% charged by other airlines (Glass Decl. ¶ 275) and the 27% charged by other large employers (Wright Decl. ¶ 23).

Based on calculations provided by American's medical plan actuary, American anticipates that the proposed changes to its active employee medical plan will reduce direct labor costs by approximately $134 million per year over the next six years. McMenamy Decl. ¶ 24.

(2) Common Retiree Medical and Life Insurance Benefits For Active Employees

Most of the other airlines have eliminated their pre-65 and 65 and over retiree medical programs. Glass Decl. ¶ 278. Those airlines that do provide access to a company-sponsored program generally pass on most if not all of the cost of coverage to the retiree. AA Ex. 827. Although fewer and fewer employers continue to provide retiree healthcare coverage as time passes (Glass Decl.¶ 283), American currently provides its qualifying union retirees with both "pre-65" and "65 and over" retiree medical and life insurance coverage.[51]

It cost American approximately $125 million in 2011 to provide its retirees with medical and life insurance benefits and its unfunded liability ***for current employees only*** with respect to those benefits is much larger—an estimated [redacted] Wright Decl. ¶ 36; McMenamy Decl.

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[50] The Company initially will set employee monthly premiums under the Value Plan at 27% of the aggregate actuarially estimated premium equivalent, with a 22% employee-only cost share and a 29% employee plus family cost share. Wright Decl. ¶27.

[51] Flight attendants and TWU-represented employees contribute to a "pre-funding" account (the Company matches these contributions dollar for dollar), which partially defrays the cost of retiree medical coverage; once in retirement, the retirees do not pay any additional amount for retiree medical coverage; for pilots, American bears the entire cost. Wright Decl. ¶ 34.

¶ 26. American simply cannot continue to bear this significant expense—one not borne by its competitors.[52]

Under American's Section 1113 proposals, the Company will not provide any post-retirement life insurance benefit to any of its employees and American will provide its unionized and non-union employees[53] with a uniform retiree medical plan. Initially, future eligible early-retirees,[54] will have access to a Company-sponsored retiree medical option, but employee contributions for this coverage will be set annually at 100% of actuarially-projected expenses (including administrative expenses). This proposal generally would transition American's Union-represented employees to the same pre-65 plan design that currently is offered to American's Management employees, with all groups paying the full cost of coverage for the exact same plan design once the Universal Benefit Changes are implemented. Wright Decl. ¶ 39.

The Company will stop offering 65 and over retiree medical coverage to any employee, but has arranged for future retiree to have access to a guaranteed issue Medicare supplement plan through a third-party administrator at the retiree's cost. Wright Decl. ¶ 40. Those employees who have participated in American's pre-funding program will receive a refund of their unused contributions, adjusted to reflect investment experience. American intends to use the contributions it previously made to fund these benefits to offset the healthcare cost to retirees until the funds are exhausted. Wright Decl. ¶ 41.

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[52] In this Motion, American seeks only to modify the current CBA obligations with respect to retiree medical benefits for currently active employees. Benefits for already-retired employees will the subject of a different motion under 11 U.S.C. § 1114.

[53] Certain non-unionized employee groups are not offered any retiree medical coverage.

[54] Generally employees age 55 with at least 15 years of service are eligible for retirement. Some pilots will continue to be eligible to participate at age 50, rather than age 55.

American estimates that these changes to its retiree health and life insurance program offered to its active workforce will result in approximately $151 million in annual cost reductions over the next six years. McMenamy ¶ 28.

(3) Controlling Soaring Pension Costs

Prior to the spate of post-9/11 bankruptcies, all of the network carriers provided defined benefit pension plans[55] for their employees. Now, they are largely gone. At Delta (as to pilots only), United, and US Airways, all defined benefit plans were terminated in bankruptcy and were assumed by the Pension Benefit Guaranty Corporation; at Northwest (non-pilot employees) and Continental (as to pilots only), the plans were frozen to stop new benefit accruals. At all of these carriers (except Continental with respect to non-pilots), the defined benefit plans were replaced by defined contribution plans.[56] Glass Decl. ¶ 267; AA Ex. 819.

American, on the other hand, currently provides traditional defined benefit retirement programs to most of its unionized workforce and to some of its non-unionized workforce.[57] The cost of doing so is astronomical. In 2011 alone, American contributed $518 million to its defined benefit plans.[58] Wright Decl. ¶ 42.

American's pension plan actuary, Towers Watson, estimates that, if American's defined benefit plans are left unchanged, American will be required to contribute an average of approximately $447 million in each of the next six years to its four defined benefit plans and that

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[55] *See* Glass Decl. ¶¶ 265-270 for an overview of defined benefit pension plans.

[56] *See* Glass Decl. ¶¶ 271-273 for an overview of defined contribution pension plans. Continental contributes to multi-employer defined benefit plans for a limited number of their employees. Glass Decl. ¶ 55.

[57] American sponsors a separate defined benefit plan for each of its three unionized workgroups and a fourth defined benefit plan for certain non-unionized employees. Wright Decl. ¶ 43.

[58] This amount does not include participant elective contributions to the $uper$aver 401(k) Plan. Wright Decl. ¶ 42.

those defined benefit plans[59] carry a combined underfunded accumulated benefit obligation of roughly $4.7 billion. Declaration of Tamara R. Shelton ("Shelton Decl."), attached as AA Ex. 702, ¶ 7. If American does not "freeze" its defined benefit plans, it will have to contribute an estimated [REDACTED] between 2012 and 2017, and an estimated [REDACTED] if that date is extended until 2019 ***just to meet its minimum funding obligation with respect to future benefits accruals***. Shelton Decl. ¶ 11. These are contributions that the other airlines generally will not have to make. Glass Decl. ¶ 267.

Towers Watson estimates that American's current cost for providing pension benefits to its workforce, expressed as a percentage of pay, is approximately [REDACTED] for pilots, [REDACTED] for flight attendants, and [REDACTED] for TWU-represented employees. McMenamy Decl. ¶ 30. A comparison of these numbers to the defined contribution plan obligations of the other carriers (also expressed as a percentage of pay), *see* Glass Decl. ¶ 280 and accompanying Exhibits, further demonstrates American's huge labor cost disadvantage.

Because American simply cannot withstand its crushing pension plan obligations, in addition to freezing its non-union defined benefit plan, under its Section 1113 proposals, American will terminate the Pilot B Plan and freeze the defined benefit plans in which its flight

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[59] In addition to the defined benefit plans described above, American sponsors a tax qualified defined contribution retirement savings plan (commonly known as the **"$uper$aver 401(k) Plan"**). Every employee with at least one year of service is eligible to contribute a portion of his or her earnings to the $uper$aver 401(k) Plan. Most employees who do not participate in a defined benefit plan receive a 100% Company match, up to 5.5% of plan-eligible compensation. While pilots are eligible to participate in the $uper$aver 401(k) Plan, they do not receive a match. Instead, they receive a guaranteed contribution to the American Airlines, Inc. Pilot Retirement Benefit Program—Variable Income Plan (commonly referred to as the "**B Plan**"), a defined contribution, money purchase plan that is equal to 11% of total compensation. Wright Decl. ¶¶ 45-46.

attendants and TWU-represented employees participate.[60] Newgren Decl. ¶¶ 177-179; Brundage Decl. ¶ 43. Instead of continuing future defined benefit plan accruals, the Universal Benefit Changes contained in American's Section 1113 proposals will provide its $uper$aver 401(k) Plan to all of American's employees, and for all non-pilot employees, American will amend that plan to provide for a 100% match, up to 5.5% of an employee's plan eligible compensation that is contributed to the plan. Wright Decl. ¶48.

In order to encourage employee participation in the $uper$aver 401(k) Plan, the Company will "auto enroll" each non-pilot employee at a 3% employee contribution level all if they are not currently contributing to the plan. Wright Decl. ¶ 48. All automatically enrolled employees (as well as those who are already contributing to the plan) will have the option to increase or decrease this contribution level, or to opt out of participation entirely. For pilots, the proposal is to provide a guaranteed Company contribution of 13.5% of plan-eligible compensation in lieu of a Company match. Wright Decl. ¶ 48.

The pension plan component of American's Section 1113 proposals will provide American's employees with a generous defined contribution plan as compared to the plans offered by other airlines and US employers as a whole, resulting in a contribution level that, according to a recent survey, is more than twice the average US employer contribution rate in 2010 (2.3%) and, for its Pilots, over five times the average US employer contribution rate. Glass Decl. ¶ 273. American's transition away from a defined benefit based pension program toward a

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[60] American is working with the Unsecured Creditors Committee, the PBGC, and APA to freeze, rather than terminate, the pilots' defined benefit plan. The structure of that plan, however, poses unique challenges that have not yet been resolved. *See* Brundage Decl. ¶ 43 and n.27. As American works with these other stakeholders to solve these problems, however, and for the purposes of this Motion, until such a result is achieved, American must seek relief from all of its pilot defined benefit plan obligations by taking the preliminary steps necessary to terminate the plan.

defined contribution-based pension program is not only necessary for reorganization, it is consistent with the benefits offered at other airlines as well as the growing national trend among employers to provide defined contribution plans as opposed to defined benefit plans. Glass Decl. ¶ 267; AA Ex. 820. Implementing the Universal Benefit Changes with respect to American's pension plans will result in average annual savings of approximately $278 million over the next six years. McMenamy Decl. ¶ 32.

b. The Remaining Changes Proposed By American Are Intended Simultaneously To Save Money And Make The Company Competitive

Labor costs are a function of wages, work rules, and benefits. Some of American's employee groups are already much more productive than others. In constructing its proposals, American attempted to be sensitive to the particular circumstances presented by each work group rather than taking a cookie-cutter approach. Accordingly, the amount and the mix of proposed productivity savings and compensation and benefit savings are different for each group, and the details of each set of proposals is explained in a group-specific volume accompanying this brief for each.

Nonetheless, American had over-arching goals for all groups: maintain, so far as possible, existing base wage rates; protect to the extent possible employee take home pay; and, achieve as much of the needed savings as possible from increased productivity. Brundage Decl. ¶ 25. American sought to make the airline among the ***most efficient*** of its peers, and not the one with the lowest pay. Thus, American's proposals leave base pay rates largely untouched, and strive to achieve efficiencies elsewhere. Newgren Decl. ¶¶ 90-95.

c. Changing Work Rules To Enhance Productivity

Although most of American's employees are hard working, work rules and practices enshrined in their CBAs limit their productivity and require American to employ more

individuals than would otherwise be needed. For example, as a result of provisions in their current CBA that have accumulated over the course of many years, American's pilots are paid more to fly fewer hours than pilots at any other network airline.

- American's average pilot works between 12 and 13 days a month. Newgren Decl. ¶ 12.
- The average pilot is paid for 81 hours of time each month, but actually flies approximately 50 hours on average. The other 30+ hours of pay is derived from training, vacation, sick time,[61] and a variety of artificial measures of pay (often called "soft" time).[62] *Id.*

Significantly, American is prohibited by its CBA from scheduling a pilot for more than 78 credit hours a month, and individual pilots can only add another five credit hours ***even if they want to add more***. No comparable restriction exists at American's competitors; in fact, pilots at some other airlines are permitted to fly up to the Federal Aviation Administration's maximum of 100 hours per month. Newgren Decl. ¶¶ 12-14, 121-123.

Flight attendants are not required to work any minimum number of hours to remain actively employed at American, and the minimum number of hours they are required to work in order to retain their "fixed benefits"—Company-subsidized health benefits, vacation pay, and

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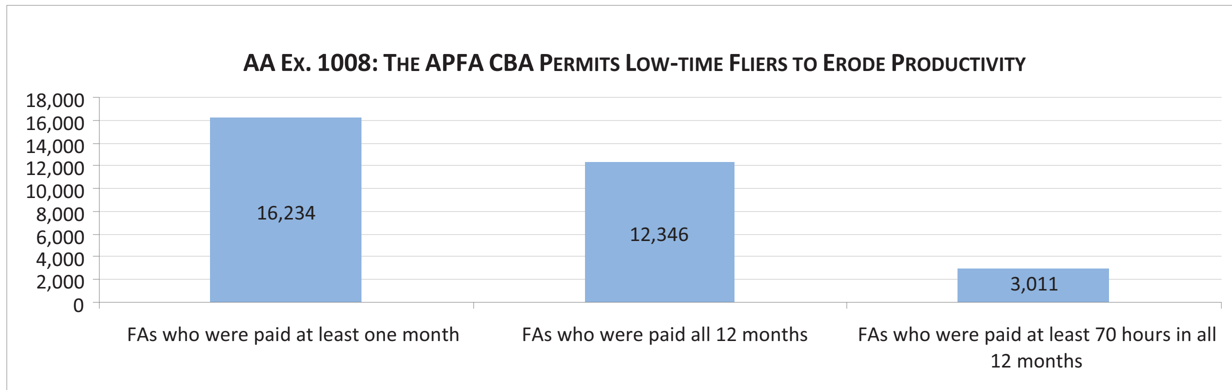
[61] In 2011, American's pilots as a group had by far the highest lost time rate last year among the eight carriers tracked in an industry study. (The other carriers are Alaska, Continental, Hawaiian, jetBlue, Southwest, United, and US Airways.). *See* AA Ex. 1302.

[62] Because pilots are paid for both the hours they actually work and for non-work hours spent away from their home base (rather than the number of calendar days they work), calculating a "days worked" figure requires some extrapolation. Consider a typical American pilot who flies three sequences in a given month: (1) Chicago to Honolulu and back to Chicago; (2) Chicago to London to Raleigh-Durham and back to Chicago; and (3) Chicago to Paris and back to Chicago. These trip sequences amount to ten compensated "days away from base," but only eight "duty period" days (days during which flying occurred). The number of "work" days—days for which compensation was owed—total 12 days. This average varies widely depending on whether the pilot flies domestically or internationally. Newgren Decl. ¶ 12 n.9.

sick pay—is just 420 per year.[63] Vaughn Decl. ¶ 21. While many of American's flight attendants are hardworking and work as much as they can, many others fly only as much as is required for them to obtain benefits, and no more. Many routinely ***sell*** their flight schedules on third party websites while maintaining their spot on the seniority list. *Id.* Unfortunately, American pays just as much to provide benefits to one of these "low-time flyers" as it does for a more productive worker, making them far less cost-effective to keep on the active roster. The following exhibit illustrates the extent to which low-time fliers predominate in American's flight attendant workforce:



Similar impediments to efficiency can be found in the TWU Agreements as well. Currently, American is obligated to do its "heavy maintenance" work[64] in-house, while its competitors have long since out-sourced this work. Glass Dec. ¶26, 31. Doing the work in-house requires American to maintain enormous hanger facilities and extensive parts inventories

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[63] Flight attendants who are inactive for any part of the year are required to work an average of 35 hours per active month to qualify for their fixed benefits.

[64] "Heavy" maintenance is performed on aircraft as they age, and it involves inspecting the airplane's major systems for wear, rebuilding the engines, and refurbishing and updating the equipment onboard. Glass Dec. ¶ 186. Because American has *by far* the oldest fleet among the network carriers, it has more heavy maintenance requirements than its competitors. Indeed, many of the more recent market entrants have little or no heavy maintenance costs because their equipment has not reached the age at which it is required.

for multiple fleet types. Burdette Decl. ¶ 20, 25-32. It also limits American's flexibility to implement product enhancements and other fleet modification programs that are time-sensitive and drive short-term workload. The work can be done more timely and more cost-efficiently by FAA-approved maintenance vendors to whom American's competitors have turned. American cannot afford to be alone in having to do the vast majority of this high-cost work in-house. *Id.*

d. Eliminating Restrictions On Entrepreneurial Opportunities

In addition to addressing items that impose direct labor costs, American seeks to alter labor contract provisions that restrict American's ability to operate its business in order to maximize revenues, discussed at great length in the Newgren and Vahidi Declarations. Newgren Decl. ¶¶ 29-32; Vahidi Decl. ¶ 14-20. Specifically, the pilot "scope" clause defines the work reserved for American's pilots, but has grown so broad over the years that it actually ***undermines*** the job security of American's pilots and other employees by inhibiting American's ability to pursue new markets, new revenue, and ultimately, new flying opportunities. Newgren Decl. ¶ 17.

Although American proposes to revise the scope clause in other respects, two principal roadblocks to reorganization reside there. First, American's regional partners are restricted to no more than 47 specific "large" regional jets (*i.e.*, larger than 50 seats), and those specific planes that APA has permitted American to use cannot be replaced as they are retired. Newgren Decl. ¶¶ 20, 55-60. American needs its partners to be able to use these new, larger regional jets (RJs) to fly where market forces make them more profitable than either larger "mainline" aircraft the Company currently operates or the smaller regional aircraft its partners are allowed to fly. American's need for this flexibility is not unusual; Delta currently can operate 255 large RJs, United can operate an unlimited number, and US Airways can operate more than 300. Newgren Decl. ¶ 60.

American also seeks to relax restrictions on "code-sharing" agreements with other airlines that fly to places American does not or cannot serve adequately by itself. Newgren Decl. ¶¶ 67-87. Code-share operations feed traffic to American hubs, strengthening the Company's network and thereby adding revenue and flying opportunities for American's own pilots. Newgren Decl. ¶ 69. Code-sharing permits the Company to extend its network into markets where it cannot currently compete (*e.g*, where gate and "slot" restrictions preclude growth) and allows it to present to the flying public seamless travel opportunities that it could not otherwise offer. Newgren Decl. ¶¶ 70, 73-77. The freedom American seeks is not extraordinary; ***every one*** of American's network competitors has more freedom in both areas than American. Newgren Decl. ¶ 70.

The TWU Agreements also contain a provision, created in 1995, that restricts American's ability to build its regional partner network and works to defeat American's ability to compete. Specifically, the ASMs flown by American's regional operations cannot exceed 6% of the ASMs flown by American's mainline operations. Like the pilot scope clause, this restriction curtails the Company's ability to increase its regional feed. Raising the 6% cap on regional operations would allow American to extend its network by allowing its regional partners to feed American's own mainline operations. Weel Decl. ¶¶ 21-22, 94.

Duration. American's labor cost restructuring must be long-lasting to be effective; temporary "holidays" from the terms of its current, uncompetitive agreements will not fix the structural problems the carrier faces. Brundage Decl. ¶ 25. To accomplish this goal, American has proposed that its new contracts remain in place for six years, a duration long enough to allow for a full recovery of American's financial strength. Six years was the term of labor agreements in bankruptcy at US Airways and United. Glass Decl. ¶¶ 43-50. As explained *infra* at 20, in

order to secure an equity infusion on emergence from Chapter 11, viable competitive costs will be a major consideration.

Upside Protection. The goal of these Chapter 11 cases is to build a new, profitable, competitive American Airlines. The Company is determined that the employees who share now in the sacrifices necessary to achieve that goal will share in the fruits of its anticipated success. American's proposals include employee profit sharing of [redacted] from the first dollar of profits, replacing a 2003 plan that shares only if profit exceeds $500 million, which has never happened since that plan was created. Wright Decl. ¶ 68. These proposed changes to the CBAs would ensure that American's employees share in the success when the airline recovers from its current, perilous economic condition.

VII. AMERICAN HAS SATISFIED THE REQUIREMENTS OF SECTION 1113

Section 1113 of the Bankruptcy Code prescribes the standards and procedures that apply to this Motion to Reject. Before this Motion can be granted, American must show: (a) that it has made proposals to its Unions "based on the most complete and reliable information available"; (b) that those proposals are "necessary to permit the reorganization"; and (c) that the proposals treat all affected parties fairly. American must then show that it met with each Union and bargained in good faith on those proposals and shared with them the information necessary to evaluate the Company's proposals. 11 U.S.C. § 1113(b)(1) (2006). Section 1113(c) provides that the Court must then approve rejection if it determines that: (a) the Unions have rejected American's proposals without good cause; and (b) "the balance of the equities clearly favors rejection." 11 U.S.C. § 1113(c); *see also Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82, 92 (2d Cir. 1987). Here, rejection of American's CBAs is clearly warranted.

A. <u>American's Proposed Terms Are Necessary For Successful Reorganization</u>

Section 1113(b)(1) requires that the debtor propose modifications to the CBA that are "necessary to permit the reorganization of the debtor." 11 U.S.C. § 1113(b)(1)(A) (1993); *see In re Royal Composing Room, Inc.*, 848 F.2d 345, 349 (2d Cir. 1988) (the section 1113(c) motion "must stand or fall on the overall necessity of [debtor's] proposal"); *In re Kentucky Truck Sales, Inc*., 52 B.R. 797, 806 (Bankr. W.D. Ky. 1985) ("the primary question in a balancing test is the effect the rejection of the agreement will have on the debtor's prospects for reorganization"). The "necessary modification" standard, and indeed, the entire §1113 analysis, "quickly melts down to the one, single question which is almost always controlling: what effect will rejection of the agreement have on the firm's prospects for reorganization?" Gibson, R.H., *The New Law of Rejection of Collective Bargaining Agreements in Chapter 11*: *An Analysis of 11 U.S.C. 1113*, 58 Am. Bankr. L.J. 325, 345 (1984). Three key principles are embedded in the "necessary modification" standard:

<u>Necessary, but not absolutely minimal, changes</u>. First, the debtor must prove "that its proposal . . . contains ***necessary, but not absolutely minimal***, changes that will enable the debtor to complete the reorganization process successfully." *Carey Transp.,* 816 F.2d at 89-90 (emphasis added); *In re Mile Hi Metal Sys., Inc.,* 899 F.2d 887, 892-93 (10th Cir. 1990) (adopting *Carey* standard of necessity). The leading treatise on bankruptcy endorses the Second Circuit's construction of "necessity" in *Carey*: "Congress did not codify a standard that modifications should be authorized only where it clearly appears that unless the agreement is rejected, the debtor will collapse[.] [T]he debtor should not have to show that absent modification, liquidation would occur." 7 Collier on Bankruptcy ¶ 1113.06[2][b] (15th ed. 2001); *In re Valley Steel Prods. Co.,* 142 B.R. 337, 341 (Bankr. E.D. Mo. 1992); *In re AppleTree*

Mkts., Inc., 155 B.R. 431, 441-42 (S.D. Tex 1993) (although debtor did not quantify necessity of each of its proposed changes, changes were "necessary" to be competitive).

A change is "necessary" if it will aid reorganization. Second, modifications are considered "necessary" if they increase the likelihood of a successful reorganization. *Teamsters Nat'l Freight Indus. Negotiating Comm. v. Howard's Express, Inc.,* 151 F. App'x 46 (2d Cir. 2005) (debtor not required to prove that it will ultimately achieve rehabilitation, but only that rejection will ***increase the likelihood*** of successful reorganization). The focus is on the success of the debtor and its ability to compete post-bankruptcy. As the Second Circuit has explained, "in virtually every case, it becomes impossible to weigh necessity as to reorganization without looking into the debtor's ultimate future and estimating what the debtor needs to attain financial health." *Carey,* 816 F 2d at 89.

Thus, this Court must "look[] into the debtor's ultimate future and estimate what the debtor needs to attain financial health." *Carey*, 816 F.2d at 89 (emphasis added); *Howard's Express*, 151 F. App'x at 49. Whatever the reasons for American's current distress, the Court's focus must remain on the changes American needs to attain economic health. *See In re Northwest Airlines Corp.*, 346 B.R. 333 (Bankr. S.D.N.Y. 2006) (granting motion to reject "CBA, based on enormous losses and uncompetitive labor costs"; discounting relevance of "[f]inancially dubious transactions, such as a leveraged buyout" even though those transaction "also doubtless played a role (as [union] emphasizes)"; "Chapter 11 provides a debtor with the tools to avoid some of the results of the past").

"Necessity" is judged as a whole, not proposal by proposal. Third, the Second Circuit has expressly rejected the suggestion that every element of the employer's proposals must independently meet the "necessary" test. If that were required:

> [N]o proposal could ever truly be 'necessary,' since any single vital element of a proposal can hardly be 'necessary' if it can be replaced by some alternative not included in the package which would achieve the same dollar savings for the debtor. [T]he union . . . could argue that a specific element could substantially be modified, rather than eliminated, to achieve virtually the same savings and the same likelihood of a successful reorganization. In other words, the union's construction of the statute would enable it to play 'hit-and-run': refusing to negotiate toward a compromise, safe in the knowledge that it will almost certainly be able to defeat a rejection application by attacking some vital modification by saying that it cannot be 'necessary' if reasonable substitutes could have been offered."

In re Royal Composing Room, Inc., 848 F.2d 345, 348 (2d Cir.1988).

American's proposals clearly meet this standard. As this Court previously explained in the *Delta Air Lines* case, uncompetitive labor costs are a basis to reject:

> It is self-evident that a debtor's long-term ability to compete in the marketplace for its product is essential for the viability of any reorganization. Thus, where the debtor's costs are directly passed on to its customer those ***costs must be competitive with the costs of the debtor's competitors.*** The Second Circuit has recognized the necessity of rejection when a debtor's labor costs are higher than those of its competitors and where the debtor faces "enormous competitive pressure." *In re Royal Composing Room, Inc*., 848 F.2d at 350. The Court of Appeals in *Royal Composing Room* said: "Royal was faced with a unionized work force in an industry wherein its new competitors were not unionized, resulting in Royal being unable effectively to meet the market price for its product." *Id*. at 346. The Court went on to find the Section 1113 proposal necessary because "[t]he Debtor will in the future be faced with enormous competitive pressure which will require it to have maximum flexibility, including with respect to utilization of its unionized labor, in order to mold and adapt in a changing business environment." *Id*. at 350. To the same effect, in *In re Carey Transp.*, 816 F.2d at 90, the Court of Appeals found that "[e]ach of the findings pertinent to this inquiry [*i.e.*, the "necessary" requirement] is supported by substantial evidence in the record. For instance, record evidence indicates that . . . Local 807 labor costs (in contrast to other employees' salaries and benefits) were well above industry averages. . . . "

In re Delta Airlines, Inc., 359 B.R. 468, 490 (Bankr. S.D.N.Y. 2007) (emphasis added) (rejection of Comair pilots' CBA).[65] Courts have found that a reduction in labor costs is "necessary to reorganization" in numerous cases where labor costs are a central part of a debtor's obligations, and cutting costs in areas besides labor would be insufficient to permit the reorganization. *See, e.g.*, *Royal Composing Room*, 848 F.2d at 349 ("Union labor cost, Royal's single largest expense, is the only expense that has not been cut in the last four years").[66]

The scope of "necessary" modifications often extends beyond wages to include changes in work rules, benefits, scope clauses, and job protection clauses because Section 1113 refers to modifications of "employees' benefits and protections." *See In re Northwest*, 346 B.R. 307, 322 (Bankr. S.D. N.Y. 2006) ("A proposal may be deemed necessary for purposes of § 1113(b) even if it includes non-economic modifications"). For example, in *Carey Transp. Inc.*, 816 F.2d 86, the court approved rejection in favor of the debtor's wide-ranging proposals not only to change

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[65] *Accord In re Delta Air Lines*, 351 B.R. 67, 74 (Bankr. S.D.N.Y. 2006) ("it is incumbent on a debtor in bankruptcy to examine every line item in its budget and seek all economies permissible under the Bankruptcy Code. That is particularly true respecting cost elements which are clearly above market, such as the flight attendant compensation.").

[66] *See also In re Garofalo's Finer Foods, Inc.*, 117 B.R. 363, 366 (Bankr. N.D. Ill. 1990) (1113(c) motion would be granted at expiration of 30 days of interim relief, if the parties failed to reach agreement, based on record that "[t]here are no other areas for expense reductions except for employee compensation. . . . [A]bsent relief under Section 1113, the Debtor is not likely to receive further extensions of credit. . . ."); *In re Blue Diamond Coal Co.,* 131 B.R. 633, 644-45 (Bankr. E.D. Tenn. 1991); *Valley Steel Prods. Co.,* 142 B.R. at 341 (debtor acted in good faith, restructured the business by liquidating 75-80% of operations, reduced the number of employees in half, and reduced management ranks); *In re Indiana Grocery Co*., 138 B.R. 40, 47 (Bankr. S.D. Ind. 1990) ("Reducing costs, including labor costs, is an essential element of this chance for success."); *Ky. Truck Sales, Inc.*, 52 B.R. at 802 (proposals "represented the minimum cost savings necessary to allow the debtor to successfully reorganize" and "were critical if the company wished to survive as a viable business entity"); *In re Tex. Sheet Metals, Inc.*, 90 B.R. 260, 266 (Bankr. S.D. Tex. 1988) (reduction in the company labor cost was "the most important factor in its ability to reorganize," and "any other changes which the debtor might make in management, in its approach to sales, or any other area, would not be enough to allow the company to reorganize if its labor cost is not also cut"; "labor is the company's biggest cost" and

the wage scale, but also to reduce health and pension benefits; reduce holidays and eliminate sick days, supplemental workers' compensation, and disability; eliminate premium payments and reduce commissions; and change numerous scheduling and assignment rules.

Similarly, in *In re Royal Composing Room, Inc.*, 848 F.2d 345 (2d Cir. 1988), *cert. denied,* 489 U.S. 1078 (1989), the court approved rejection where the debtor had proposed to eliminate seniority rules to give it more flexibility in laying off and assigning workers: "One of the major difficulties facing Royal was the relative inflexibility it had in utilizing its work force."[67]

In this case, the changes described in the Union-specific materials filed with this brief are necessary from an operational perspective because they are essential to achieving a new and competitive cost structure and the ability to seek and win revenues in an intensely competitive market. As described in detail in the Declaration of David Resnick, American can only attract the capital it will need to exit bankruptcy and to thereafter sustain profitable operations if it can achieve the full amount of cost savings it projects from labor and non-labor sources. Upon emerging from Chapter 11, American will require an equity investment to support its restructuring strategy and business plan. American's recent accommodation to its Unions to

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that "the company cannot compete in the marketplace without the proposed reduced labor cost").

[67] *In re Maxwell Newspapers, Inc*., 981 F.2d 85 (2d Cir. 1992), entailed rejection of a guarantee of lifetime employment for typesetters, similar to the APA and TWU no-furlough clauses here. The Second Circuit approved rejection, in part because the number of full-time-equivalent typesetters had been reduced by only 13 percent, and all other work groups had endured a greater percentage reduction. *See also In re Century Brass Prods., Inc.,* 795 F.2d 265, 274 (2d Cir. 1986) (modification of retiree welfare benefits); *In re Hoffman Bros. Packing Co.,* 173 B.R. 177, 187 (B.A.P. 9th Cir. 1994) (elimination of dues checkoff and seniority); *AppleTree Mkts*., *Inc.,* 155 B.R. at 439-40 (approving rejection of requirement for 50% of work hours to be worked by full-time employees in 5-day, 40-hour weeks); *Blue Diamond Coal Co.*, 131 B.R. at 644 (subcontracting); *In re Salt Creek Freightways*, 47 B.R. at 835, 838 (Bankr. D. Wyo. 1985) (grievance procedure).

freeze rather than terminate all but one of its defined benefit plans (and to work towards that goal with the remaining one) necessitates substantial ongoing cash contributions and further increases American's long-term obligations post-Chapter 11. The requisite level of equity investment to address these and other obligations cannot be obtained absent the cost reductions requested by this motion. *See generally* Declaration of David L. Resnick.

The requested labor savings, in particular, are necessary to enable AMR to establish the financial profile needed to convince potential investors of its long-term viability. Without the requested labor savings, American's post-Chapter 11 financial performance, as measured by any number of key financial metrics, will be insufficient to attract new capital investment. Failure to reduce its labor cost as requested will leave American with insufficient liquidity and inadequate financial flexibility to withstand the varied exogenous shocks which inevitably confront the US airline industry, including economic downturns, spikes in fuel prices and the like. And failure to achieve relief from the contractual restrictions on American's ability to commission regional flying and enter into code-sharing agreements will significantly compromise the improvement in revenue performance that are essential to the Business Plan. As detailed in the Resnick Declaration, the requested reductions in labor costs and other contractual changes are essential to align American with the other major US airlines in the several financial metrics most germane to capital investors, including EBITDAR margins, credit ratings and debt leverage ratios. Absent the requested relief, American would not have the financial profile or the revenue-generating capabilities of its competitors, thereby effectively denying its access to the necessary capital and preventing a successful reorganization. Resnick Decl. ¶¶ 24-33.

Further, Resnick's Declaration places the essential metrics of American's business plan in context by comparing American's financial targets against those sought by the several other

U.S. airlines as they emerged from bankruptcy. The key metrics of American's Business Plan are comparable to those sought by the other carriers as they exited Chapter 11 and, additionally, are reasonable when compared to the currently available financial forecasts for the other large U.S. airlines. Resnick Decl. ¶¶ 34-43.

B. American's Proposals Provide Fair And Equitable Treatment For All Stakeholders.

Section 1113 requires that union-represented employees bear only a fair share of the burden of reorganization. However, "[f]airness and equity do not require that the proposed treatment of employees belonging to the bargaining unit be identical to the anticipated treatment of other affected parties." *In re Bowen Enters, Inc.*, 196 B.R. 734, 743-44 (Bankr. W.D. Pa. 1996). *Accord In re Century Brass Prods, Inc*. 795 F.2d 265, 273 (2d Cir. 1986) (purpose of section 1113(b)(1) is to "spread the burdens of saving the company to every constituency while ensuring that all sacrifice to a similar degree").[68]

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[68] *See also In re Allied Delivery Sys. Co.*, 49 B.R. 700, 703 (Bankr. N.D. Ohio 1985); *Carey Transp. Inc.*, 816 F.2d at 90 ("The debtor is not required to prove, in all instances, that managers and non-union employees will have their salaries and benefits cut to the same degree that union workers' benefits are to be reduced."). All parties must make only their fair share of concessions. *See Tex. Sheet Metals, Inc.*, 90 B.R. at 268 ("The purpose of this requirement is to spread the burden of saving the company to every constituency, while ensuring that all sacrifice to a similar degree."); *Garofalo's Finer Foods, Inc.*, 117 B.R. at 370 ("[t]he requirement of fair and equitable treatment . . . does not equate with identical . . . treatment."); *Bowen Enters., Inc.*, 196 B.R. at 743-44 (company permitted to raise wages of non-union managerial employees whose wages were lower than the wages some non-managerial union employees; nothing unfair in debtor's principals receiving eighty percent of their salaries for now rather than receiving no salary at all); *Ind. Grocery Co.*, 138 B.R. at 48-49 (proposed wage cut of 20% commensurate with implemented wage cut for another union of 16.5%; reductions made in management salaries; no bonuses paid for top management; sacrifices made by debtor's creditors; "Equity under section 1113 means fairness under the circumstances, not a dollar for dollar comparison."); *Ky. Truck Sales, Inc.*, 52 B.R. at 803 (concessions similar to those made by non-union employees—*e.g.*, non-union employees received no salary increases, limited number of vacation days, and less expensive health care insurance); *Tex. Sheet Metals, Inc.*, 90 B.R. at 269 (all office staff and supervisors took a five percent pay cut; overtime payments for supervisors were eliminated; cost cutting measures were taken in all areas of the debtor's business); *In re Sol-Sieff*

> [T]he debtor's proposal must "spread the burden of saving the company to every constituency while ensuring that all sacrifice to a similar degree." The key phrase here is "to a similar degree." "Similar" cannot mean identical—indeed, there are too many subjective variables at play to determine what an identical sacrifice would be for flight attendants as compared, say, with pilots, or mechanics, or executives. In the end, the Court must fall back on the subjective statutory standard of fair and equitable.

In re Delta [*Air Lines*], 342 B.R. 689, 698 (Bankr. S.D.N.Y. 2006).

American's allocation methodology is self-evidently fair and equitable. Although the ***manner*** in which American proposes to reduce its costs in each group differs (and has been tailored at the table to account for feedback from each employee group), each employee group—union and non-union alike—is being asked to take reductions in proportion to its contribution to American's labor costs. Each group—unionized and non-union—is being asked to reduce its existing contribution to American's overall labor costs by approximately 20%. American has done all it could to ensure equitable treatment across its employee groups.[69] Where other parties

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Produce Co., 82 B.R. 787, 794 (Bankr. W.D. Pa. 1988) (non-union workers received less than union employees; owner took no salary for several months; owner injected over $220,000 with no return on investment; prior owners agreed to 50% reduction in amount owed).

[69] TWU claims that American's proposals are inequitable because they contemplate subcontracting heavy maintenance operations and, as a consequence, many mechanics will lose their jobs. American would prefer to avoid ***any*** job loss (including the 1,400 management and support staff employees who will be laid off), but subcontracting of heavy maintenance is an economic imperative that has become standard in the airline industry. *See* Glass Decl. ¶¶ 26, 31; Burdette Decl. ¶¶ 20-32; Weel Decl ¶ 10. No alternative wage or benefit costs could achieve what American needs to achieve in this aspect of its business. Employers in bankruptcy must make hard decisions about the deployment of capital and the basic scope of the enterprise—even where these structural changes mean the elimination of jobs, that does not make the Section 1113 proposal unfair or inequitable. *See In re Karykeion, Inc*. 435 B.R. 663, 679-80 (Bankr. C.D. Cal. 2010) (hospital's 1113 proposal to eliminate successorship clause so that purchaser would not be required to hire existing employees did not fail fair and equitable prong of 1113 test: "The fact that the workers who have put their heart and soul into saving this hospital for the past 18 months are not guaranteed jobs in a sale is undoubtedly an unfair result. That reality must, however, be tempered by an understanding of all the parties and interests in evaluating this prong of the analysis as well as the realities of this case. . . [If the debtor had not delayed negotiations with the

in interest are "shoulder[ing] a proportional" share of the cost-cutting burden, rejection should be approved. *Carey Transp.,* 816 F.2d at 90; *Accord Blue Diamond Coal Co*., 131 B.R. at 645; *In re Indiana Grocery Co.*, 138 B.R. at 49 ("Comparing the specific burdens assumed by these differing parties is like comparing apples to oranges. The court is left with only the general guidance that equity means fairness under the circumstances.").

C. American Shared The Information On Which Its Proposals Were Based With The Unions, And Conferred With Them In Good Faith

As set out in detail in the Brundage and Lynn Declarations as well as the Declarations and exhibits related to the specific Union proposals, American has dealt in good faith with the unions both before and after making its Section 1113 proposals to them. Sharing the Company's financial information is and has been at the core of the relationship between American and its Unions. The proposals American has made were based on the best information available—the same kinds of information and financial models on which American has based its most important business plans and operational decisions, and the same kinds of information—and in many instances the very same data—on which American and the Unions based their bargaining proposals in pre-petition negotiations. As explained in the Lynn Declaration, American has shared some of its most sensitive financial information with the Unions, including the data on which it relied, the models it used in performing its own analyses, and the assumptions that underlie its projections into the future. It made its experts available to meet with each Union, immediately and as regularly as needed to explain what it was proposing and why.

The Unions also have experienced, sophisticated legal and financial advisors to assist them in evaluating American's proposals and financial situation in light of the extensive

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buyer contingent on rejection], the hospital would have closed in early 2009.)

financial data that American provided, and when those professional advisors have had questions or sought clarifications, American responded fully, promptly, and without hesitation. American well understands that its future could depend on its willingness to open its books to the Unions, and that is precisely what it has done.[70] Declaration of Denise Lynn ("Lynn Decl.") ¶ 6.

1. American Answered All Relevant Union Questions, Fulfilled All Data Requests, And Shared Even Its Most Sensitive Information On Request From Each Union

Pre-Chapter 11: Since 2002—since before the last agreements were reached with its Unions—American has provided to each of its Unions the same monthly financial information that American's management gives to the Company's Board of Directors. In addition, also since 2003, American has hosted a monthly meeting of Union advisors and leaders called the Joint Union Financial Committee. At these meetings, American management has made financial presentations and American's senior financial officers have made themselves available to answer questions about the Company's condition and its plans.[71] In addition, in 2003, the Company established the National Joint Leadership Team ("**NLJT**"), a group that meets each month with American's CEO and other executives to keep leaders of all of its Unions apprised as to American's strategic challenges and initiatives.[72] Lynn Decl. ¶ 7.

Post-Chapter 11: Since filing for Chapter 11 protection last November, American has responded promptly to every request for information it has received from each of the Unions.

[70] As explained above and in greater detail in the Lynn Declaration, the data reflecting American's needs and its financial and competitive positions was not new to the Unions, as American has been sharing that information routinely with the Unions for years at the bargaining table.

[71] A chronology of these meetings and a list of attendees at each is provided as AA Ex. 909.

[72] American has repeatedly urged APA to attend NLJT meetings, but in 2007, APA's leadership announced to its membership that it has not elected to speak with American's management. Newgren Decl. ¶ 28.

Attached as AA Exhibits 1502-1504 is a chart reflecting the information each Union has requested and the date on which it was provided. ***No reasonable Union request was refused***.

This data exchange involved American's most senior executives. For example, on November 29—the very morning these Chapter 11 cases were commenced—the Company's new CEO, Thomas Horton, personally contacted the leadership of each of the Unions to discuss the Company's plans and to solicit their help in achieving ***consensual*** agreements in order to avoid the prospect of contract rejection.

On February 1, 2012, American met with its Unions to share its new restructuring business plan and the efforts made throughout the Company to find the cost reductions needed for a successful organization, and to explain the role the Unions and their members would have to play. More than 170 Union leaders, attorneys, and professional advisors were invited to attend. Lynn Decl. ¶ 12. After presentations by Tom Horton and other American executives, the leaders and advisors for each of the Unions met separately with American's negotiating teams to receive the Company's Union-specific Section 1113 proposals and to discuss the particular changes American proposed for each of the groups. Each Union received a breakdown of the cost reductions required and a Section 1113 proposal explaining how American intended to achieve its goal. Lynn Decl. ¶ 15.

That day, American also gave each Union access to an encrypted, password-protected website to which American posted the detailed information on which American's proposals were made—the financial and statistical models, the costing formulae and protocols, and the assumptions American made in constructing the proposals—so that each union immediately had the information on hand to begin examining the proposals and the way in which they were valued. Lynn Decl. ¶¶ 15-19.

As detailed in the Lynn Declaration, each Union asked for additional clarification of American's proposals, the financial and other information and projections underlying the Business Plan, the costing methodologies used to formulate the proposals, and the efforts American is making to reduce costs in other areas. In each instance, the Company has promptly produced enormous amounts of operating and financial data and has offered its subject matter experts to answer the Unions' questions.[73] AA Exhibits 1502-1504 list the information requests American has received and the date on which they were answered. Specifically, APA has sent American more than 100 written requests for documents and information (Lynn Decl. ¶ 41), TWU has sent more than 280 written requests and numerous other informal requests (Lynn Decl. ¶¶ 75-117), and APFA has sent more than 150 written requests (Lynn Decl. ¶¶ 118-79). As discussed above, American responded thoroughly and promptly to each and every reasonable request. Thus, since 2003, American has given the Unions all of its most sensitive financial data and its most closely-held business planning documents, and since filing for Chapter 11 has shared with the Unions the information and projections underlying its Business Plan and its proposals.[74]

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[73] Pre-petition sharing of information can be sufficient in itself to satisfy the section 1113 standard. *See*, *e.g.*, *In re AppleTree Mkts., Inc.,* 155 B.R. 431, 438 (Bankr. S.D. Tex. 1993) (debtor satisfied requirement to give information; debtor had opened its books and made information available during pre-section 1113 bargaining). The information provided to the Unions is the most complete and reliable data available to American, and the Company freely shared it with the Unions so that they might evaluate its proposals. Brundage Decl. ¶ 37.

[74] American's information-sharing compares favorably with that of other debtors who have satisfied the section 1113 requirements. *E.g., Bowen Enters., Inc.,* 196 B.R. at 741; *In re Sol-Sieff Produce Co.,* 82 B.R. 787, 794 (Bankr. W.D. Pa. 1988) ("The Debtor's accountant was instructed to make all financial data available to the Union; [and] to 'hold nothing back'"). Therefore, the information-sharing prong of the test has been satisfied; *compare Mesaba Aviation, Inc.*, 341 B.R. 693, 715-16 (Bankr. D. Minn. 2006) (airline debtor failed "information-sharing" test by failing timely to furnish unions with a working computer program; noting widespread practice in airline bankruptcies to share computer modeling because of "utility to the

2. American Has Conferred In Good Faith

As noted above, the debtor must also confer in good faith in an attempt to reach mutually satisfactory modifications of the agreement. 11 U.S.C. § 1113(b)(2). As one court noted in granting a debtor's request to reject a CBA:

> 'Good faith' is defined as 'conduct indicating an honest purpose to arrive at an agreement as the result of the bargaining process.' The requirement is satisfied if debtor seriously attempts to negotiate . . . reasonable modifications of an existing CBA prior to its motion to reject it.

In re Bowen Enters., 196 B.R. 734, 744 (Bankr. W.D. Pa. 1996) (citation omitted).[75]

There can be no question that American has satisfied this requirement. The Company, of course, bargained with each of the Unions for years even before filing these cases. After filing for Chapter 11 protection, American gave APA, APFA, and TWU written proposals for modification to each union's CBAs, explained those proposals, and indicated that American's negotiators would be available to commence around-the-clock negotiations. Brundage Decl. ¶¶ 12, 40-48; Newgren Decl. ¶ 37; Vaughn Decl. ¶ 57; Weel Decl. ¶¶ 34-36; Burdette Decl. ¶¶ 11-15. In the nearly two months since then (and as explained in the Union-specific

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negotiation of these complex disputes." "The provision of an airline's dynamic model might be considered as part of a custom and usage .... [I]ndustry-wide experience establishes such a model as 'relevant information as is necessary to evaluate an employer's proposal for concessions from a union.").

[75] *See also, e.g., In re Kentucky Truck Sales, Inc.,* 52 B.R. 797, 801 (Bankr. W.D. Ky. 1985) ("Congress intended section 1113's 'good faith' provision to be interpreted by bankruptcy courts in a nontechnical fashion. Therefore, in our opinion, the 'good faith' requirements of section 1113 can be satisfied by the debtor showing that it has seriously attempted to negotiate reasonable modifications in the existing CBA with the union prior to the rejection hearing."); *In re Texas Sheet Metals, Inc.*, 90 B.R. 260, 270 (Bankr. S.D. Tex. 1988) (finding that employer satisfied good faith requirement where "the debtor made every attempt to meet with both unions, and any reluctance to meet was on their part, not on the part of the debtor").

Declarations), American has met 65 times with APA, on 21 days with APFA, and 100 times with TWU. Newgren Decl. ¶37; Vaughn Decl. ¶ 57; Weel Decl. ¶ 38; Burdette Decl. ¶ 16.

Nor is this a case in which an employer has "gone through the motions" of collective bargaining. In public statements, American's Unions have complained that the Company has presented only a set of "take-it-or-leave-it" propositions and thus has failed to bargain in good faith.[76] This accusation is unfounded, legally and factually.

American has made concessions. American presented its Section 1113 proposals on February 1, and thereafter it has listened. American's initial Section 1113 proposals were premised on termination of all three relevant defined benefit plans. The proposal was profoundly unpopular with each Union, and so as explained above, the Company has worked on the issue with the PBGC, the Unsecured Creditors' Committee, and each Union to find a way to change its proposals to meet employee objections. Brundage Decl ¶ 43. Now, American has proposed to ***freeze*** rather than terminate the TWU and APFA plans, and is still working with APA to overcome unique obstacles to accomplishing the same result for the Company's pilots, all without otherwise increasing the cost savings American is seeking from the Unions in other areas. *Id.* Given that termination was a cornerstone of American's opening set of proposals, it is simply false for the Unions to contend that the initial proposals were given on a take-it-or-leave it basis.

Similarly, the Company initially proposed an active employee medical plan solution with three different plan design options: The Value Plan, the Core Plan, and the Standard Plan. Brundage Decl. ¶ 44. The Company proposed to set aggregate employee monthly contributions

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[76] *See*, *e.g.*, APFA: http://aviationblog.dallasnews.com/archives/2012/03/apfa-explains-to-flight-attend.html; APA: http://aviationblog.dallasnews.com/archives/2012/02/apa-to-american-airlines-you-c.html

at 23% of the total premium equivalent for all three plans, determined on an actuarial basis. In response to Union concerns with the initial proposal, American redesigned its medical plan proposal to bifurcate the determination of employee monthly contributions by considering the Core Option and the Standard Option separately from the Value Option. Doing so allowed the Company's revised proposal to offer a Core Option and a Standard Option that will lower the aggregate employee monthly premium equivalent to 21%, with a 17% employee only cost share and a 22% employee plus family cost share. At the same time, it adjusted the design features of the Value and Standard Options in response to the concerns expressed by the Unions, again without increasing the Unions' cost reduction targets. Wright Decl. ¶ 27.

There have been a great many other, smaller, concessions made by American throughout bargaining. For example, at the pilot bargaining table, the Company has withdrawn or modified a variety of other proposals to account for APA comments or criticisms (discussed in further detail in the Newgren Dec. ¶¶ 38-41):

- modified proposal on the elimination of international rates of pay;
- withdrew proposal to change the way Check Airmen are paid;
- withdrew proposal that would have prohibited pilots from accruing additional vacation with on long-term sick leave;
- withdrew proposal regarding job protections for St. Louis-based pilots to reflect tentative agreement on dispute resolution;
- withdrew from proposal to that would have resulted in termination of pilots who fail to complete training successfully in certain circumstances; and
- increased first year pay to $40.00 (currently $35.37).

As part of its original Section 1113 Proposals to APFA, the Company proposed to eliminate or modify provisions of the APFA Agreement that guaranteed that flight attendants would receive the greater of (1) at least one minute of flight time pay and credit for each two

minutes they spent on-duty; (2) at least three hours' pay and flight time credit for every duty period worked; (3) at least five hours' pay and flight time credit on average for every duty period worked in a given trip; or (4) at least one minute of flight time pay and credit for each three and one-half minutes of time away from the flight attendant's home base station. APFA voiced its concerns over the Company's proposal across the table during early bargaining. As part of the dialogue between APFA's financial consultant and the Company's financial team, a question arose regarding assumptions unrelated to these duty rigs. The Company reevaluated its position, considered the Union's alternative methodology, and ultimately agreed to change its assumptions. The change in assumptions produced enough savings to allow the Company to modify its term sheet to address most of APFA's concerns regarding the previous duty rig proposal. Vaughn Decl. ¶ 50.

The same give-and-take has been evident at the TWU bargaining tables. American initially proposed a contractual change with regard to the Instructors group that would have given the Company the ability to change any Instructor's monthly schedule from 20 work days (as provided in the current contract) to 21 days, as needed. *See* Weel Decl. ¶ 84. TWU asked the Company to modify its proposal in two ways, both of which were accepted by the Company. *Id.* First, TWU proposed that the Company would be limited to requiring a twenty-first day of work from no more than 55% of Instructors in any given bid cycle. *Id.* Second, TWU proposed that the twenty-first day of work be built into the schedules in advance, rather than the Company having discretion to request the twenty-first work day from any Instructor at any time. *Id.*

Good faith bargaining does not require surrender. Even if American had remained firm as to each of its Section 1113 Proposals, the Unions' accusations of "take-it-or-leave-it" bargaining would be misplaced. Under §1113(b)(1)(A), American was required to formulate

proposals of a sort that, when taken collectively, are "necessary to permit the reorganization of the debtor." If American had made a "wish list" from which it could then collapse towards some smaller package of concessions, it would almost by definition have failed in its statutory obligation. "If the union[s] believe[d] that a vital part of [American's] proposal [was] unacceptable, it should [have] enter[ed] into good faith negotiations aimed at moderating that element, or at substituting a measure less offensive to [labor] ***but achieving comparable savings for the debtor***." *In re Royal Composing Room, Inc.*, 848 F.2d 345, 349 (2d Cir. 1988) (emphasis added).

Even in traditional, non-§1113 bargaining, where it is common to begin with a more aggressive set of proposals than one could expect ultimately to result in an agreement with the expectation of moving towards some compromise, "[c]ourts . . . resist finding violations of the [duty to bargain] based solely on evidence of hard bargaining, inability to reach agreement, or intransigent positions." *AFA v. Horizon Air Indus.*, 976 F.2d 541, 545 (9th Cir. 1992); *REA Express, Inc. v. Brotherhood of Ry., Airline & Steamship Clerks*, 358 F. Supp. 760, 772 n.43 (S.D.N.Y. 1973) ("a party does not violate its duty [to bargain] under the Act if it chooses to be adamant in its position"); *accord IFFA v. TWA*, 682 F. Supp. 1003, 1026 (W.D. Mo. 1988) ("[m]ere insistence on demands that seem extremely harsh to the other side and that a neutral party may consider 'hard' is not a violation of bargaining duties" . . . "[a]n employer may insist on positions ... even if the union may consider the proposals greedy."). As the Second Circuit has held under the National Labor Relations Act, "the obligation to bargain [in good faith] does not compel either party to agree to a proposal or require the making of a concession. A party thus is entitled to stand firm on a position if he reasonably believes that it is fair and proper or that he has sufficient bargaining strength to force agreement by the other party." *NLRB v.*

Advanced Bus. Forms Corp., 474 F.2d 457, 467 (2d Cir. 1973) (internal citation and quotation marks omitted).

In this case, American has demonstrated by its "conduct . . . an honest purpose to arrive at an agreement as the result of the bargaining process." *In re Blue Diamond Coal Co.*, 131 B.R. 633, 646 (Bankr. E.D. Tenn 1991) (§1113 case). Few employers have studied its competitive situation as completely as has American, few employers have shared more information with their Unions in an effort to reach agreement as has American, and few employers have demonstrated a more genuine desire to find common solutions than has American. *See Sol-Sieff Produce Co.*, 82 B.R. at 795; *Bowen Enters., Inc.,* 196 B.R. at 745 ("debtor genuinely sought to reach agreement at the bargaining sessions and seriously attempted to negotiate reasonable modifications to the existing [CBA]"). American has satisfied its good faith obligation because it "has seriously attempted to negotiate reasonable modifications in the existing [CBA] with the union prior to the rejection hearing."[77]

American recognizes that it cannot achieve long term success without the enthusiastic support of and commitment from its employees. Thus, even if rejection is granted, American intends to continue to negotiate with each union to reach new ***consensual agreements***. On the day American advised its Unions that it intended to file this Motion, it reiterated unambiguously

[77] *In re Ky. Truck Sales, Inc.,* 52 B.R. 797, 802 (Bankr. W.D. Ky. 1985) ("it is clear that the parties were unable to reach a compromise on these issues due to their differing interests and the 'distance' between their offers, rather than to any lack of good faith on the part of either party"); *In re Ind. Grocery Co.*, 138 B.R. 40, 49 (Bankr. S.D. Ind. 1990) (debtor's "take it or leave it" position on one issue did not mean it failed to negotiate in good faith where the union declined to negotiate any alternative and agreed that the parties were deadlocked); *In re Salt Creek Freightways*, 47 B.R. 835, 839 (Bankr. D. Wyo. 1985) (debtor acted in good faith by meeting four times with the union, considering each of the union's counter-proposals, conveying why those proposals were inadequate, providing alternative proposals to the union, participating in mediation, and giving the union a "last best offer").

its desire to negotiate while the §1113 process continued. All of the proposals American has made were intended to act as the springboard for ***agreements***, and, as noted above, it is American's fervent hope that the Court will never have to decide this Motion. Even if it does, American hopes that the implemented terms of its proposals can quickly be replaced by negotiated arrangements that benefit the airline and the long-term interests of its employees.

D. The Failure Of Each Union To Agree To American's Proposals Is Without Good Cause

In assessing whether the Unions had good cause to reject American's offers, the focus is not on the Unions' obvious and understandable reluctance to make concessions of the scale requested—no union could embrace such change eagerly. The focus, however, is and must be on what is necessary to permit reorganization. Indeed, a union will ***never*** "have good cause to reject an employer's proposal [if it] contains only those modifications essential for the debtor's reorganization, that is, the union's refusal to accept it will be held to be without good cause." *In re Maxwell Newspapers, Inc.*, 981 F.2d 85, 90 (2d Cir. 1992). A "good reason" to refuse is not enough:

> [T]he Union may often have a principled reason for deciding to reject the debtor's proposal and which may, when viewed subjectively and from the standpoint of its self-interest, be a perfectly good reason. However, the court must review the Union's rejection utilizing an objective standard which narrowly construes the phrase "without good cause" ***in light of the main purpose of Chapter 11, namely reorganization of financially distressed businesses.***[78]

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[78] *In re Salt Creek Freightways*, 47 B.R. 835, 840, 841 (Bankr. D. Wy. 1985) (emphasis added) (union rejected the employer's entire proposed modification based on its policy decision that it could not negotiate away pension benefits or deviate from the Master Freight Agreement; court held that although "this is certainly not an unreasoned basis for rejection of the debtor's proposal, it does not constitute 'good cause' within the meaning of § 1113(c)(2)."). *See also In re Indiana Grocery Co., Inc.*, 138 B.R. 40, 50 (Bank. S.D. Ind. 1990) ("Purely selfish concern cannot be good cause for refusing to cooperate with debtor's good faith efforts to reorganize."); *In re*

To show that "good cause" exists to reject American's proposals, the Unions must articulate in detail the reasons for doing so. *See Carey Transp. Inc.*, 816 F.2d at 92; *Tex. Sheet Metals*, *Inc*., 90 B.R. at 263-64; *Garofalo's Finer Foods, Inc.*, 117 B.R. at 371. Where the Union makes demands that the employer cannot meet and offers no alternatives focusing on the needs of the employer's reorganization, it does not have "good cause" for rejecting the proposal. *In re Maxwell Newspapers, Inc.,* 981 F.2d 85, 89-91 (2d Cir. 1992).

The Unions have failed to make alternative proposals that would achieve the savings necessary for a successful reorganization, and in many cases have attempted to resurrect the Company's pre-petition proposals that they rejected. In part, it appears that APA and APFA are, indeed, trying to "reverse the trend" established by American's principal competitors, as APA's President conceded, by proposing to retain restrictions and protections that exist only at American. While the desire to hold on to those protections is understandable, the practical circumstances make it impossible for American to enter into such an agreement. Accordingly, American could not possibly agree to their demands. This continued insistence on an impossible position demonstrates that their rejection of American's proposed modifications is without good cause.

Walway Co., 69 B.R. 967, 974 (Bankr. E.D. Mich. 1987) ("The legislative history of § 1113 indicates that 'good cause' is not a barrier to rejection if the proposal contains the specified 'necessary' modifications."); *In re Allied Delivery Sys. Co.*,, 49 B.R. 700, 704 (Bankr. N.D. Ohio 1985) ("If the proposal is necessary and is fair and equitable, . . . then the union's refusal to accept it on the basis that the proposal is unjust . . . is not for good cause); *In re Amherst Sparkle Mkt., Inc.*, 75 B.R. 847, 853 (Bankr. N.D. Ohio 1987) (union lacked good cause where '[t]he Union understood that the Debtor would not survive financially unless it received a certain level of concessions," and union did not produce evidence "sufficient to controvert the financially distressed position demonstrated by the Debtor").

E. **The Balance Of The Equities Favors American**

The balance of the equities clearly favors rejection of American's CBAs because the specter of liquidation is much worse for all constituencies. *In re Sol-Sieff Produce Co.,* 82 B.R. 787, 794 (Bankr. W.D. Pa. 1988) (balance of equities favored debtor because "absent said rejection, the Debtor will fold"). *See also In re Bowen Enters. Inc.*, 196 B.R. 734, 747 (Bankr. W.D. Pa. 1996) (balance of equities favored rejection of CBA where "debtor unquestionably will have to undergo liquidation in the very near future unless" modification is made to the agreements); *In re Indiana Grocery Co., Inc.*, 138 B.R. 40, 50 (Bankr. S.D. Ind. 1990) (balance of equities favor rejection where employees will be out of work absent rejection). If American disappears, all of its employees, including all of its unionized employees, would lose their jobs, and other stakeholders also would receive less than if the airline emerges as a going concern.

When weighing the equities, courts have considered the following factors:

- The likelihood and consequence of liquidation if rejection is not permitted;
- The likely reduction in the creditors' claims if the bargaining agreement remains in force;
- The likelihood and consequences of a strike if the bargaining agreement is voided;
- The possibility and likely effect of any employee claims for breach of contract if rejection is approved;
- The cost-spreading abilities of the various parties, taking into account the number of employees covered by the bargaining agreement and how various employees' wages and benefits compare with those of others in the industry; and
- The good or bad faith of the parties in dealing with the employer's financial dilemma.

Carey Transp. Inc., 816 F.2d at 93. The Court balances these factors while mindful of the ultimate goal of Chapter 11—the success of the reorganization. *See id.* at 92-93 (quoting

NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984)). Here, each of these factors weighs in favor of rejection.

Reorganization Will Not Occur In the Absence of a Labor Cost Reductions. As explained above, and as described in detail in the Goulet, Vahidi, Dichter and Resnick Declarations, achieving the savings and entrepreneurial freedoms set out in the Company's Section 1113 Proposals is necessary to American's successful reorganization. American's Business Plan is built on non-labor cost reductions in every aspect of its business—some already accomplished, some that lie ahead in these cases—and fundamentally contemplates cost reductions from all employee groups, union and non-union alike. Without these labor cost reductions, American will be unable to exit Chapter 11 as a going concern because it will not be able to attract the capital it needs to operate. Simply stated, if the Court does not grant the relief sought here, American will have no viable business enterprise. Not only American's employees, but the flying public will be harmed if American closed its doors. American's disappearance would be an enormous loss to a national transportation system.

Without Rejection, Creditors' Claims Will Be Impaired. American's creditors are being asked to sacrifice in order to give American the chance for success embodied in the Business Plan. That Business Plan depends on achieving ***all*** of the cost reductions it outlines, the ability to operate the planes it needs in the markets where they make sense, and the ability to extend its network through regional flying and code-share arrangements. If it cannot achieve these goals, it cannot realize the growth projected by the Business Plan and the value of the Creditors' claims will be decimated if not destroyed altogether. Those creditors will be far better off if American remains a going concern.

A Strike Would Be Unlawful. Following rejection, both labor and management would still be bound by the duty to bargain in good faith by Railway Labor Act, Sections 5 and 6, 45 U.S.C. § 155 and 156. No self-help would be permitted. *Chicago & N.W. T. Co. v. UTU*, 402 U.S. 570 (1971) (strike injunction will issue to enforce duty to bargain and status quo under Railway Labor Act); *In re Northwest Airlines, Inc.*, 483 F.3d 160 (2d Cir. 2007) (after rejection of RLA collective bargaining agreement in bankruptcy, strike would be unlawful under RLA bargaining process has been exhausted, and injunction should issue to prevent strike or other self-help activity); *In re Delta Airlines Inc.*, 359 B.R. 491 (Bankr. S.D.N.Y. 2007) (neither rejection of CBA nor imposition of new terms violated the status quo under the Railway Labor Act or enabled pilots dissatisfied with new terms to strike); *Mesaba Aviation, Inc v. Aircraft Mechanics Fraternal Ass'n*, 350 B.R. 112 (Bankr. D. Minn. 2006) (post-rejection strike not allowed).

Employee Claims for Damages Would Be Better Than Liquidation. No damage claims arise from contract rejection under Section 1113,[79] but even if such a claim did arise, it is self-evident that American's employees would be better off with good, well-paying jobs than participating with the other unsecured creditors in uncertain damage claims.

American's Proposals Are Equitable. In considering the cost-spreading abilities of the parties, it is important to bear in mind that, even if American implements the Section 1113 Proposals, American's employees will still have good pay and benefits in comparison with most

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[79] The Second Circuit has observed that contract rejection "damages [would be] inconsistent with Congress's intent in passing § 1113." *In re Northwest Airlines Corp.*, 483 F.3d 160, 172 (2d Cir. 2007); *see also In re Blue Diamond Coal Co.*, 147 B.R. 720, 731 (1992), *aff'd*, 160 B.R. 574 (Bankr. E.D. Tenn. 1993) (Section 1113(c) rejection does not give rise to employee damage claims; reasoning that it was "difficult to believe that Congress provided for rejection of a CBA under § 1113, but neither defined the status of any claim which might result from that rejection nor provided a remedy for the breach cognizable under the Bankruptcy Code.").

other workers in the United States, and comparable to, or better than, those at many other U.S. airlines. Rejection of American's CBAs will allow American to compete in the current airline environment; to continue employing most of American's current active unionized employees; and will provide the best possible chance to secure a fair return for American's creditors.

VIII. CONCLUSION

For all of these reasons, and as explained in further detail in the accompanying Appendices, Declarations, and Exhibits, American respectfully requests that the Court grant its motion for an order authorizing it to reject the APA, TWU, and APFA CBAs pursuant to section 1113 of the Bankruptcy Code.

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