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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re **AMR CORPORATION,** ***et al.,*** Debtors.	Chapter 11 Case No. 11-15463 (SHL) (Joint Administration Pending)

ASSOCIATION OF PROFESSIONAL FLIGHT ATTENDANTS' OBJECTION TO DEBTORS' MOTION TO REJECT COLLECTIVE BARGAINING AGREEMENT PURSUANT TO 11 U.S.C. § 1113

Date: May 7, 2012

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The Association of Professional Flight Attendants ("APFA") submits this memorandum in opposition to the motion of American Airlines to reject its collective bargaining agreement. As set forth below, American has not met, and will not be able to meet, its burden of proof under 11 U.S.C. § 1113.

INTRODUCTION

Section 1113 governs the process a debtor must follow and the standards it must satisfy to reject a collective bargaining agreement. Unlike Section 365 of the Bankruptcy Code which affords deference to a debtor's judgment that rejection of an existing contract will benefit the estate, Section 1113 demands far more. In effect, Section 1113 puts the debtor's proposed contract modifications on trial. The burden rests with the debtor to prove that these changes are necessary to permit a successful reorganization, are fair and equitable to all stakeholders, and that the union did not have good cause to reject the proposal.

Not only is the content of the proposals at issue, but the process used to achieve a consensual agreement is also subject to the Court's scrutiny. The Court must assess whether the debtor based its proposal on the most complete and reliable information, negotiated in objective good faith, and provided the labor organization with the information needed to evaluate the proposed modifications. Finally, the statute requires the Court to take a broad overview of the evidence and balance the equities to determine if rejection of the contract or the motion is the clearly favored outcome.

While Section 1113's requirements are the same in each case, the facts material to their application are always different. The circumstances surrounding American's motion and the array of facts germane to its adjudication are unique to this bankruptcy. As set forth below and as will be presented during the APFA's case next week, the framework in which this Section

1113 motion should be resolved is comprised in large part of evidence supportive of and supplementing the following facts:

- Only American and its paid advisors support the current plan to emerge from bankruptcy as a stand-alone airline. Wall Street analysts are virtually unanimous in their criticism and neither they nor the Unsecured Creditors Committee endorse the business plan.

- The Company settled on the current stand-alone business plan without assessing the possibility of a merger or other transaction. However, two weeks ago American announced that it would consider consolidation as an alternative to the stand-alone plan in conjunction with Unsecured Creditors Committee.

- Consolidation is not a theoretical exercise as US Airways has been pursuing a merger with American and has signed agreements with American's unions which would apply in the event the two carriers merge.

- After realizing that its stand-alone business plan was $1.25 billion short of reaching an inordinately high EBITDAR target, American decided that employee concessions would fill that gap.

- American prepared its proposals to APFA and the other unions without considering whether the existing collective bargaining agreements are market competitive. The Flight Attendants' contract will reach market rates within the next year. If the Company imposes $230 million annually in changes, as it has proposed, the Flight Attendants' contract would fall 30% behind the market.

- For all other stakeholders – suppliers, vendors, aircraft lessors, and even the employees of American Eagle – the Debtors demand for concessions is based on market rates.

- The Company's Section 1113 proposal would cause the involuntary furlough of over 2000 Flight Attendants, cut Flight Attendants' take-home pay by an average of 16.9% (which is already 30% below their 2003 wages in real dollars), and make health benefits unaffordable for many Flight Attendants.

- On March 26, 2012 when the Company filed its Section 1113 application, AMR had approximately $4.8 billion in cash. The Company has not needed and is not expected to need debtor-in-possession financing during the bankruptcy. Also, the Debtors will not determine whether exit financing, if any, is required until much closer to emergence from bankruptcy.

Based on these and other related facts, American cannot satisfy the standards or requirements of Section 1113. Denial of the motion would compel the Company to replace its

current proposal with one that conforms to the dictates of the statute. Should that occur, the likelihood of a consensual agreement with APFA and, in turn, a successful reorganization would be greatly enhanced. Accordingly, APFA respectfully requests that the motion be denied.

STATEMENT OF FACTS

The APFA is the certified, exclusive representative under the Railway Labor Act, 45 U.S.C. § 151 *et seq.* ("RLA"), of the craft or class of Flight Attendants employed by American Airlines, Inc. ("American" or the "Company"). *American Airlines, Inc. / TWA Airlines, Inc.*, 29 NMB 278, 280 (2002).

Two other labor organizations represent American employees: the Allied Pilots Association ("APA") is the certified representative of the Pilots, *American Airlines, Inc. / TWA Airlines, Inc.*, 29 NMB 260, 262 (2002), and the Transport Workers Union of America, AFL-CIO ("TWU") is the certified representative of American's Mechanics and Related Ground employees, Fleet Service employees, Stock and Stores employees, Dispatchers, Ground School Instructors, Simulator Technicians, and Technical Specialists, *American Airlines, Inc. / TWA Airlines, Inc.*, 29 NMB 293, 297–98 (2002).

I. THE APFA MEMBERSHIP

There are currently approximately 16,400 American Flight Attendants: 15,500 who are active, 700 on leave, and approximately 200 on furlough status (meaning they have a contractual right to be recalled in the event of a vacancy). AA Ex. 1000 (Vaughn Decl.) ¶ 5. American Flight Attendants include both "lineholders" who are scheduled particular trips, and "reserves" who are scheduled days when they must be on call. APFA Ex. 200 (Loew Decl.) ¶ 15. The APFA membership includes international Flight Attendants and domestic Flight Attendants; a distinction that effects how they are scheduled and paid. *Id.* ¶ 3.

Because of the unusual nature of the work, the compensation methods for Flight Attendants (at every airline and whether unionized or unrepresented) are unique. Typically, block hours will determine the amount of a Flight Attendant's pay. Block hours are measured by the time between an aircraft's departure from the gate of the flight's origin to its arrival at the gate of its destination. Flight pay is determined by multiplying the Flight Attendant's applicable hourly wage by the number of block hours worked. However, block hours have very little to do with the length of a Flight Attendant's time on duty. APFA Ex. 2200 (Loew Decl). ¶ 5.

Flight Attendants are generally not paid for the work necessary to prepare the plane for departure, including, boarding passengers, stowing luggage, and attending to passengers before departure. *Id.* ¶ 11. Similarly, Flight Attendants are generally not paid for the time spent deplaning passengers following a flight's arrival. *Id.* Currently, the APFA CBA only guarantees that Flight Attendants will be paid for, at minimum, 50% of the time that they are on duty. *Id.* ¶ 17.

In addition, Flight Attendants work irregular schedules. Domestic Flight Attendants can be on duty for thirteen scheduled hours in a day, and fifteen unscheduled hours in a day. *Id.* ¶ 9. Work days are even longer for international Flight Attendants. *Id.* Duty periods can span through the night and into the following morning. Tr. 4/27/12, 55:12-20 & 56:2-4 (Vaughn). Flight Attendants are generally on duty for three consecutive days, and can be on duty for up to six consecutive days. APFA Ex. 200 (Loew Decl.) ¶ 11. The Company is required to provide only nine hours of rest between Flight Attendant duty days. *Id.* ¶ 13. As a result, Flight Attendants will often receive less than five hours of sleep. *Id.* ¶ 14.

According to the Company, "the typical flight attendant receives about $45,000 in salary[.]" AA Ex. 1000 (Vaughn Decl.) ¶ 21.

II. APFA BARGAINING HISTORY PRIOR TO BANKRUPTCY

A. The 2003 Agreement

The current collective bargaining agreement between APFA and American is the product of decades of bargaining and mutual compromise, often in the face of economic adversity. The most recent amendments to the agreement were made in 2003 in response to severe financial distress experienced across the industry in the aftermath of the 9/11 terrorist attacks. While other mainline carriers went through Chapter 11 bankruptcy, American sought an out-of-court restructuring, including $1.8 billion in annual cost reductions from its employees. APFA Ex. 801 at 10.

American calculated an allocation of concessions based on the industry-standard cost structure for each represented employee group as well as the market rates for each work group. *Id.* at 9-28. Consequently, the percentage reduction in labor cuts of each work group ranged from 10% to 30%. *Id.* at 10. The $340 million in annual savings sought from Flight Attendants represented 26% of their labor cost, which was the second highest percentage of any work group. *Id*. As explained by AMR Chief Restructuring Officer Beverly Goulet: "those proposals [were] based on what we thought was necessary to move our employee compensation to what was then market." Tr. 4/23/12, 223:6-9 (Goulet). The Company explained to the labor groups that this method was "fair" because "allocations for all groups were based on market rates." APFA Ex. 852 at 14.

After independently analyzing the Company's finances, business plan and proposal valuations, APFA agreed to provide the requested concessions, and did so after intensive negotiations over just 17 days of bargaining. APFA Ex. 100 (Glading Decl.) ¶ 2. The other represented employees did likewise, and in April 2003 the collectively-bargained Restructuring

Participation Agreements ("RPAs") provided the Company with $1.6 billion in annual savings. APFA Ex. 700 (Akins Decl.) ¶ 67.

The Flight Attendants' concessions were phased in to produce the annual average savings of $340 million over the RPA's five-year term. *Id.* ¶ 68. Immediately, wages were cut 15.6% across the system; vacation time was cut by one-third; and rest time was reduced. *Id.*

The value of the concessions increased over each year so that in 2008 they approached a value of $530 million annually to the Company. *Id.¶* 69. Today, Flight Attendant pay is 30% less in real dollars than it was under the negotiated CBA that was in effect at the time of American's 2003 restructuring. *Id.* ¶ 68. As explained in more detail below, the labor costs of American's Flight Attendants will soon fall below those of its competitors.

Just after APFA members had ratified the RPA, the Company filed statements with the SEC revealing that executives had received special retention bonuses and new retirement accounts immune from bankruptcy creditors. APA Ex. 400a (Updated Roghair Decl.) ¶ 15. The ensuing outrage prompted American's then-CEO Donald Carty to resign almost immediately. *Id.* ¶ 16.

B. 2008-2011 Bargaining

The APFA CBA (as amended by the RPA) became open for renegotiation in the Spring of 2008. AA Ex. 1000 ¶ 25. On February 29, 2008, APFA served American with written notice of intended changes to that Agreement, pursuant to Section 6 of the RLA. AA Ex. 1012. On February 28, 2008, American served APFA with its own Section 6 notice. AA Ex. 1011.

APFA and American began negotiations over their respective Section 6 notices on June 10, 2008, and conducted 46 days of negotiations over the next seven months. AA Ex. 100 ¶ 27. On December 18, 2008, both parties agreed to jointly invoke the mediation services of the

National Mediation Board ("NMB"), pursuant to Section 5, First of RLA. 45 U.S.C. § 155, First. AA Ex. 100 ¶ 27. All negotiations thereafter, including during this bankruptcy case, have been under the auspices of the NMB. APFA Ex. 200 ¶ 20. In total, approximately 125 pre-petition bargaining sessions were held between the parties. *Id.* ¶ 21.

During the pre-bankruptcy negotiations, American maintained that there was a "labor cost gap" between it and its major competitors. In order to determine the size of the "labor cost gap," the Company consistently engaged in a market-based labor benchmarking method that determined "the amount by which [American's labor costs] exceed what such costs would be if they were determined based on other network carrier labor contracts." APFA Ex. 700 (Akins Decl.) ¶ 71. In other words, American estimated what the Company's hypothetical labor costs would be if the terms and conditions of employment for its competitors' employees were applied to the demographics of American's workforce. This methodology was explained in detail in presentations presented to the APFA, and referred to as "convergence analysis." APFA Ex. 802. American's bargaining position in the Flight Attendant negotiations was premised on this method as early as 2010 and up until the filing for bankruptcy. APFA Ex. 802; APFA Ex. 804 at 47.

Indeed, American relied on this method as recently as March 2012 when describing its labor cost disadvantage in a presentation to the PBGC. APFA Ex. 805 at 3-4.[1] American's expert witness Jerrold Glass also testified that he has used this same benchmarking method "the

[1] The slides and analysis in that presentation are the same as those included in a November 2011 presentation to American's Board of Directors, except that the Company excluded a slide explaining that its labor costs would converge with those of its competitors in the imminent future. APFA Ex. 700 (Akins Decl.) ¶ 38.

most" when comparing employee costs in the restructuring setting. Tr. 4/24/12, 82:13-17 (Glass); *see also* Tr. 4/24/12, 14:13-25 (Glass).

American also consistently defined its competitors as the other "network" carriers. APFA Ex. 803 at 20. Currently, these airlines are United Airlines, Continental Airlines (which is in the process of integrating with United), Delta Air Lines, and US Airways. AA Ex. 800 (Glass Decl.) ¶ 14. The Company has excluded other, "low-cost carriers" from its analysis. For example, in an April 2011 presentation to the TWU that included market-based analysis, American explained: "[w]e have included only the other legacy carriers in our analysis because their cost, unit revenue, and operating structures provide a more consistent comparison than those of low-cost-carriers." APFA Ex. 806 at 5. As testified to by one of American's expert witnesses: "For American, the primary comparator group is obvious[.]" AA Ex. 800 (Glass Decl.) ¶ 14; *see also* Tr. 4/24/12, 23: 2-8 (Glass).[2]

In an early 2011 SEC filing, American estimated that the "labor gap" for all employees was "approximately $600 million per year." APFA Ex. 851 at 29. In April of 2011, American estimated that Flight Attendant costs accounted for ██████████ of this gap. APFA Ex. 808 at 7. American has consistently recognized, and explained to its investors and the SEC, that "convergence" between its labor costs and those of its network carrier rivals would occur naturally "as open industry labor contracts [were] settled." APFA Ex. 851 at 29.

These predictions regarding convergence made in early 2011 have proved correct with respect to Flight Attendants. Every other network carrier will be improving the terms of employment of their Flight Attendants, thereby increasing their Flight Attendant labor costs. In

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[2] The only other airline that could arguably be included in the comparator group is Southwest Airlines, which one American witness described as "in the range of a large network carrier." Tr. 4/25/12, 172:2-5 (Resnick). Southwest Flight Attendants are the highest paid in the industry. Tr. 4/24/12, 21:19-22 (Glass).

February 2012, United Flight Attendants approved an amended CBA which provides an immediate 10% wage increase and an early out program with a $60,000 maximum payment. APFA Ex. 700 (Akins Decl.) ¶ 82. In March of 2012, US Airways Flight Attendants voted down a tentative agreement that provided significant wage increases, but the final agreement, nevertheless, is anticipated to include significant pay increases. *Id.* ¶ 83. Delta, whose Flight Attendants are not represented by a union, will receive a 7.5% wage increase in July, and are fully expected to keep pace with Flight Attendants at other network carriers. *Id.* ¶ 84. Under the terms of the current contract, the Company's cost disadvantage would thus become a ██████ annual cost *advantage* by 2013. *Id.* ¶ 85.

The parties' final pre-bankruptcy proposals were made in April 2011. The parties met in early April for an intensive mediation/negotiation session under the auspices of the NMB. APFA Ex. 200 (Loew Decl.) ¶ 22. The Board-appointed mediator directed each side to make "supposals," which would not bind the parties, but would hopefully help move them toward agreement. *See* APFA Ex. 804 at 39. The APFA proffered a supposal which sought contractual improvements averaging $95 million over the next three years. APFA Ex. 200 (Loew Decl.) ¶ 22.[3] American countered with a supposal that would have increased its costs by an annual average of $65 million over a three-year term. *Id.* On April 20, the APFA transmitted another supposal to the Company that narrowed the average annual gap between the parties to $23 million. *Id.* ¶ 23.[4]

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[3] The Company's assertion that the APFA simply sought to "restore" the contract to pre-2003 levels in pre-bankruptcy negotiations, *see* AA Mem. Supp. Mot. Reject, Part One at 56, is simply not the case. *See* Tr. 4/27/12 75:15-18 (Vaughn).

[4] The actual savings represented by the APFA's supposal extended well beyond the proposed three-year term, because, as a practical matter, some of the union's concessions could not realistically be reversed in the next round of bargaining. For example, the APFA agreed to a switch the pension plan for new hires from a defined-benefit plan to a defined-contribution plan.

The April 2011 exchange of supposals was the practical end of the parties' pre-bankruptcy bargaining. After over three years and over 120 sessions of negotiations, the average annual gap between APFA's and American's proposals was just [redacted] of the Company's annual Flight Attendant labor costs. *Id.*

The final offer from American would have preserved the APFA's pension plan for existing employees, provided a signing bonus, and increased wages. APFA Ex. 804 at 40. According to American's own valuation of its proposal, the Flight Attendant labor costs would "nearly converge" with the projected costs of other carriers by 2014, and would provide a [redacted] [redacted] advantage by 2015. APFA Ex. 804 at 50.

Even on the eve of bankruptcy, the Company continued to endorse the goal of reaching market-based labor contracts. In the fall of 2011, American entered into market-based tentative agreements with two TWU workgroups. AA Ex. 1123 (October 2011 tentative agreement with the Fleet Service Clerk employees); AA Ex. 1124 (November 2011 tentative agreement with the Dispatcher group). And in a November 2011 "Financial and Strategic Update" presentation made to the AMR Board of Directors, American reaffirmed the goal of reaching market-based contracts in negotiations with the Flight Attendants. APFA Ex. 804 at 39 & 47. In total, the Company would have increased its annual labor costs by $300 million under its pre-petition proposals to its unions. Tr. 4/24/12, 140:12 (Goulet).

III. DEVELOPMENT OF AMERICAN'S BUSINESS PLAN

After filing for bankruptcy, the Company's position changed by $1.55 billion annually so that it now seeks $1.25 billion in annual cost reductions from employees. AA Ex. 507. More

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APFA Ex. 811. Likewise, the APFA agreed to significantly increase the maximum number of hours that a Flight Attendant was allowed to be scheduled, providing the Company with an estimated $8.2 million in savings in the final year of the contract. *Id.*

fundamentally, American's methodology has changed. As discussed below, the Company's current positions are derived entirely from a top-down methodology based on its current business plan, rather than the bottom-up benchmarking approach that it utilized pre-bankruptcy. Accordingly, one must understand American's business plan and how it developed (both before and after the Company filed for bankruptcy) to understand its proposal.

A. American's Pre-Petition Market Position

American's recent struggles are largely attributable to the recent Delta/Northwest, United/Continental, and US Airways/America West mergers. These events reduced the Company's market share and exposed its network deficiencies. Up until 2008, the Company was the world's largest airline and its network could compete in what was a fractionalized industry. APFA Ex. 700 (Akins Decl.) ¶ 16.

The Company itself notes this cause and effect throughout its legal memoranda and testimony: "Mergers at Delta (with Northwest), United (with Continental) and US Airways (with America West) have expanded their networks. With those enhanced networks … American's principal competitors have preyed on American's market share." AA Mem. Supp. Mot. Reject, Part One at 9; *see also id.* at 38 ("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"); AA Ex. 1 (Kasper Decl.) ¶ 61 ("Moreover, as a result of recent mergers (United with Continental and Delta with Northwest), United and Delta now have more comprehensive domestic and international route networks than American."); AA Ex. 100 (Goulet Decl.) ¶ 36 ("These mergers enabled the new Delta and United to combine their cost advantages with materially enhanced network strength.").

At the hearing, American executives similarly acknowledged that the mergers of the Company's competitors had put American at a competitive disadvantage. CRO Goulet testified that "there are advantages to larger networks," Tr. 4/24/12, 147:1-2 (Goulet), and acknowledged that American has experienced a disadvantage because of the difference in the size of its network by virtue of the mergers of the other legacy carriers, Tr. 4/24/12, 146:19-20 (Goulet). Likewise, Chief Commercial Officer Virasb Vahidi agreed that "the lack of network breadth compared to Delta and United-Continental has made it increasingly difficult for AA to maintain and win the high value customer." Tr. 4/25/12, 263:5-8 (Vahidi). One of the Company's expert witnesses also explained that it will be "important for American to increase its network" because "a larger footprint … enables the carrier to attract highly valued business customers." Tr. 4/23/12, 236:14-25 (Kasper).

B. American's Pre-Petition Business Plan

In 2009, American developed a "cornerstone strategy" in response to these developing challenges. In short, the Company concentrated its network in five "cornerstone" hubs – DFW, MIA, JFK, LAX, and ORD. APFA Ex. 700 (Akins Decl.) ¶¶ 19-21. The strategy has been unsuccessful particularly in those hubs where American is not dominant (JFK, ORD, and LAX). *Id.* ¶¶ 22-25. Additionally, in July 2011, the Company placed an order for 460 mainline aircraft. APA Ex. 100 (Yearley Decl.) ¶ 29. This is the largest aircraft order in aviation history and would be 35% larger than the entire fleet of US Airways.[5] *Id.*

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[5] The Company developed a comprehensive business plan when evaluating and implementing these strategic decisions. *See* Tr. 4/24/12, 214:13-19 (Goulet); *see also* Tr. 4/24/12, 38:10-17 (Resnick) (testifying that the Company had a comprehensive business plan when he began his engagement in late October, 2011). These plans were withheld from the APFA. In response to a request for all business plans since 2007, the Company provided January and November 2011 presentations to the AMR Board of Directors. APFA Ex. 804; APFA Ex. 850. But unlike the presentation made in support of the Company's post-petition Business Plan,

C. Merger Alternative Will Be Pursued

American has long acknowledged that a merger may be a better approach than remaining a stand-alone airline. AMR explained recently in an SEC filing that the possibility of a merger is "regularly … explore[d]" by the Company:

> In the future, there may be additional mergers and acquisitions … including those in which we may participate and those that may be undertaken by others. Any airline industry consolidation … could substantially alter the competitive landscape and result in changes in our corporate or business strategy. *We regularly assess and explore the potential for consolidation in our industry and changes in airline alliances, our strategic position and ways to enhance our competitiveness, including the possibilities for our participation in merger activity.*

APFA Ex. 827 at 16-17 (emphasis added).

AMR CEO Tom Horton has also long acknowledged the potential benefits of a merger. In April 2010, Horton stated that "[t]he industry needs to evolve into a more rational structure, and consolidation may be part of that outcome." APFA Ex. 823. In the month before filing for bankruptcy, CEO Horton observed that "further consolidation" could enable American to grow. APFA Ex. 824.

Since filing for bankruptcy, Horton has reiterated to the press that merger scenarios will be considered: "It's not hard to envision how we could be a force in the industry and, potentially, a consolidator." APFA Ex. 825; *see also* APFA Ex. 826 ("We're not opposed to consolidation in the industry, and I wouldn't rule it out for American as things develop"); APFA Ex. 822 ("For years I've said that I think consolidation has been – can be healthy and constructive for the U.S. airline industry"); *id.* ("I don't think American is compelled to do a combination … American needs to be bigger.").

APFA Ex. 818, these presentations do not explain how the Company arrived at its financial targets, or how American planned to achieve those goals. The testimony cited above plainly establishes that these plans existed.

Testimony at the hearing also confirmed that the merger alternative had been discussed among the AMR officers and advisors post-petition, and will eventually be pursued." CRO Goulet testified that she agreed with financial advisor David Resnick that:

> "Mr. Horton has always said that he believes consolidation is something that *has to occur in the industry* and something *where American needs to participate*, and that there are a number of options available and the *question really is when to pursue consolidation* and then, also, to analyze with whom and where there would be the most value."

Tr. 4/24/12, 176:7-13 (Goulet) (emphasis added); *see also* Tr. 4/24/12, 188:12-14 (Goulet) (testifying that she has had conversations with Horton about pursuing a combination); Tr. 4/24/12, 120:4-7 (Goulet) (testifying that shortly before the petition filing date, "Mr. Horton said … that he believes that industry consolidation … has been good for the industry and that it might well have a role as we move forward.").

D. Merger Alternative Has Not Yet Been Considered During Bankruptcy

Despite the AMR CEO's belief that American "needs to participate" in consolidation and that the "question really is when" to pursue that option, Tr. 4/24/12, 176:7-13 (Goulet), the Company developed the business plan without evaluating whether a merger in bankruptcy was a better alternative. As CRO Goulet confirmed at the hearing, American "did not undertake any analysis of potential mergers as part of developing the business plan underlying its current labor proposals." Tr. 4/24/12, 120:22 – 121:2 (Goulet); Tr. 4/24/12, 120:13 – 121:2 (Goulet) (discussing exchange between APA counsel and AMR counsel).

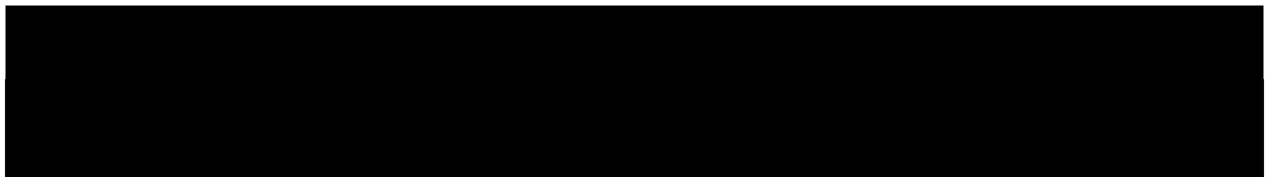
Nor did the Company request that its advisors engage in this analysis. McKinsey did not analyze any potential merger-based business plans because it "was not part of [their] scope" as it was explained to them by the Company. Tr. 4/26/12, 69:15-18 (Dichter). Likewise, Rothschild has not yet been instructed to conduct a financial analysis comparing the current stand-alone plan

to any merger alternatives. While American has engaged Rothschild generally to analyze options, Tr. 4/25/12, 36:22-24 & 144:18-20 (Resnick), the restructuring team's "focus to date has been on the stand-alone plan," Tr. 4/25/12, 111:22-23 (Resnick).

This singular focus on stand-alone alternatives was confirmed by a February 2012 statement by CEO Horton in the press: "all of our energy and focus is on completing the restructuring as an independent company." APFA Ex. 828.

E. American's Current Stand-Alone Plan

The Company's business plan is essentially a continuation of its pre-petition cornerstone strategy. APFA Ex. 700 (Akins Decl.) ¶ 32. Although the new business plan uses the term "key hub" instead of "cornerstone," it is predicated on the same concentrated growth model in the



does not project an increase in its share of capacity relative to its competitors. Tr. 4/26/12, 35:6-11 (Dichter).

Industry analysts have responded negatively to American's stand-alone business plan. Rodman and Renshaw analyst Daniel McKensie concluded: "AMR's plan to grow 20% over 5 years … is problematic … threatens industry pricing - bad for AMR & the industry in our view." APFA Ex. 701. J.P. Morgan analyst Jamie Baker concluded: "We are underwhelmed with AMR's standalone restructuring plan, insofar as it fails to adequately address the decade-long marginalization of its domestic network." APFA Ex. 702. Wolfe Tranhan analyst Hunter Keay concluded: "We view AMR's restructuring plan, founded on the idea of 'growth and renewal,' as unlikely to succeed[.]" APFA Ex. 705. These views reflect the consensus opinion, as explained

by Analyst Baker: "Most airline's management and clearly the majority of investors feel that American's stand-alone plan represents a clear and present danger." APFA Ex. 706.

Nothing in the record challenges this consensus; no one has opined that pursing a stand-alone strategy is superior to a merger or that the current plan is likely to succeed. The Company proffered testimony from only one witness – Alexander Dichter of McKinsey & Company, Inc. – in support of its business plan.[6] Mr. Dichter, however, merely endorsed the revenue projections as "achievable provided the Business Plan is implemented." AA Ex. 400 (Dichter Decl.) ¶¶ 6(e) & 25. Mr. Dichter provided no assessment as to the likelihood of successfully implementing the plan. Nor did Mr. Dichter endorse a stand-alone plan as providing a better option than a merger. He and his team did not analyze that alternative. Tr. 4/26/12, 69:15-18 (Dichter). He merely testified that in his opinion the operational plan was the optimal stand-alone option. AA Ex. 400 (Dichter Decl.) ¶¶ 6b, 20, & 30.

Notably, the Unsecured Creditors Committee has also not provided an assessment of the business plan. Rather, at a hearing held on March 22, the UCC stated that it has "yet to endorse."

F. The Stand-Alone Plan Is Untested and Flawed

American has not conducted "stress-testing" of its plan by evaluating the effects of any downside scenarios on its projections. APFA Ex. 600 (Szlezinger Decl.) ¶¶ 17-24. Mr. Dichter testified he had not modeled the effect of fuel price changes, GDP changes, or demand changes being worse than the business plan assumes. Tr. 4/24/12, 95:22-24 (Dichter). Likewise, in a response to an information request sent by APFA's financial advisors, the Company explained

[6] David Resnick testified that Rothschild was not involved in developing the operational side of the Business Plan. Tr. 4/25/12, 89:1-3 (Resnick). American's other expert witnesses expressly stated that they did not review the Business Plan Model. Tr. 4/23/12, 81:18-22, 84:10-17, & 186:1-24 (Kasper); Tr. 4/24/12, 39:18-22 (Glass).

that "developing any comprehensive downside case scenario … would consume limited resources currently devoted to the Company's reorganization[,]" and, therefore, had not been undertaken. APFA Ex. 820 at 11. In another response, American similarly stated that it "has no non-privileged analyses of upside or downside scenarios to the business plan model projections." APFA Ex. 821 at 5.

As explained in the Declaration of Leon Szlezinger, a Managing Director at Jefferies & Company investment banking firm, significant investments will generally not be made until such a downside projection is completed. APFA Ex. 600 (Szlezinger Decl.) ¶ 17. In a case as complex as AMR, investors would generally expect the business model to be stress-tested by considering different assumptions such as fuel costs, competitive response, and macro economic conditions. *Id.* ¶ 18. Moreover, investors would expect the model to reflect the effects of various codeshare alternatives and different network scenarios. *Id.* ¶ 18.

A prudent investor would also not invest in American's business plan until the Company had fully considered a merger alternative. *Id.* ¶¶ 25-28. As various industry analysts have opined, there is a widely held view that a strategic transaction such as a merger would be better for American than the stand-alone plan. *Id.* ¶ 26. The investment community, therefore, should be expected to wait for these alternatives to be fully developed and considered before committing any funds. *Id*.

The flaws of American's current business plan are outlined below and discussed fully in APFA Exhibit 700, the expert report of airline economist Daniel Akins. First, the business plan does not sufficiently address the deficiencies of the Company's network. APFA Ex. 700 (Akins Decl.) ¶¶ 33-41. The Company has not developed a solution to its lack of feed from cities along the east coast. *Id.* ¶¶ 33 & 39. Nor has the company addressed its problems in the three markets

that were failing under the cornerstone strategy. American is the second largest carrier at Chicago-O'Hare behind United, but in the current market, airlines have not succeeded in operating a hub profitably as the number two airline. *Id.* ¶ 34. The Company's solution for New York City relies entirely on a speculative codeshare relationship with [REDACTED] *Id.* ¶ 36,

[REDACTED]

Moreover, an expanded relationship with [REDACTED] is unlikely to be successful for a number of reasons. APFA Ex. 700 (Akins Decl.) ¶ 37. Finally, the Company's plans for LAX are problematic because it relies on a speculative [REDACTED] ompound annual growth rate to [REDACTED] where American does not operate an extensive network. *Id.* ¶ 41.

The Company's plan is also flawed because it is predicated on highly volatile rates of growth that will outstrip the market demand, a problem which is unaccounted for in the model. *Id.* ¶¶ 50-60. For example, American projects an [REDACTED] growth rate for [REDACTED] but only [REDACTED] growth in the market. *Id.* ¶ 51. American's model assumes that it will be able to achieve this above-market growth without suffering a reduction in unit revenue. *Id.* ¶ 51. This assumption is contrary to the basic economic principle of supply and demand: if the rate of growth in a market exceeds demand, then unit revenue will decrease. *Id.* ¶¶ 60-61.

Additionally, the current business plan is flawed because it assumes that American's competitors will not respond to the Company's planned growth. For example, American assumes there will be no competitive response to regauging its fleet or enhancing its product. *Id.* ¶ 46. More fundamentally, the model assumes that airlines will not respond competitively to American's attempts to introduce new routes. *Id.* ¶ 61. The Company recognizes that the airline industry is a highly competitive. AA Ex. 1 (Kasper Decl.) ¶ 6 (industry "highly competitive"); Tr. 4/23/12, 23:17 (Opening Statement) (industry "intensely competitive"); Tr. 4/25/12, 253:21-

24 (Vahidi) ("very competitive" marketplace). American should therefore assume that other airlines will attempt to prevent it from achieving its goals. APFA Ex. 700 (Akins Decl.) ¶ 62.

Finally, the Company has not yet developed a targeted route structure, the principle element of an airline's operations. American's business plan merely projects growth rates from

APFA Ex. 819 at 12. In response to a request for information regarding the particular routes that American intends to add in order to achieve the projected growth, the Company explained that it "cannot provide this level of response" because a "route profitability model" had not been constructed. APFA Ex. 820 at 1. The lack of a specific growth plan forecloses any detailed analysis of the profitability of the projected route development. APFA Ex. 700 (Akins Decl.) ¶ 57.

IV. BANKRUPTCY NEGOTIATIONS

On February 1, 2012, American served its initial Section 1113 proposal on the APFA, AA Ex. 1025, and its final pre-motion proposal on March 22, 2012, AA Ex. 1003. Overall, American seeks concessions from Flight Attendants averaging $230 million annually. As discussed fully below, the final proposal would reduce the average Flight Attendant's take-home pay by 16.9%; significantly increase the Flight Attendant contributions for medical benefits; freeze the Flight Attendants' pension plan and replace it with a less generous 401(k) plan; and shift the entire cost of retiree medical benefits to Flight Attendants. Many of these changes were never discussed in pre-petition negotiations. APFA Ex. 200 (Loew Decl.) ¶ 31. The proposal was not formulated using market-based analysis and would place the Company's Flight

Attendants costs 30% below those of its competitors. The sole source of American's proposal is the business plan described above.

A. The Basis for American's Section 1113 Proposal to APFA

During a February 8 negotiation session, APFA negotiators asked whether the Company's Section 1113 proposal was market-based and, if so, how American's Flight Attendants would stand relative to their peers under the Company's proposed terms. *Id.* ¶ 30. The Company's chief negotiator, Taylor Vaughn, responded both that he did not know how the Flight Attendants would fare relative to their peers at other network carriers, and that no analysis had been undertaken regarding how American's labor costs would compare to its competitors if APFA agreed to $230 million in annual savings, as the Company sought. *Id.* As Mr. Vaughn explained, the Company's ask was instead derived from the business plan.[7] *Id.*

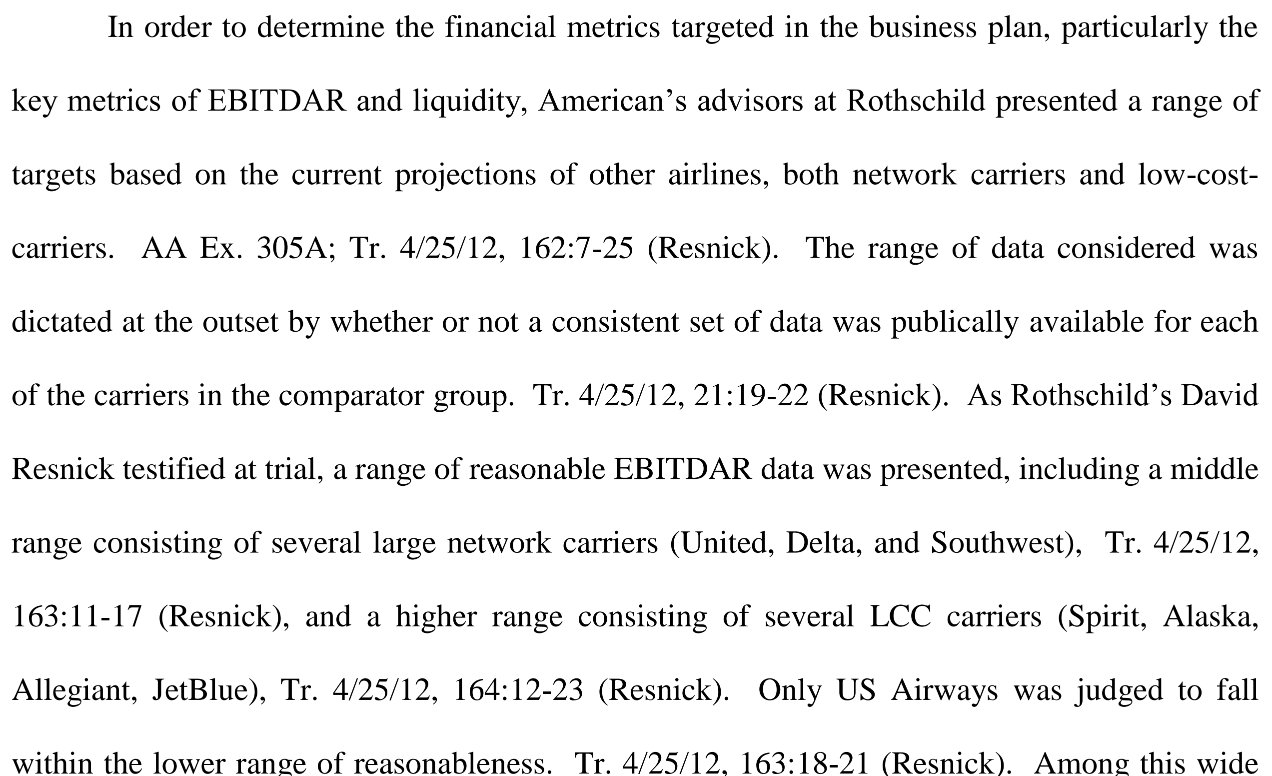
At trial, AMR's CRO Beverly Goulet described the process used by the Company to derive its labor cost reduction target as follows. She testified that American "worked with [its] financial advisors at Rothschild to determine what the financial metrics might be that would suggest the goals that I just described." Tr. 4/24/12, 100:19 – 23 (Goulet). The Company "also looked at what the company's revenue generating opportunities were in order to determine that we in fact were deploying those assets in a manner to maximize the revenue generating capability of the company." *Id.* at 100:24-101:2. American also examined possible reductions in non-labor costs, as well as opportunities to restructure those costs through bankruptcy. *Id.* at 101:3-11. "And then finally [the Company] looked at what kind of labor costs would be

[7] That same day, APFA made a written request to American for the "collective bargaining agreement or work rules from which each proposed modification was taken." APFA Ex. 817 at 5. The Company responded: "[t]o the extent American has looked at other airlines' contracts, it did so only to confirm that with very few exceptions the Company's proposals are in the range of other large network carriers." *Id.* at 6.

necessary in order for us to generate those kinds of financial metrics that we had established." *Id.* at 101:12-14; *see also* Tr. 4/24/12, 115:14-25 (Goulet) (American looked at revenue projections and non-labor cost reductions "in the context of the financial metric that we had established and then used that as a means of determining the amount of the labor costs that we believe we need to remove from the business.").

Ms. Goulet's description at trial is consistent with Company documents describing the calculation of American's labor cost reduction target. APFA Ex. 818 at 54 & 62. The resulting target for labor cost reductions was $1.5 billion on a steady-state 2017 measurement, which translates to an average $1.25 billion annually over the course of the next six years. Tr. 4/24/12, 116:4-9, 113:22-25, & 114:1 (Goulet).

In order to determine the financial metrics targeted in the business plan, particularly the key metrics of EBITDAR and liquidity, American's advisors at Rothschild presented a range of targets based on the current projections of other airlines, both network carriers and low-cost-carriers. AA Ex. 305A; Tr. 4/25/12, 162:7-25 (Resnick). The range of data considered was dictated at the outset by whether or not a consistent set of data was publically available for each of the carriers in the comparator group. Tr. 4/25/12, 21:19-22 (Resnick). As Rothschild's David Resnick testified at trial, a range of reasonable EBITDAR data was presented, including a middle range consisting of several large network carriers (United, Delta, and Southwest), Tr. 4/25/12, 163:11-17 (Resnick), and a higher range consisting of several LCC carriers (Spirit, Alaska, Allegiant, JetBlue), Tr. 4/25/12, 164:12-23 (Resnick). Only US Airways was judged to fall within the lower range of reasonableness. Tr. 4/25/12, 163:18-21 (Resnick). Among this wide



Rothschild did not recommend a specific EBITDAR target to American. Tr. 4/25/12, 95: 9-14 (Resnick). Ultimately, CRO Goulet chose an EBTIDAR target. Tr. 4/24/12, 245:22-25 &

reduction in targeted EBITDAR translates into less needed by the Company in improved earnings. APFA Ex. 700 (Akins Decl.) ¶ 27.

Once the target amount of labor cost reductions was determined based on the business plan and its target financial metrics, the target number was given to Senior Vice President of Human Resources Jeffrey Brundage. Tr. 4/26/12, 195:6-24 (Brundage). Then, Mr. Brundage and his labor relations staff worked to identify contract changes that would satisfy the target. *Id.*, 197:10-17. The $1.25 billion target represented a 20% reduction overall in labor costs. The 20% reduction was then applied to the labor costs attributable to each employee group, resulting in an average annual reduction for Flight Attendants of $230 million. AA Ex. 507.

B. American Seeks a Below Market Contract

In actuality, American has proposed contract changes that would place its Flight Attendant costs well below market rates. This fact is established using the Company's own market-based methodology, which it uniformly utilized in pre-petition negotiations, and endorsed in a post-bankruptcy presentation to the PBGC. APFA Ex. 805 at 3. This is the same methodology which the Company's expert testified is "most" used in the restructuring context. Tr. 4/24/12, 82:13-17 (Glass). The Company's Section 1113 proposal would place its Flight Attendant costs $176 million below other network carriers (Continental, Delta, United, and US Airways) in the contract's first year. APFA Ex. 700 (Akins Decl.) ¶ 86. This cost advantage

over competitors would grow to $347 million by 2015. *Id.* This would place American 30% below the industry standard. *Id.*

C. Effect of the Section 1113 Proposal on Flight Attendants' Quality of Life

This below market proposal would significantly reduce Flight Attendants' quality of life. American seeks changes in work rules that would result in the furlough of 2,064 Flight Attendants, APFA Ex. 400 (Rohan Decl.) ¶ 4, which equates to more than 13% of the Flight Attendant workforce. The burden of being laid off will be particularly high for the Flight Attendants, because unlike every other work group, they do not receive severance. APFA Exs. 830 & 836 (among long-time employees, high-level managers receive a full years of severance, while other employees generally receive thirteen weeks).

Those Flight Attendants who are not laid off would incur a 16.9% reduction in take-home pay under the Section 1113 proposal. APFA Ex. 700 (Akins Decl.) ¶ 88. The proposed elimination of incentive pay would equate to a 2.5% reduction. *Id.* The proposed change to rules governing vacations would result in a 2.0% reduction. *Id.* The sought increases in premiums and other health plan design changes would result in a 6.4% reduction. *Id.* In addition, the proposed replacement of the defined benefit plan with a defined contribution plan would necessitate that Flight Attendants contribute up to 5.5% of their income in order to receive a matching employer contribution.[8] *Id.*

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[8] The Company claims that its proposal would allow Flight Attendants to "make hundreds of dollars **more** per month." AA Mem. Supp. Mot. Reject, Part Three at 42-43. This claim is baseless. As an initial matter, the Company fails to control for the number of hours worked. Instead, American compares the income of a Flight Attendant working 75 hours per month prior to the cuts to the income of a Flight Attendant working 85 hours per month after the cuts. AA Ex. 1042. Moreover, the Company misrepresents the effect of the Section 1113 proposal by only showing the effect of the medical plan changes on Flight Attendants without dependant healthcare coverage and without taking into account the substantial increases in deductions and out-of-pocket maximums. Tr. 4/27/12, 77:2-19 (Vaughn).

Under the Section 1113 proposal, many Flight Attendants would also have to work more than ten years longer to retire with an annuity equivalent to the payment they are entitled to receive under the current defined benefit plan. American seeks to freeze the Flight Attendant defined benefit plan, and replace it with a defined contribution plan with up to an employer match of up to 5.5% of pay. APFA Ex. 300 (Condrick Decl.) ¶ 6. As shown in the chart below, Flight Attendants with significant service will have two options: retire with significantly less retirement income or work significantly longer in order to make up for the loss of what they would have accrued.[9] *Id.* ¶ 9.

AMR PROPOSAL – YEARS TO RECOVER YEARLY LOST BENEFIT			
		5% Assumed DC Plan Return	
Sample Flight Attendant	**Item**	**Retirement Age 60**	**Retirement Age 65**
Age 40, Service 10, Pay $42,000	Lost Benefit Additional Years	$22,984 14	$29,584 12
Age 51, Service 17, Pay $46,000	Lost Benefit Additional Years	$9,174 13	$15,084 12
Age 60, Service 20, Pay $46,000	Lost Benefit Additional Years	$0 0	$4,916 12

AMR PROPOSAL – YEARS TO RECOVER YEARLY LOST BENEFIT			
		7% Assumed DC Plan Return	
Sample Flight Attendant	**Item**	**Retirement Age 60**	**Retirement Age 65**
Age 40, Service 10, Pay $42,000	Lost Benefit Additional Years	$21,237 11	$25,682 9
Age 51, Service 17, Pay $46,000	Lost Benefit Additional Years	$8,963 11	$14,362 10
Age 60, Service 20, Pay $46,000	Lost Benefit Additional Years	$0 0	$4,856 10

APFA Ex. 300 (Condrick Decl.) at 4.

[9] Of note, American's proposed 401(k) match is contingent upon the parties reaching a consensual agreement and will not be implemented if the Court authorizes rejection and the Company freezes the defined benefit plan. Tr. 4/26/12, 219:1-11 (Brundage).

American also seeks to eliminate subsidization of retiree medical care. APFA Ex. 500 (Wohl Decl.) ¶ 17. Flight Attendants would have to purchase pre-Medicare coverage if rejection is authorized. *Id*. This would consume up to 74% of Flight Attendants' pension income. *Id*.

Although the Company offered a profit-sharing plan in its Section 1113 proposal, this possibility, even in the best case scenario, would not begin to restore the concessions that the Company seeks to impose. American proposes to change its current profit-sharing plan so that 15% of American's profits are returned to employees whereas now the employees only receive 15% of profits above $500 million. *See* AA Mem. Supp. Mot. Reject, Part One at 74. This change provides a maximum potential of $75 million (15% of $500 million) in new compensation for American employees combined. Assuming that the Flight Attendants are paid a pro-rata share relative to the percentage of total labor costs (18%), AA Ex. 507, they would thus receive [redacted] or less tha [redacted] of what American calculates as the annual reduction under its Section 1113 proposal. Thus, under American's proposal, even a successful post-bankruptcy Company does not return a significant portion of what the Flight Attendants are being asked to sacrifice. Moreover, if rejection is ordered by the Court, American has stated that not only will it not implement this change in the profit sharing program, but, in addition, the Company will take away the existing profit-sharing plan. Tr. 4/26/12, 219:1-11 (Brundage); *see also* Tr. 4/24/12, 36:5-7, 36:16-19, & 37:1-3 (Glass).

D. American's Position in Negotiations

American has repeatedly made clear to the APFA that any agreement would have to provide $230 million in annual cost savings over a six-year term. These two issues, the overall target and contract duration, were non-negotiable. For example, in the Memorandum filed in support of rejection of the APFA contract, American states:

> As a result, the Company had to develop proposals that would meet the *$230 million in targeted cost reductions* from the other provisions in the APFA CBA. *The Company repeatedly told the Union that it would consider alternatives*, including reductions in the hourly pay rates, *so long as the alternatives generated the same overall amount of cost reductions*.

AA Mem. Supp. Mot. Reject, Part Three at 37 n.34 (emphasis added). American's Senior Vice President of Human Resources Jeffrey Brundage, to whom Taylor Vaughn reports, has stated:

> American, however, has told Union leaders for each group that, almost without exception, the *Company is willing to consider any reasonable alternative* suggestions the Union might have to the Company's cost reduction proposals *so long as the total cost reduction total is met.*

AA Exh. 500 (Brundage Decl.) ¶ 28. There can be no genuine dispute that the $230 million target was presented to the APFA as "non-negotiable."[10]

The parties last met for negotiations on March 27, 2012, the day American filed its Section 1113 motion. APFA Ex. 200 (Loew Decl.) ¶ 45. At that meeting, APFA explained that further negotiations would not be productive unless the Company was willing to negotiate regarding the $230 million target for concessions. *Id.* On April 8, 2012, APFA reiterated its position to American. *Id.* The Company has still not indicated that it is willing to move from its $230 million target. Nonetheless, negotiations will resume on May 8.

E. APFA's Position in Negotiations

The APFA's goal throughout post-petition negotiations has been to protect its members while also providing the Company with market-based operational flexibility and labor costs. The APFA's current proposal would provide annual average savings of $199 million over a four-year term. APFA Ex. 700 (Akins Decl.) ¶ 92. Recognizing the realities of bankruptcy, the

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[10] Although American's chief negotiator, Taylor Vaughn has stated: "Neither I nor any member of the Company's negotiating team has ever told APFA that its $230 million cost reduction target is 'non-negotiable'", AA Ex. 1000S (Supp. Decl. Vaughn) ¶ 10, this statement is contradicted by American's actions and official positions.

APFA has been willing to agree to concessions in those specific areas of the contract that American has flagged as outliers when compared to terms of other Flight Attendant contracts. These concessions can be grouped into work rules and productivity provisions, health benefits, and pension benefits.

Work Rule and Productivity Provisions. As shown below, the APFA has been willing to align Flight Attendant work rules and productivity provisions with those of the other network carriers. The only Flight Attendant provisions highlighted by American in its Section 1113 filing (thus presumably the most important to the Company) were agreed to in whole or part by the APFA before the Company filed its motion. First, the company complains that "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 sick pay – is just 420 per year." AA Mem. Supp. Mot. Reject, Part One at 70-71. But the APFA had already agreed to the Company's proposed revision to this contract provision. APFA Ex. 202 at 3-4. Second, American complains that "[c]urrently, flight attendants can manipulate their work and vacation schedules in order to turn a two week vacation into a month off with pay." AA Mem. Supp. Mot. Reject, Part One at 3. But the APFA had also agreed to address this issue. APFA Ex. 202 at 4.

Likewise, many of the other examples listed in the Company's "APFA Memorandum" were agreed to in whole or part by the Union. For example, elimination of the duty aloft restriction, *see* AA Mem. Supp. Mot. Reject, Part Three at 25-26, has been agreed to in full by the APFA. APFA Ex. 202 at 8. Before the filing of the Section 1113 Motion, the APFA had already agreed to an increase in the "monthly maximum" to 100 hours a month. *See* AA Mem.

Supp. Mot. Reject, Part Three at 23-25. APFA Ex. 202 at 8. Thus, the Company's statement that APFA is seeking to "retain restrictions and protections that exist only at American," AA Mem. Supp. Mot. Reject, Part One at 94, is erroneous.

Medical Benefits. The APFA also agreed to a significant reduction in Flight Attendants' medical benefits, both for future retirees and active Flight Attendants. The APFA agreed to eliminate the current retire medical plan contingent on replacing it with a union-controlled Voluntary Employee Beneficiary Association ("VEBA"), which is fully explained in the declaration of Stuart Wohl, a health benefits expert with the Segel Company. APFA Ex. 500 (Wohl Decl.) ¶¶ 21-26. The Company itself projected that APFA's proposal on retiree medical would provide them with $28 million in annual savings. AA Ex. 1043.

The APFA also agreed to a change in the active Flight Attendants' medical plan. APFA Ex. 500 (Wohl Decl.) ¶¶ 11-16. This change would provide the Company with $48 million in annual savings. APFA Ex. 201 at 8. However, American and its advisors have undervalued the savings that would be generated from the APFA's proposal because of flaws in the Company's valuation methodology. For example, contrary to accepted industry practice, American failed to account for the decrease in utilization that would result from increasing employees' contributions, deductibles, and out-of-pocket maximums. APFA Ex. 500 (Wohl Decl.) ¶ 13.

Pension Benefits. Finally, the APFA has proposed a change to the Flight Attendants' pension plan that would align the Company's costs in that area with its competitors. The APFA agreed to a freeze of the Flight Attendant defined benefit plan, and to replace it with a defined contribution plan that included higher employer contributions for Flight Attendants depending on their age. APFA Ex. 300 (Condrick Decl.) ¶ 10. The escalating rates are designed to offset the

substantial reduction in pension benefits that senior Flight Attendants would suffer as a result of the freeze. *Id*.

F. APFA's Early Out Proposal

Labor negotiations are not inherently zero-sum. Agreement can be reached on issues that provide management savings, but also benefits for a union's membership. Recognizing this general principle, the APFA proposed an "early out" program that would incentivize top-of-scale Flight Attendants to retire. This win-win solution would reduce the Company's costs associated with having a senior Flight Attendant workforce that is concentrated at the top of the contractual pay scale, while eliminating or reducing the 2,064 furloughs projected by American.

The Flight Attendant agreement provides step increases in Flight Attendant pay rates. Thus, a first year Flight Attendant makes $20.24 an hour, whereas a Flight Attendant with fifteen or more years of service makes $46.00 an hour. APFA Ex. 400 (Rohan Decl.) ¶ 10. Currently, the vast majority of American Flight Attendants are at the top of the pay scale. *Id.* ¶ 9. This demographic composition of the workforce -- one concentrated at the top of the pay scale and eligible for retirement -- provides an opportunity for savings by incentivizing top-scale Flight Attendants to retire voluntarily.

From the outset of the bankruptcy negotiations, APFA viewed an early out program as an important ingredient to achieving a consensual and ratified Flight Attendant agreement. APFA Ex. 100 (Glading Decl.) ¶ 9. Accordingly, the APFA developed a specific early out proposal and repeatedly told the Company that it was willing to discuss alternatives programs. APFA Ex. 400 (Rohan Decl.) ¶¶ 5-17. But American refused to seriously entertain APFA's early out proposal and, instead, withheld information necessary to progress towards a jointly beneficial program. Although American indicated it would participate in developing a cost-neutral early out program,

in actuality, the Company made no real attempt to reach consensus on this issue. *Id.* ¶¶ 17-88. For example, in its March 12 response to an APFA information request, American stated: "The Company does not feel that this information [relating to the early-out proposal] is relevant to the APFA's evaluation of the Company's Section 1113 proposals, as it is not making an early-out proposal at this time." APFA Ex. 832 at 5. This information, however, was available for production. On February 23, American had made a presentation to the UCC Labor Subcommittee detailing its analysis of the APFA's early out proposal and a cost-neutral option. APFA Ex. 833. This document was not provided to the APFA until a month later, shortly before the Company filed its Section 1113 application. APFA Ex. 400 (Rohan Decl.) ¶ 19.

The Company's refusal to engage with APFA over the terms of an early-out program is notable given that American has now implemented an early-out program for its non-union Passenger Service employees. Capasso Suppl. Decl. ¶ 7 (Doc. No. 2605), Ex. D (American Letter Dated May 1, 2012).

G. APFA's Discussions with US Airways

In March 2012, APFA was first approached by US Airways regarding that airline's interest in merging with American. APFA Ex. 100 (Glading Decl.) ¶ 18. The week of April 9, APFA met in person with US Airways executives who explained the advantages of a merger for American. *Id.* ¶ 20. After four days of discussion, APFA and US Airways arrived at a consensual term sheet outlining terms of employment for American Flight Attendants in the event of a merger. *Id.* This term sheet provides for $153 million in cost savings and is fundamentally superior to what the Company seeks to impose by way of its Section 1113 motion. *Id.* at ¶ 21. The US Airways term sheet would not require any furloughs, includes an early out

program, and commits the APFA and US Airways to a binding arbitration process if a complete agreement cannot be reached between the parties. APFA Ex. 106.

V. THE MERGER ALTERNATIVE

The merger alternative to the current stand-alone business plan, which the Company has consistently stated it will eventually "pursue" and which it "regularly … explores," is now being evaluated by American and other stakeholders. According to the Company itself, this process does not require first rejecting the collective bargaining agreement of the Flight Attendants or any other work group.

A. American and the UCC Are Now Evaluating the Merger Alternative

On April 20, 2012, US Airways announced to its investors and employees that it will be pursuing a potential merger with American while the Company is in bankruptcy. APFA Ex. 829. Following this development, American's financial advisor David Resnick testified that reviewing merger alternatives "would be likely because the debtor's obligation is to maximize value for stakeholders, and … the stakeholders would want to insure that they are getting the highest possible value." Tr. 4/25/12, 134:10-22 (Resnick). Mr. Resnick described this as "part of the company's fiduciary obligation." Tr. 4/25/12, 111:16 (Resnick).

Likewise, in a letter mailed to American's employees, CEO Horton explained that:

> What's best for our company, our people and our financial stakeholders will be determined by the facts in a disciplined manner and process. And this includes whether American will choose to pursue any combination down the road. This is the charge of the Board of Directors and the leadership team to be done in close collaboration with the creditors committee.

APFA Ex. 5. This process of "close collaboration" is currently underway: Mr. Resnick testified that American "recently" gave a presentation to the UCC "where they talked … about … consolidation opportunities." Tr. 4/25/12, 156:17-18 (Resnick).

Mr. Resnick acknowledged that it is possible that the alternatives to the stand-alone plan that are considered would require less in labor cost reductions from the Flight Attendants and other employees. Tr. 4/25/12, 177:20-23 (Resnick).

B. Merger Can Be Evaluated Without Rejection

Mr. Resnick also testified that before considering mergers, Rothschild had to "develop through the business plan … what we would call a stand-alone plan … and use that as a basis against which to analyze alternatives that would produce maximum value for our stakeholders, and that could include mergers … [Y]ou need the discipline of having your stand-alone plan as essentially your base case." Tr. 4/25/12, 166:5-12 (Resnick). He explained further that "it's important to have the stand-alone plan as an alternative, because in my view it makes no sense to essentially put all your eggs in one basket and pursue one alternative without having the ability of looking at an array of options that can maximize value for the stakeholders." Tr. 4/25/12, 166: 21-25 – 167:1 (Resnick).

Mr. Resnick explained that although the stand-alone plan had to be developed, it did not have to be implemented in order to model alternative plans of reorganization, such as those involving mergers, and compare them against the current plan. Tr. 4/25/12, 183:2-19 (Resnick). Although Mr. Dichter asserted that implementation would provide American with bargaining leverage, he still did not assert that evaluation of mergers required implementing the base case. Tr. 4/26/12, 69:24-5 & 70:1-2.

C. Company's Sought Implementation Date Is Arbitrary

Although the Company seeks to implement its proposed changes by July 1, 2012, and has constructed the business plan based on that assumption, this date is not dictated by any external requirement, but rather was simply chosen by the Company. AA Ex. 100 (Goulet Decl.) ¶ 62

n.25. American is not reliant on outside financing contingent on rejection, and is still formulating its plan of reorganization. The Company's exclusivity period ends on September 28, 2012 and the Company has not asserted any reason for proceeding with rejection before that date. Order Granting Extension of Exclusivity Period (Doc. No. 1987).

"AMR is not in crisis. It has nearly $5 billion of cash, no DIP financing agreements that subject AMR to covenant or liquidity tests, and … will apparently not need exit financing or seek a revolving credit facility upon emergence from bankruptcy." APA Ex. 100 (Yearley Decl.) ¶ 9. As the Company recognizes, being self-financed is atypical in a large bankruptcies in general, Tr. 4/26/12, 129:2-4 (Dichter), and airline bankruptcies in particular, Tr. 4/26/12, 185:3-6 (Brundage). As Mr. Brundage testified, because AMR "filed with a reasonable amount of liquidity and we didn't have DIP financing, so there were no restraints … put on us in terms of what we needed to do kind of day one." Tr. 4/26/12, 184:18-21 (Brundage).

Nor does American have a fully developed plan of reorganization. Since filing its motion, the Company has materially changed its position regarding the amount of equity financing needed to execute its business plan, most recently suggesting that it may not need any. When the Company filed its Section 1113 motion, the business plan assumed [REDACTED] in equity financing. APFA Ex. 600 (Szlezinger Decl.) ¶ 14. The UCC advisors and the unions noticed significant errors in that model which prompted the Company to correct its business plan. As a result, AMR's projected total debt balance at the end of 2013 has been reduced by [REDACTED] nd its projected cash balance at the end of the six-year business plan is [REDACTED] higher than previously projected. *Id.* Rather than revisit the amount of concessions sought from employees, AMR reduced the amount of its planned equity raise [REDACTED] *Id.* ¶ 15.

More fundamentally, Mr. Resnick has now indicated that equity financing may not even be necessary:

> In connection with these 1113 proceedings, I am presently not taking a position as to whether or not the additional equity capital raise is either required or sufficient for emergence. Whether or not such capital is either required or sufficient will depend on the facts and circumstances that exist at that point in time.

AA Ex. 300 (Revised Resnick Decl.) ¶ 23. Thus, Mr. Resnick believes that it is too soon to determine the financial picture of American when it exits bankruptcy. American may need some "equity raise" and that amount may be [redacted] or it may be zero. Similarly, Ms. Goulet testified that she was not sure whether there will be an equity raise because "that's several months from now, and, you know, in the airline business a lot can change in a handful of months." Tr. 4/24/12, 262:23-25 & 264:1-3 (Goulet).

STATUTORY BACKGROUND

Section 1113 of the Bankruptcy Code, 11 U.S.C. § 1113, was enacted to address recurrent efforts by financially troubled companies to use federal bankruptcy law as a method of "economic blackmail" in order to obtain "sacrifices from employees." *See* Rosalind Rosenberg, *Bankruptcy and the Collective Bargaining Agreement – A Brief Lesson in the Use of the Constitutional System of Checks and Balances*, 58 Am. Bankr. Law J. 293, 304–306 (1984); *see also Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82, 87 (2d Cir. 1987) (Section 1113 enacted to address Congressional concerns that "some companies were misusing the bankruptcy law in collective bargaining").[11]

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[11] Prior to 1984, when Section 1113 was added to the Bankruptcy Code, collective bargaining agreements were treated as executory contracts subject to rejection under Section 365 of the Bankruptcy Code. *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984) ("*Bildisco*"). Although acknowledging the "special nature" of collective bargaining agreements vis-à-vis other executory contracts, the Supreme Court in *Bildisco* nevertheless held that rejection of labor contracts should be allowed under Section 365 under a relatively lax standard. 465 U.S. at 524,

Section 1113 provides the narrow, exclusive avenue for rejection of collective bargaining agreements: Section 1113(a) provides that a debtor may "assume or reject a collective bargaining agreement only in accordance with the provisions of this section," and Section 1113(f) prohibits a debtor from "unilaterally terminat[ing] or alter[ing] any provisions of a collective bargaining agreement prior to compliance with the provisions of this section." 11 U.S.C. § 1113. The underlying objective of this provision is to protect employees and promote consensual resolution. *See, e.g.*, *In re Century Brass Prods.*, *Inc*., 795 F.2d 265, 273 (2d. Cir. 1986); *In re Maxwell Newspapers, Inc.*, 981 F.2d 85, 89 (2d Cir. 1992) (Section 1113 prevents debtors from "using bankruptcy as a judicial hammer to break the union"); *In re Pierce Terminal Warehouse*, *Inc*., 133 B.R. 639, 646 (N.D. Iowa 1991) (court must consider welfare of unionized employees).

Courts have distilled the elements of a Section 1113 motion into nine requirements. *In re Lady H Coal Co.*, 193 B.R. 233, 241 (Bankr. S.D. W.Va. 1996) (collecting cases). Notably, rejection of a collective bargaining agreement "is not a tentative step to be confirmed at a later stage of the bankruptcy case, but [is] a final act that has immediate consequences … There is no indication … that a rejection order can be subject to reconsideration … months after the contract has been rejected[.]" *In re Northwest Airlines*, *Corp.,* 366 B.R. 270, 270-272 (Bankr. S.D.N.Y. 2007).

The nine factors are:

1. The debtor in possession must make a proposal to the Union to modify the collective bargaining agreement.

2. The proposal must be based on the most complete and reliable information available at the time of the proposal.

532-33.

3. The proposed modifications must be necessary to permit the reorganization of the debtor.

4. The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.

5. The debtor must provide to the Union such relevant information as is necessary to evaluate the proposal.

6. Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the Union.

7. At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement.

8. The Union must have refused to accept the proposal without good cause.

9. The balance of the equities must clearly favor rejection of the collective bargaining agreement.

In re Am. Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984). The debtor bears the burden with regard to *each* requirement.[12] *Id.*, 44 B.R. at 909.

A. THE DEBTOR'S PROPOSALS MUST BE NECESSARY FOR A SUCCESSFUL REORGANIZATION.

The debtor must prove that its proposed "modifications … are necessary to permit the reorganization of the debtor[.]" 11 U.S.C. § 1113(b)(1)(A). As the Second Circuit has held, this means proof by a preponderance of the evidence that the modifications are necessary to ensure the debtor's successful reorganization and long-term financial stability. *Carey Transp,. Inc.,* 816 F.2d at 89; *see also In re Royal Composing Room, Inc.*, 848 F.2d 345, 348 (2d Cir. 1988).

[12] APA and TWU have submitted briefs to the Court addressing the legal significance of proposals made at various times before the commencement of the hearing in this matter in terms of evaluating the different Section 1113 factors. APFA concurs with the legal analysis presented by APA and TWU. In the case of APFA, however, the Company's last proposal to the Union was made on March 22, 2012, prior to the filing of its application to reject the collective bargaining agreement. APFA's last counter-proposal was made on March 26, 2012, also prior to the filing of the application. No proposals were exchanged after the Company's application was filed and before the commencement of the Section 1113 hearing.

Several factors go into the "necessary" analysis.

As a threshold matter, the debtor's proposed economic modifications must be derived from a fully developed and viable business plan for reorganization. *See In re Howard's Express, Inc.* 151 F.App'x. 46, *2 (2d Cir. 2005) ("the Company ha[d] met its burden to demonstrate that each of its proposed modifications to the Agreement, both economic and non-economic, are necessary to its business plan"); *In re Delta Air Lines, Inc.*, 359 B.R. 468, 481 (Bankr. S.D.N.Y. 2006) ("labor cost reductions in Comair's business plan are necessary"); *In re Northwest Airlines Corp.*, 346 B.R. 307, 323 (Bankr. S.D.N.Y. 2006) ("In order to achieve this goal, the business plan requires the reduction in costs that the Debtors have sought").

In addition, courts evaluating the necessity of proposals under Section 1113 look to the relevant labor market to determine whether the debtors' financial difficulties are linked to excessive labor costs. *See, e.g.*, *In re Royal Composing Room, Inc.*, 848 F.2d at 350 (debtor's main competitors had lower costs); *Carey Transp.*, *Inc.*, 816 F.2d at 82, 89 ("[e]ach of the findings pertinent to [the "necessary"] inquiry... is supported by substantial evidence in the record. For instance, record evidence indicates that ... Local 807 labor costs (in contrast to other [Debtor] employees' salaries and benefits) were well above industry averages..."); *In re Northwest Airlines Corp*., 346 B.R. at 324.

Even where a debtor is "on the brink of financial disaster," proposed modifications to work rules, layoff provisions, and seniority should not be deemed "necessary" if the debtor cannot provide cost analysis justifying the financial necessity of the changes. *In re Sun Glo Coal Co.*, 144 B.R. 58, 63-64 (Bankr. E.D. Ky. 1992).

And economic modifications cannot be deemed necessary if a successful reorganization would still be likely *without* the proposed changes. *See, e.g*, *In re Express Freight Lines*, 119

B.R. at 1014 ("the court must find [that] … without [the proposed] changes, the reorganization would be unlikely"); *In re Cook United, Inc.*, 50 B.R. 561, 563 (Bankr. N.D. Ohio 1985) (modifications deemed unnecessary where operating plan still projected positive cash flow without the rejection of the collective bargaining agreement).

Moreover, cost-saving modifications will be deemed necessary generally only if the debtor can demonstrate the unavailability or impracticality of other cost-saving measures. *See, e.g.*, *Matter of Walway Co.*, 69 B.R. 967, 973, n.15 (Bankr. E.D. Mich. 1987) ("a financially troubled company should consider rejection of a labor contract a last resort to help the company survive"). Allowing modification absent such a showing would contravene the purpose of Section 1113 "to encourage collective bargaining and . . . ensure that employers cannot use Chapter 11 solely to rid themselves of unions[.]" *In re Chestnut Hill Rehab Hosp.*, L.L.C. 387 B.R. 285, 288 (Bankr. M.D. Fla. 2008). Such a failure to differentiate labor contracts from ordinary contracts would be contrary to Section 1113. S*ee Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., AFL-CIO-CLC*, 791 F.2d 1074, 1088 (3d. Cir. 1986).

B. FAIR AND EQUITABLE TREATMENT.

The debtor must prove by a preponderance of the evidence that its proposal "assures that all creditors, the debtor[s] and all of the affected parties are treated fairly and equitably[.]" 11 U.S.C. § 1113(b)(1)(A). The debtor must "spread the burdens of saving the company to every constituency while ensuring that all sacrifice to a similar degree." *In re Century Brass Prods.*, 795 F.2d at 273; *see also In re Lady H Coal Co.*, 193 B.R. at 242. The comparison between the various constituencies should "consider a group's prepetition cost reductions in determining whether that group would 'shoulder a proportional' share of the debtor's proposed cost reductions." *In re Northwest Airlines Corp.*, 346 B.R. at 325; *see also Carey Transp. Inc.*, 816

F.2d at 91; *In re Elec. Contracting Servs. Co.*, 305 B.R. 22, 28 (Bankr. D. Colo. 2003).

The "fair and equitable" requirement is primarily aimed at ensuring that the unionized employees do not bear a disproportionate share of the burden. *See In re Texas Sheet Metals, Inc.*, 90 B.R. 260, 269 (Bankr. S.D. Tex. 1988) (union should not be "singled out"); *In re Indiana Grocery Co.*, 136 B.R. 182, 194 (Bankr. S.D. Ind. 1990) (denying motion because of imbalance between cuts to union and non-union employees); *In re Liberty Cab & Limousine Co*., 194 B.R. 770, 776-77 (Bankr. E.D. Pa 1996) (ordering further negotiations because debtor failed to make "commensurate" reductions to non-union employees); *In re Garofalo's Finer Foods, Inc*., 117 B.R. 363, 375 (Bankr. N.D. Ill. 1990) (conditioning approval of proposal on similar compensation reductions for non-union employees); *In re Pierce Terminal Warehouse*, 133 B.R. at 647-48 (holding that it would not be fair and equitable to reduce union wages, but not non-union wages). Indeed, even where unionized work groups receive industry leading pay, their burden must still be proportionate. *In re Delta Air Lines, Inc.*, 342 B.R. 685, 698-99 (Bank. S.D.N.Y. 2006) (denying motion as not fair and equitable where unionized flight attendants, who were unique in receiving industry leading pay, were asked to accept 21% of the total cost reductions, but only comprised 10.5% of the payroll).

Fairness is also measured against other, non-employee, parties. "[T]he bankruptcy court ha[s] an obligation to analyze the treatment of all major creditors and other affected parties." *Mesaba Aviation, Inc.*, 350 B.R. at 460 (D. Minn. 2006). A "debtor will not be allowed to reject a union contract where it has demanded sacrifices of its union without shareholders, non-union employees and creditors also making sacrifices." *In re. Elec. Contracting Servs. Co.*, 305 B.R. at 28. Where the debtor has "failed to prove that top management and creditors are bearing an equitable burden in [its] reorganization," the Section 1113 motion must be denied. *See In re*

Indiana Grocery Co., 136 B.R. at 194–95.

C. GOOD FAITH NEGOTIATIONS.

In the Section 1113 context, good faith bargaining requires "an honest purpose to arrive at an agreement as the result of the bargaining process." *Matter of Walway Co.*, 69 B.R. at 973. Good faith is measured by an objective standard; the debtor's belief that its actions were permissible is not controlling. *Matter of GCI, Inc.*, 131 B.R. 685, 693 (Bankr. N.D. Ind. 1991).

Bankruptcy courts have found a lack of objective good faith in a variety of circumstances. In particular, a "take it or leave it" attitude in negotiations indicates a lack of good faith. *In re S.A. Mech., Inc*., 51 B.R. 130, 132 (Bankr. D. Ariz. 1985); *In re Liberty Cab & Limousine Co.*, 194 B.R. at 777. A debtor may also evidence bad faith where it insists on a total dollar amount of labor cuts, and is only willing to negotiate on the components that add up to that total, *In re Delta Air Lines, Inc.*, 342 B.R. 685 (Bankr. S.D.N.Y. 2006), or when it commits itself unnecessarily to a course of action which is unduly detrimental to unionized employees. *In re Lady H Coal Co.*, 193 B.R. at 242.

D. RELIANCE ON AND PROVISION OF COMPLETE, RELIABLE, AND RELEVANT INFORMATION.

Closely related to the good faith bargaining requirement, the second and fifth elements of the *American Provision* test relate to the quality of information relied on and shared by the debtor: the debtor's proposal must be based on "the most complete and reliable information available at the time of the proposal," and the debtor must provide relevant information to the union as is necessary for the union to evaluate the proposal. *In re Am. Provision*, 44 B.R. at 909.

The "most complete and reliable" standard "essentially bars a debtor … from making a proposal that is … arbitrary, or one where specific terms are result-driven in isolation rather than process-derived and based on actual evidence." *In re Mesaba Aviation, Inc*., 341 B.R. 693, 705

(Bankr. D. Minn. 2006).

With respect to the provision of information, the debtor must show that it specifically answered the union's questions regarding the reorganization plan. *See, e.g.*, *In re Appletree Mkts., Inc.,* 155 B.R. 431, 438 (S.D. Tex. 1993). This includes requests for business plan information and supporting models used to make financial projections. *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 715-16 (Bankr. D. Minn. 2006).

In total, the debtor must provide "sufficient information to enable [the] union to determine whether the specific concessions sought … were reasonable or necessary." *In re George Cindrich Gen. Contracting, Inc.*, 130 B.R. 20, 23 (Bankr. W.D. Pa. 1991). Thus, the information must be factually specific and substantiate the proposed concessions. *In re Jefley, Inc.*, 219 B.R. 88, 92 (Bankr. E.D. Pa. 1998); *In re George Cindrich Gen. Contracting, Inc.*, 130 B.R. at 23-34. And the debtor must provide up-to-date information throughout the bargaining process. *In re Fiber Glass Indus.,* Inc., 49 B.R. 202, 207 (Bankr. N.D.N.Y. 1985) (denying Section 1113 motion because carrier did not provide information regarding the effect of layoffs occurring between the debtor's initial proposal and the rejection hearings). Without this information, the union would be unable to evaluate the accuracy of the debtor's proposal and to thereby structure one of its own. *Matter of Walway Co.*, 69 B.R. at 973.

E. THE UNION'S GOOD CAUSE TO REFUSE.

The statute also accounts for the employees' interests by providing that even if the Debtor has satisfied all of the other elements of Section 1113, the Court must deny an 1113 motion if the union had "good cause" to refuse the proposed contract modifications. 11 U.S.C. § 1113(c)(2). The burden here is on the debtor to prove an absence of good cause: once the union has come forward with its reasons for its refusal to accept the proposal, the debtor "retains the

ultimate burden of persuading the court that the union lacked good cause for refusing proposed modifications[.]" *Carey Transp. Inc.*, 816 F.2d at 92. A union has "good cause" if it has a "well-founded reason" for its actions. *In re U.S. Truck Co. Holdings*, 165 L.R.R.M. (BNA) 2521, 2540 (Bankr. E.D. Mich. 2000). Building on other factors required by Section 1113, if a debtor's proposal is not necessary to its reorganization, or it is not fair and equitable, then it follows that the union has good cause to reject proposed modifications. *See In re Express Freight Lines*, 119 B.R. at 1017. But because the "good cause" factor is separate from the other criteria of the Code, it also follows that "good cause" may exist even if all the other factors support allowing rejection. *See, e.g.*, *Nken v. Holder*, 556 U.S. 418, 444 (2009) ("We should not lightly conclude that Congress enacted a provision that serves no function"); *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 163 (1982) ("We decline to construe the Act so as to render these provisions nugatory, thereby offending the well-settled rule that all parts of a statute, if possible, are to be given effect.") (internal citations and quotations omitted).

The Second Circuit in *Carey Transportation* emphasized that "a union's counterproposal of an equally effective set of modifications" may constitute good cause to reject a company proposal. *Carey*, 816 F.2d at 92.

F. THE BALANCE OF THE EQUITIES.

As with the "good cause" element, which operates as a limit even where all the other factors are satisfied, the Code prevents rejection unless the Court also "finds that … the balance of the equities clearly favors rejection of such agreement." 11 U.S.C. § 1113(c)(3). Debtors face an increased burden under this subsection. As one court explained, the presence of the modifier "clearly favors" suggests that a mere preponderance of the evidence will not be sufficient to meet the debtor's burden. *Matter of K & B Mounting, Inc.*, 50 B.R. 460, 467 (Bankr. N.D. Ind. 1985).

The "balance of the equities" requirement codifies the pre-Section 1113 *Bildisco* standard, and requires balancing the interests of the debtor, creditors and employees, including a comparison of each union's sacrifices. *Carey Transp. Inc.*, 816 F.2d at 88; *In re Cook United, Inc.*, 50 B.R. at 564. There are at least six such equitable considerations, many of which also apply to the other requirements of Section 1113(c). *Carey Transp. Inc.*, 816 F.2d at 93.[13] "[T]he controlling question [in balancing the equities] is whether the hardships imposed [on employees] are outweighed by a reasonable expectation of successful reorganization." *Int'l Bhd. of Teamsters v. IML Freight, Inc.*, 789 F.2d 1460, 1462 (10th Cir. 1986).

ARGUMENT

I. CONTRACT REJECTION SHOULD NOT BE ALLOWED BASED ON A PLACEHOLDER BUSINESS PLAN WHICH IS DESIGNED TO BE SUPPLANTED, AND WHICH IS INCOMPLETE, SPECULATIVE, AND INADEQUATE.

The labor concessions American demands, which are the basis for the present motion, are predicated on the needs of a business plan which the company admits is merely a placeholder or a stalking horse for a likely merger or acquisition and which, as a stand-alone plan, has failed to garner the support of any key constituent or outside analyst who is not on American's payroll. Section 1113 requires that for a labor contract to be rejected in bankruptcy, the company's proposal must be based on the most complete and reliable information; that the changes sought

[13] The equitable factors include: "(1) the likelihood and consequences of liquidation if rejection is not permitted; (2) the likely reduction in the value of creditors' claims if the bargaining agreement remains in force; (3) the likelihood and consequences of a strike if the bargaining agreement is voided; (4) the possibility and likely effect of any employee claims for breach of contract if rejection is approved; (5) 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 to those of others in the industry; and (6) the good or bad faith of the parties in dealing with the debtor's financial dilemma." *Carey*, 816 F.2d at 93.

are necessary for the successful reorganization of the debtor; that the debtor has negotiated with objective good faith and that its proposals are fair and equitable; and that the union which refuses to accede to the last pre-motion offer must lack "good cause" for doing so. The facts regarding American's business plan demonstrate that the company satisfies none of these elements here.

A. DEFICIENCIES IN THE BUSINESS PLAN REQUIRE DENIAL OF THE MOTION.

To the extent the business plan was (and remains) deficient on its own terms, the proposal is not based on the most complete and reliable information available; proposed modifications generated by that business plan are not necessary modifications … that are necessary to permit the reorganization of the debtor; and, independently, the APFA had good cause to refuse to accept the company's proposal.

1. To briefly recapitulate the key facts, rather than request labor concessions which would put labor costs at a market rate, and rather than use a market-based analysis to develop labor contract proposals, American set target financial metrics which it felt desirable to meet over the course of several years. It then accounted for projected revenue and non-labor cost changes, and concluded that there was an annual shortfall which was designated to come from employees. From this figure, specific proposals aimed at each unionized group were developed and proposed.

The operational aspects of the plan have been roundly criticized, and to date it lacks the support or endorsement of the Unsecured Creditors Committee as a basis for a plan of reorganization. As outlined above and in the testimony of Dan Akins and Leon Szlezinger, the current business plan suffers a number of substantial defects. Basically, the plan is a continuation of the failed "cornerstone" strategy, which has been in place since 2009. As such, the plan does not address the fundamental deficiencies in American's network, such as a lack of

feeder traffic from the east coast and the Company's failure to thrive in three of its five cornerstone cities. As a result, the plan fails to address adequately the root causes of American's uncompetitive position versus its larger network rivals United and Delta. The plan is also premised on volatile rates of growth, back-loaded in the final years of the model, and thus posits growth far in excess of projected demand at various points in time.

Many key elements of the plan are speculative or ill-defined. For example, the plan assumes a code-share relationship with [redacted] which is uncertain to materialize, and fraught with operational difficulties even if it did occur. In addition, although the plan assumes deployment of large numbers of new aircraft, there is no detail as to where the planes will fly beyond the identification of entire continents [redacted] or sub-continents [redacted] Although the Company has repeatedly emphasized in its Section 1113 case that the airline industry is brutally competitive, the business plan itself does not model a competitive response, either with respect to the new flying assumed or planned new product offerings. For purposes of the plan, it is as if United, Delta, and all others will stand on the side-lines while American plays catch-up. Finally, American and its advisors have not stress-tested the plan by running possible down-side or up-side scenarios through the model, largely due to a claimed lack of time to accomplish this analysis. Even a well-conceived business plan cannot be expected to hit the bulls-eye exactly. Flight Attendants are entitled to know the probable risks or rewards before being asked to make a substantial contribution to the business plan.

2. American must prove that its 1113 proposal is "based on the most complete and reliable information available at the time of such proposal." 11 U.S.C. § 1113(b)(1)(A). This requirement means that when, as here, an underlying business plan is the foundation for an 1113

proposal, and that plan is based on inadequate information, the Section 1113 motion should be denied.

The statutory language, "the most complete and reliable information available" means something, and "by definition excludes hopeful wishes, mere possibilities and speculation." *In re Karykeion, Inc.*, 435 B.R. 663, 677-678 (Bankr. C.D. Cal. 2010). "The requirement essentially bars a debtor in possession from making a proposal that is cursory or arbitrary, or one whose specific terms are result-driven in isolation rather than process-derived and based on actual experience." *In re Mesaba Aviation, Inc.,* 341 B.R. at 709; *see also In re Indiana Grocery Co.*, 138 B.R. 40, 47 (Bankr. S.D. Ind. 1990) ("[t]hough projections based on the same set of historical facts may differ, the Court believes that IGC based its proposals on the best historical data and projections it could produce at the time of each proposal").

Here, the manifest inadequacies of American's business plan establish that American fails to meet that test.

3. Independently, the flaws in the business plan are such that labor contract modifications dictated by nothing more than the plan itself are not necessary to the reorganization of American. The "necessary" requirement must be analyzed within the framework of the debtor's "ultimate future," expressly because a plan of reorganization cannot be approved unless the debtor can establish its long-term viability:

> In making the decision whether to permit the debtor to reject its bargaining agreement, however, the court must consider whether rejection would increase the likelihood of successful reorganization. A final reorganization plan, in turn, can be confirmed only if the court determines that neither liquidation nor a need for further reorganization is likely to follow. Thus, 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.

Truck Drivers Local 807 v. Carey Transp. Inc., 816 F.2d 82, 89 (2d Cir. 1987). As a result, when courts hold that a contract proposal is "necessary," the holding is based on the view that the proposal taken as a whole is required for the debtor's long-term profitability under the business plan proffered in support of the motion. *See, e.g.*, *In re Howard's Exp., Inc.* 151 F. App'x 46, *2 (2d Cir. 2005) ("the Company ha[s] met its burden to demonstrate that each of its proposed modifications to the Agreement, both economic and non-economic, are necessary to its business plan"); *In re Delta Air Lines, Inc.*, 359 B.R. 468, 481 (Bankr. S.D.N.Y. 2006) ("labor cost reductions in Comair's business plan are necessary"); *In re Northwest Airlines Corp.*, 346 B.R. 307, 323 (Bankr. S.D.N.Y. 2006) ("In order to achieve this goal, the business plan requires the reduction in costs that the Debtors have sought"). In other words, to satisfy the "necessary" requirement, the debtor must prove that its proposed modifications are necessary for it to be able to propose a confirmable plan of reorganization.

The "necessary" requirement thus cannot be satisfied when the business plan underlying the Section 1113 motion is so defective that it could not serve as the basis for a confirmable plan of organization, because the proposed changes would not increase the likelihood of successful reorganization. To establish a confirmable plan of reorganization, the Debtors will have the burden of showing that the post-rejection business plan would provide "reasonable assurance of success" and is based on "credible projections of future earnings." *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir. 1988).[14]

The requirements for confirmation of a Chapter 11 plan are set forth in 11 U.S.C. § 1129(a). The proponent of a proposed plan must prove that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization." 11

[14] The Second Circuit in *Carey Transportation* recognized the link between the 1113 necessary standard and the standards for plan confirmation. 816 F2d at 89.

U.S.C. § 1129(a)(11). The purpose of this requirement is "to prevent confirmation of visionary schemes which promise creditors and equity security holders more under a proposed plan than the debtor can possibly attain after confirmation." *Matter of Pizza of Hawaii, Inc.*, 761 F.2d 1374, 1382 (9th Cir. 1985). The Section 1129(a)(11) element is routinely referred to as the "feasibility standard." *See, e.g.*, *In re Quigley Co.*, 437 B.R. 102, 142 (Bankr. S.D.N.Y. 2010).

As a general matter, the feasibility standard is satisfied when "the plan offers a reasonable assurance of success. *See Kane,* 843 F.2d at 649; *see also In re WorldCom, Inc.,* 2003 WL 23861928, at *57 (Bankr. S.D.N.Y. Oct. 31, 2003) (the plan proponent must prove that "the Plan is workable and has a reasonable likelihood of success").[15]

The evidence supporting the feasibility showing must be objective, reliable and accurate. *See Kane*, 843 F.2d at 649 (finding a "reasonable assurance of success" based on extensive evidence of feasibility, "credible projections of future earnings," and well-researched and supported predictions regarding future costs); *In re Young Broadcasting*, 430 B.R. at 129 ("projections must not be speculative, conjectural, or unrealistic"); *In re Am. Media, Inc.,* 2010 Bankr. LEXIS 4942, at *39-40 (Bankr. S.D.N.Y. Dec. 20, 2010) (the evidence must: "(a) [be] reasonable, persuasive, credible and accurate …; (b) utilize reasonable and appropriate methodologies and assumptions; (c) have not been controverted by other evidence; (d) establish that the Plan is feasible . . . and (e) establish that the Reorganized Debtors will have sufficient funds available").

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[15] Courts have found the following factors probative: "1. the adequacy of the capital structure; 2. the earning power of the business; 3. economic conditions; 4. the ability of management; 5. the probability of the continuation of the same management; and 6. any other related matters which will determine the prospects of a sufficiently successful operation to enable performance of the provisions of the plan." *In re Young Broadcasting*, 430 B.R. at 129 (collecting cases).

Thus, if the Debtors' current business plan does not provide reasonable assurance that future liquidation or further reorganization will be avoided, then it would not satisfy either the "feasibility standard" or the "necessary" requirement. Here, since the current business plan does not provide the requisite reasonable assurance we submit that it cannot be used to satisfy the Debtor's burden of proving necessity.

4. The flaws in the business plan also gave the APFA ample "good cause" to refuse to accede to contract modifications premised on that plan. Good cause, which is a separately-enumerated factor included in the Section 1113 standard, has been defined to mean a "well-founded reason." *In re U.S. Truck Co. Holdings*, 165 L.R.R.M. (BNA) at 2540. The evidence here strongly supports the APFA's reasons to refuse to accept American's proposal: the proposal is driven by a business plan which has significant flaws, lacks the support of the Unsecured Creditor's Committee and independent analysts, and which the APFA's experts have advised is unrealistic. No one else has bought into the Company's plan, and the flight attendants cannot be assailed for declining to be the first to do so simply because the Company has threatened contract rejection.

B. THIS PLACEHOLDER PLAN CANNOT BE THE BASIS TO ALLOW REJECTION.

Independently, to the extent the business plan is simply a placeholder or stalking horse for a merger transaction, and even if the stand-alone plan was unassailable as a business matter, the motion should be denied because the refusal to consider or await development of viable alternatives such as a merger, which would not involve such draconian cuts to employees, renders the proposal made not "fair and equitable" under the Code and similarly tilts the balance of the equities against granting the motion. In addition, since a merger or similar consolidation, either during or after the bankruptcy, would fundamentally change the business model going

forward, it cannot be said at this stage that the modifications based on the business plan are necessary to reorganize. Moreover, both the APFA's counter-proposals to American and the prospect of a merger (either with US Airways and including the extant term sheet, or otherwise) gives the APFA ample "good cause" to refuse the Debtor's current proposal.

1. The record establishes that while developing its current business plan, the Company studiously avoided consideration of the obvious strategic alternative: merger or consolidation with another carrier. At the outset of the case, American took the position that a merger or consolidation should be considered only after emerging from bankruptcy. Tr. 4/26/12, 71:21-72:2 (Dichter). Carrying out that mandate, American's consultants and advisors did not look to merger or acquisition options when developing the business plan. Tr. 4/26/12, 69:15-18 (Dichter); *see also* Tr. 4/26/12, 111:19-23 (Resnick). Rather, the Company chose to develop a stand-alone plan which, upon emergence or before, might well be replaced by a merger or consolidation. Thus, from the beginning, and underlying all of the changes requested in the Section 1113 motion, the Company has sought to lock its represented employees into six years of contract terms which are predicated on a business plan with a much shorter shelf-life, a temporary business plan which is in fact designed as a transitional platform to a much larger and more profitable merged airline.

The potential shelf-life of the business plan became even shorter as events unfolded after the Section 1113 motion was filed. While American initially claimed it was not going to consider a merger until after this case was completed, US Airways, touted by many as the logical merger partner, approached the APFA and the other organizations and negotiated term sheets which would be far superior to employees than what American has offered, to become effective in the event of a merger and without the unnecessary injury and tumult of contract rejection in

the interim. When US Airways approached American Airlines directly to propose a transaction, American publicly rebuffed the idea. However, and tellingly, the Company's position on the timing of merger has shifted. Before, the Company's view was that it would emerge from bankruptcy with a stand-alone business plan and only then entertain and/or seek out merger opportunities. Now, faced with US Airways, CEO Horton has said that: "whether American will choose to pursue any combination down the road … is the charge of the board of directors and the leadership team to be done *in close collaboration with the creditors committee*." APFA Ex. 5 (emphasis added). And the hearing testimony confirmed that it was "likely" that a merger and similar transactions would be explored during the bankruptcy in order to fulfill "the debtor's obligation … to maximize value for stakeholders." Tr. 4/25/12, 134:10-22 (Resnick). In other words, consolidation is no longer off the table until after reorganization. The Company's experts also testified that it was possible that alternatives to the stand-alone plan could require less in labor-cost reductions. Tr. 4/25/12, 177:20-23 (Resnick). However, rather than develop labor contract terms which mesh with and support the actual reorganization plan that eventually emerges, the company continues to press ahead to seek rejection of the existing contracts based on a proposal driven entirely by the metrics of the placeholder plan.

2. American's insistence on a stand-alone plan, with its attendant 20% cuts to labor costs, and its refusal to consider (prior to seeking rejection) a merger or consolidation which could generate business synergies and lessen the requested sacrifices, fails the "fair and equitable" and "good faith" elements of Section 1113. *In re The Lady H Coal Co*., 193 B.R. 233 (Bankr. S.D. W. Va. 1996). In *Lady H Coal,* the debtors, which were party to a collective bargaining agreement with the United Mine Workers of America, committed themselves to an asset sale (subject to bankruptcy court approval) to a purchaser which refused to assume the

agreement or enter into a new one with the union. The court found that "little effort was made" by the Debtors to secure such agreement, and that only after the sale agreement was made did the Debtors seek to modify the collective bargaining agreement and to then reject it. *Id.* at 239, 241. This sequence of events, the court held, violated the duty to negotiate in good faith, and also precluded a finding that the company's contract proposals were fair and equitable. With respect to good faith, "the Debtors could not have bargained in good faith as the Debtors were, prior to any negotiations with the union, locked into an agreement where the purchase was not assuming [the labor contract] …. Further, there is evidence … that the officers did not pursue a possible sale to another buyer who was willing to assume" the labor contract. *Id.* at 242.[16]

Similarly here: American committed itself at the outset to a stand-alone business plan which by its own devising "required" the cuts it seeks from employees, refusing to pursue or even consider the merger alternative prior to seeking contract rejection. This course of action precludes a finding of objective good faith or fair and equitable treatment.

3. The real prospect of a merger or similar transaction also precludes the Debtors from meeting their burden of proving that the changes it sought are "necessary modifications … that are necessary to permit the reorganization of the debtor." 11 U.S.C. § 1113(b)(1)(A). At this stage of the case, with the Company itself now in the process of considering, during the bankruptcy case, a business plan which includes a merger or similar transaction, and conceding that such a plan might involve less drastic labor cost cuts, it cannot realistically be said that the contract changes dictated by the stand-alone plan are necessary to reorganization. It appears that reorganization, when that becomes a more concrete eventuality, may well involve a merger

[16] It should be noted that "good faith" in the Section 1113 context is measured objectively, and not subjectively. *See Matter of GCI, Inc.*, 131 B.R. 685, 693 (Bankr. N.D. Ind. 1991).

partner and substantially different contract terms than proposed by American. If US Airways is a merger partner, then we already know that it has agreed to much more favorable contract terms paid for by the projected savings and growth from a combined operation. Now is simply not the time to determine whether or not the changes from a stand-alone plan are the changes which will be needed to reorganize or which would even facilitate reorganization.

American may argue that it would prefer to have contract rejection in hand before negotiating with a merger partner, on the ground that this would provide greater bargaining leverage. The Company's advisor and expert witness, Mr. Resnick from Rothschild, testified, however, that alternative plans could be modeled against the stand-alone plan without having the stand-alone plan fully implemented. Tr. 4/25/12, 183:2-19 (Resnick). And while Mr. Dichter from McKinsey opined that having an implemented stand-alone plan would give more "power" in merger negotiations (Tr. 4/26/12, 69:24-70:21 (Dichter)), Section 1113 "necessity" has never been held to be satisfied through a proposal which simply provides the additional bargaining leverage to the company vis-à-vis outsiders. Nor could it: whether a Section 1113 proposal is "necessary" must be tested against "what the debtor needs to attain financial health," *Carey Transp.*, 816 F.2d at 89, not whether new terms would simply provide the company with a marginally preferable bargaining position.[17]

4. The placeholder status of the current stand-alone plan also provides good cause for the APFA to decline the Company's requested contract changes. The Company seeks to lock in essentially permanent contract changes, linked to a business plan which itself appears likely to

[17] In addition, the underlying fact of the matter is that contract rejection would not achieve that result – the debtors would still have to have ratified labor agreements to be in the more desirable bargaining position of having an implemented business plan since the plan itself is predicated upon consensual agreements. Tr. 4/25/12 128:23-129:2 (Resnick).

change, and to change relatively soon. Likewise, a rejection order now could not be reconsidered in light of later developments. *In re Northwest*, 366 B.R. 270, 272 (Bankr. S.D.N.Y. 2007). There is ample reason for APFA to await the outcome of the Company's merger consideration before committing to these terms.

II. AMERICAN'S SECTION 1113 PROPOSAL TO APFA IS NOT BASED UPON MARKET RATE COMPARISONS, AND INSTEAD IS DERIVED FROM ESSENTIALLY ARBITRARY FINANCIAL METRICS RESULTING IN PROPOSED CONTRACT TERMS FAR BELOW PREVAILING MARKET RATES.

American's motion should also be denied because the contract changes it has sought from flight attendants – based on target financial metrics rather than a market-based analysis of labor costs - would unnecessarily put its labor costs so far below the relevant market as to be inequitable. No non-labor party is being asked to accede to such below market demands.

Market-based rates represent the proper standard in this case for determining whether the contract changes proposed to Flight Attendants are fair and equitable and necessary to a successful reorganization. First, in the ordinary course of its business and in its prior restructuring, American has relied on market-based comparisons to set labor terms. The 2003 concessions were based on the relevant labor market costs. Similarly, in pre-bankruptcy negotiations, American steadfastly maintained that its goal was to obtain a contract based on market rates in order to close a labor cost gap between it and its network carrier competitors. American's methodology for market rate comparisons was reflected in its convergence analysis, which seeks to superimpose competitor terms of employment for flight attendants upon American's workforce. And even post-petition, American and its advisors have continued to endorse the convergence analysis as the most accurate means of comparing employees' terms and conditions of employment.

Consistent with that approach, the Section 1113 proposals made to employees at AMR subsidiary American Eagle are predicated on market-based rates. Tr. 4/24/12, 125:4-126:9 (Goulet). American Eagle management explained to the unions on that property: "Using a 'bottom up' method, we compared the wages, benefits, longevity and productivity of each labor group at Eagle to its counterparts at Republic and Pinnacle." APFA Ex. 849 at 33. "This analysis resulted in a $75 million labor cost disadvantage at Eagle." *Id*. In turn, Eagle management apportioned the proposed cuts relative to the purported "gap between [each] group's costs vs. the comparable workgroup at these competitors." *Id*. at 32.

In addition, the thousands of other stakeholders who will renegotiate contracts in the course of this bankruptcy will not be expected to accept less than market-based rates. Tr. 4/24/12, 183:25-184-7 (Goulet). Accordingly, throughout this case, including during these Section 1113 proceedings, the Unsecured Creditors Committee ("UCC") has consistently recognized that the touchstone for cuts made in the bankruptcy process should be achieving market-based costs, whether for unionized labor or other interested parties. In its opening statement in this matter, the UCC reiterated that Debtors need to obtain a "revenue and expense structure" that is "aligned with their principle competitors." Tr. 4/23/12, 113:2-7 (Butler). The UCC also noted that to this point no "consensual resolution has been reached that results in market-based collective bargaining agreements." *Id*., 113:11-17. In prior proceedings related to American's non-union Passenger Service Agents, the UCC similarly stressed the need for "market-based revenue and cost structures," including "market-based collective bargaining agreements." Objection to PSA Motion (Doc. No. 1789), at 4, 5.

In fact, even in the context of this Motion, American accepts that its proposals should result in competitive contracts relative to its peers (although the Company fails to establish that

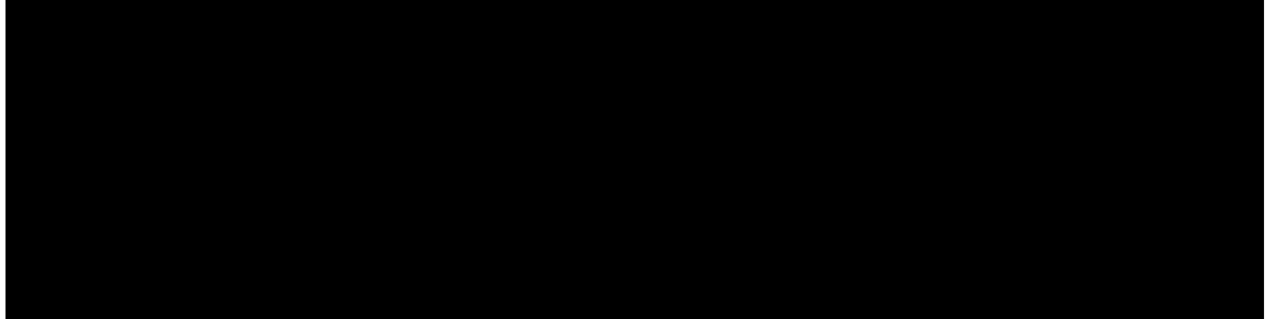
its proposal to the Flight Attendants will have such an effect). In filings before this Court, American has stated that a "competitive cost structure" is the needed contribution from unions for a successful reorganization. For example, the Debtors stated that they "have always made it abundantly clear that labor costs must be reduced across-the-board for all employees–both union represented and non-represented–in order to achieve a competitive cost structure and resultant economic viability." Objection to PSA Motion (Doc. No. 1794), at 16.

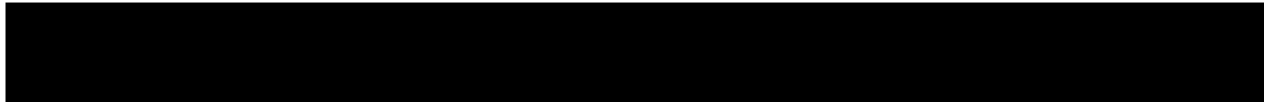
Despite acknowledging that competitive costs are the appropriate goal in Section 1113, it is clear from the record that American did not arrive at its labor cost reduction target through an analysis of competitive market rates or costs. Instead, American's target for Flight Attendants was derived solely from the business plan, and most specifically the financial metrics selected for the plan, particularly the targeted EBITDAR. Tr. 4/24/12, 100:8-101:14 (Goulet); Tr. 4/26/12, 195:6-24 (Brundage); Tr. 4/27/12, 93:7-16 (Vaughn). In contrast to American's widely relied upon methodology for determining competitive labor costs, the process for selecting the EBITDAR and other financial targets was essentially arbitrary. Rothschild presented American's management with a wide range of possible targets – spanning ███ basis points from highest to lowest. Although Rothschild ranked the targets as high, middle, and low range comparators, the firm made no recommendation to management as to the appropriate target to select. Tr. 4/25/12, 95:9-14 (Resnick).

The comparator set also included several LCCs with far higher EBITDAR targets than any of the comparator network carriers included in the data set.[18] In fact, in Rothschild's view, the LCCs represented the high end of the range of options under consideration. Nevertheless, the management team headed by Beverley Goulet selected an EBITDAR target above all other

[18] As American's expert Mr. Glass testified, the LCCs are not proper comparators for American. Tr. 4/24/12, 23:2-8 (Glass).

network carriers and at the high end of the middle range identified by Rothschild. It is also significant that the EBITDAR target was selected based upon comparisons for 2013, the first full





concessions needed from labor to satisfy this financial metric. Moreover, American has presented no evidence that it could not successfully reorganize with a lesser EBITDAR target and other financial metrics.

This approach warrants denial of American's motion. Section 1113 does not permit the debtor to make "a proposal that is cursory or arbitrary or one whose specific terms are result-driven in isolation rather than process-derived and based on actual experience." *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 709 (Bankr. D. Minn. 2006). American's use of self-selected financial targets to drive its labor ask is simply a top-down, result-driven process. This process stands in stark contrast to the bottom-up reliance on market-based rates to determine an appropriate labor ask, such as the approach followed at American Eagle. Similarly, simply picking a number from a wide-ranging data set must be contrasted to deriving market rates through a consistently used and widely recognized methodology for costing labor contracts.

In addition, absent a showing of dire necessity and potential liquidation, courts have not endorsed as "necessary" proposed labor cost cuts which go as far below market as American's

proposal. *Compare In re Northwest Airlines Corp.*, 346 B.R. 307, 330 (Bankr. S.D.N.Y. 2006) (finding it appropriate for Northwest to base proposals on comparison with US Airways/ America West rather than previous comparison to with United Airlines), *and In re Mesaba Aviation*, 341 B.R. 693, 751, 757 (Bankr. D. Minn. 2006) (appropriate to propose cuts which would make union employees "very low paid, as compared to their colleagues elsewhere in the industry", when evidence showed that the company "will not survive as an operating airline if it does not get the total reduction" it sought).[19]

To be sure, and despite the fact that the targeted labor cost reductions were not arrived at through the analysis of market labor rates, American has suggested that its top-down approach has nevertheless resulted in market competitive rates. However, the evidence presented simply does not sustain this argument. Relying on the work of Daniel Kasper, American asserts that its labor compensation overall is 20% above market and suggests that the 20% across-the-board reduction sought from labor is related to this analysis.[20] Mem. Supp. Mot. Reject, Part One, at 46, 61. But reliance on Mr. Kasper in this regard is not warranted. Mr. Kasper's methodology for comparing labor costs is different from the methodology consistently used and endorsed by American. As is appropriate, American's methodology accounts for scheduled contractual increases in Flight Attendant compensation going forward, as well as differences in the workforce demographics at different network carriers. In contrast, Mr. Kasper's analysis is

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[19] Similarly, in determining whether the equities "clearly favor" rejection, the Court must look at "how various employees' wages and benefits compare to others in the industry." *Carey Transp.*, 816 F.2d at 93.

[20] Mr. Kasper's 20% figure reflects compensation for all American employees, and is not limited to Flight Attendants. In analyzing Flight Attendant costs, which includes costs beyond compensation (an analysis which we believe is flawed for the reasons indicated above), Mr. Kasper concludes that American's Flight Attendant costs are 17.8% above other network carriers.

based on a single snap-shot in time (*i.e.*, the third quarter of 2011) and makes no allowance for differences in demographics or operations among carriers.[21] At trial, some of American's witnesses also suggested that once labor cost reductions were set by the demands of the business plan metrics, those target reductions were then assessed against market comparators. However, the testimony of American's witnesses in this regard was vague, at best. *See* Tr. 4/24/12, 79:19-80:18 (Dichter) (McKinsey evaluated whether labor cost reductions placed American "significantly higher" or "significantly below" peers); Tr. 4/27/12, 93:7-16 (Vaughn) (looked at competitors to determine that American was not "off the charts" or "way out there"). Tellingly, however, despite producing over 6,500 pages of material in support of its Motion, American has not provided the Court with a single document reflecting American's purported after-the-fact analysis of competitor costs and thus there is no record whatsoever regarding the methodologies used or results analyzed.[22]

[21] Mr. Kasper's analysis also suffers from other substantial defects. To the extent that Mr. Kasper relies on labor CASM comparisons, one of American's other experts, Jerrold Glass, testified that airlines do not typically consider such comparisons determinative in comparing their contract terms to those at other carriers. Tr. 4/24/12 2-18:5-8 (Glass). Mr. Kasper's treatment of United and Continental as a single unit for purposes of comparison (*see, e.g.*, AA Ex. 0058) also puts him at odds with Mr. Glass's opinion that since these two carriers continue to operate separately at present, they should be considered separately in terms of labor comparisons. Tr. 4/24/12 22:9-13 (Glass). Finally, Mr. Kasper's mix of weighted and simple averages even within the same chart is methodologically unsound. Tr. 4/23/12 198:2-5 & 1-200:8-24 (Kasper).

[22] These reports have also not been produced to the APFA's standing request for "All documents concerning any analysis of American's labor costs or labor cost benchmarking, including any comparison of American's labor costs with the labor costs of any other Airlines, which were prepared or received by one or more members of the Executive Group since January 1, 2008." AA Ex. 1595, Attachment A at 3. In fact, in response to a March 6 request for "all documents concerning any analysis prepared since January 1, 2011 of American's Flight Attendants labor costs or labor cost benchmarking," the Company stated that "there are no documents responsive to your request[.]" AA Ex. 1648.

In this case, the relevant market for determining Flight Attendant costs has been previously defined by American itself, as has the appropriate methodology for making market comparisons. The relevant market consists of the other large network carriers: Continental (which is in the process of merging its workforce with United's), Delta, United, and US Airways. These are the airlines to which American has consistently compared itself in terms of analyzing its labor cost gap over the preceding years. The appropriate methodology for making comparisons to this peer group is the one consistently used by American for this purpose – the market-based convergence analysis. American's expert Mr. Glass too agreed that this is the appropriate approach and one that he has used many times both in restructuring cases and other labor relations contexts. Tr. 4/24/12, 14:7-15:13 & 82:13-17 (Glass).

Applying this methodology to compare American's Section 1113 proposal to the relevant market shows that the proposed contract changes will place Flight Attendants far below their market peers. As economist Daniel Akins demonstrates in his testimony, even under the current contract without change, the Flight Attendant labor cost gap between American and its peers will disappear by 2013. APFA Ex. 700 (Akins Decl.), ¶¶ 79-80, 85. Under American's Section 1113 proposal, Flight Attendant compensation would be pushed $176 million below market competitive rates in 2012. *Id.* ¶ 86 & Chart 25. By 2015, this differential would increase to $347 million or approximately 30% below industry. *Id.* Thus, the proposed 20% reduction in Flight Attendant costs would severely disadvantage Flight Attendants relative to their peers. Such a result is neither fair nor equitable considering that no other stakeholders in this proceeding are expected to accept terms inferior to market-based rates.

III. AMERICAN HAS FAILED TO PROVIDE RELEVANT INFORMATION NECESSARY FOR APFA TO EVALUATE ITS PROPOSAL.

American's obligation to produce all relevant information, as with all of the Section 1113 "prerequisites[,]" arises out of the statute's "aim[] at facilitating consensual modifications to collective bargaining agreements." *In re Northwest Airlines, Inc.*, 346 B.R. 307, 321 (Bankr. S.D.N.Y. 2006). This nexus has been most clearly summarized as follows:

> If the statute is to operate as intended, the provision of the information has an additional function, dovetailing into the broader congressional purpose of fostering consensual resolution before presentation to the court. That is to enable a union's representatives and members to subjectively attach some bedrock legitimacy to a debtor's proposal—to convince them that the process of formulating the proposal was not arbitrary, not "loaded" toward a particular result, not manipulated to produce an unfair allocation of burdens among the constituencies to the bankruptcy case.

In re Mesaba Aviation, Inc., 341 B.R. 693, 715 (Bankr. D. Minn. 2006).

While American may point to its production of a "terabyte" of information to the unions, (Tr. 4/24/12, 108:1-3 (American Counsel)), it has failed to comply with this key statutory duty in at least two fundamental ways. First, American has failed to provide sufficient information for the APFA to evaluate the burden that will be imposed on other interested parties and thus whether the Section 1113 proposal would "produce an unfair allocation of burdens." *Mesaba*, 341 B.R. at 715. Second, the Company has failed to provide its pre-bankruptcy business plan, which is needed so that the APFA can evaluate whether the Company's dramatic post-petition change in its labor negotiation position is truly necessary and not arbitrary. The motion should be denied because American has failed to satisfy its burden to produce all relevant information.

A. INFORMATION REGARDING ALLOCATION OF BURDENS.

Section 1113 requires that American's proposal must "assure[] that all creditors, the debtor and all of the affected parties are treated fairly and equitably." 11 U.S.C. § 1113(b)(1)(A).

It has thus been a key goal of the APFA to learn and understand what contributions management and other non-union employees, as well as outside contractors, vendors, and lessors will make towards a successful reorganization. Unfortunately, despite repeated requests, key information has been withheld for months, such that the APFA has not been able to discern what sacrifices will be made by the non-union parties.

While the Company pledged broadly that the costs of non-union employees and management will be reduced by 20%, that forecast was not supported by information detailing how the 20% reductions would be achieved or costing the value of employment changes that will be made to meet the 20% target. APFA Ex. 837. Indeed, American has even ignored APFA's request for information regarding the valuation and costing methodology for how it will value the furlough pay that will be received by employees laid off in all other work groups. APFA Ex. 8. Moreover, APFA's repeated requests for information regarding the specific treatment of the non-union employees were refused. *See, e.g.*, APFA Ex. 817 at 4. Likewise, although American has stated that it intends to achieve "significant savings from the renegotiation of contracts with vendors or the rejection or renegotiation of facilities leases[,]" APFA Ex. 818 at 52, it has not identified the specific sources of proposed cuts, APFA Ex. 842. The APFA was thus prevented from developing its own valuations of the proposed treatment of these parties.

As the Company's expert witness Mr. Glass explained, labor and management routinely have legitimate disputes regarding the valuation of proposed cuts. Tr. 4/24/12, 13:19-23 (Glass). The standard practice in other airline bankruptcies has thus been for the company to treat reductions for management and non-contract employees with transparency, including providing the costing valuation methods for savings achieved from these groups. APFA Ex. 700 (Akins Decl.) ¶ 93. These airlines have plainly recognized an obligation to provide sufficient

information to demonstrate that the sacrifice of other employees will be "fair and equitable." American's deviation from this standard practice is grounds for denying the Motion. *See Mesaba*, 341 B.R. at 715 (denying Section 1113 motion because airline-debtor failed to provide information that "industry-wide experience establishe[d] …. [was] 'relevant information as is necessary to evaluate' an employer's proposal for concessions from a union").

American acknowledges the central role of transparency in these labor negotiations. Tr. 4/26/12, 233:23-234:15 (Brundage). Transparency is particularly essential in this case because of management's behavior in 2003. During the last round of labor concessions, management extracted $1.8 billion from its unionized employees in the name of "self-sacrifice," and immediately utilized some of the savings to pay themselves generous bonuses. Transparency is thus of utmost importance here, and American, at minimum, had an obligation to provide an equivalent amount of information regarding the treatment of non-represented and management employees as previous airlines have during Section 1113 negotiations.

As of the filing of its Section 1113 Motion, American had not disclosed any specifics regarding cuts for management and other employees that are not represented by a union.[23] The Company had merely promised to "target" a 20% reduction in their annual costs, specified the portion which will be due to reductions in benefits, APFA Ex. 837, and generally claimed that

[23] Although the Company provided more information regarding these groups on April 18, this evidence cannot be considered by the Court for purposes of determining whether American has shown its proposed labor cuts are "fair and equitable." *See Teamsters Airline Division v. Frontier Airlines, Inc.*, 2009 WL 2168851, *11 (S.D.N.Y. July 20, 2009) ("this Court concludes that the timing clause in subsection (b)(1) limits review of a debtor's disclosure effort to the time period 'prior to filing an application seeking rejection.'") Moreover, the disclosure of information at the hearing may actually demonstrate that the Company failed to satisfy the pre-petition requirement. *Id.* at *13 ("It may be that post-hearing disclosure could shed light on the adequacy of pre-motion disclosures."). Even if post-application disclosure were relevant, the cutoff would have to be the start of the hearing, and disclosures made after the commencement of the hearing cannot cure the failing.

their cuts will be based on "the Business Plan and competitive landscape." APFA Ex. 817 at 6. Unlike with the unionized groups, American did not provide term sheets specifying the remainder of the proposed cuts, or its methods of valuation.

Management costs will purportedly be reduced by $165 million annually. This includes $58 million in savings arising from a reduction in employee retirement and medical benefits, but the rest of the savings have not been specified. APFA Ex. 837. However, there will be no reduction in the compensation levels for the Management employees. AA Ex. 600 (Wright Decl.), at 60. Instead, the remaining savings will purportedly come from a "cascade" project intended to thin the management ranks that is not scheduled to be completed until "late summer" 2012. APFA Ex. 835 at 1, 2. But any long-term, high-level management employee that is laid off will receive an entire year of pay. APFA Ex. 830. It is unknown how this severance cost (or anything else) is calculated into the targeted savings because American has refused to provide APFA with specific term sheets or valuations for the Management employees, even though such information is apparently available.[24]

American did not explain how it will achieve $95 million in annual savings from its unrepresented Passenger Service workgroup. Unlike with its unionized employees, American's position is that it may unilaterally reduce its costs for these employees. Objection to PSA Motion (Doc. No. 1794), at 16. As of filing the Section 1113 Motion, American had only

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[24] In fact, it appears that American has withheld material information regarding the valuation methods underlying its proposed management cuts. The "cascade" project is being overseen by Boston Consulting Group ("BCG"), which apparently has developed and valued various methods to achieve the purported 20% target. BCG's First Monthly Fee Statement includes an entry dated February 27, which states "create slides on various approaches to setting cost reduction targets." Doc. No. 2072 at 28. American, however, has refused to provide the specific valuation model to the APFA. APFA Ex. 817 at 5. Additionally, the Company has ignored the APFA's request for information regarding how furlough pay will be valued. APFA Ex. 8.

disclosed that $40 million of the cuts will come from a reduction in their benefits. APFA Ex. 837. As to the remaining $55 million, American explained "the remainder of the changes are being evaluated and will be shared once they are announced." *Id*. The reason for the delay was American's unilateral decision to hold "Restructuring Forums" in order to receive "input and ideas through an online feedback process" from the Passenger Service employees. APFA Ex. 817 at 4. The results of this process were disclosed in "Fact Sheets" posted by the debtor on April 18. APFA Exs. 834 and 835. But these Fact Sheets were not supported by valuations until after the hearing began, unlike the proposals made to the unions.

American rebuffed the APFA's requests by claiming that it could not provide information regarding the contributions of other parties because it is still finalizing how these parties will be treated. APFA Ex. 817 at 4. But this explanation is non-responsive. The APFA requested information regarding the current specific plans for these parties, *id*., as well as the methodology that would be used to evaluate the final cuts, APFA Exh. 8. The answers to these questions were not dependent on final decisions.

American also withheld from the Union key information regarding the planned treatment of vendors and lessors. The APFA requested information regarding pre-bankruptcy projects that were undertaken to achieve savings from vendors and lessors, as well as post-bankruptcy plans regarding these parties, AA Ex. 1569 at 19, so that it could determine whether they will contribute fairly and equitably to the restructuring. In response, American merely provided a summary graph displaying annual percentage changes in total supplier costs over the past decade. APFA Ex. 842. Ms. Goulet testified, however, that the Company had "identified probably well north of 10,000 contracts that will be addressed in the course of this bankruptcy,"

and that "the company prepared a list of the projects that they intend to pursue or are pursuing with regard to non-labor costs." Tr. 4/24/12, 179:20-22 & 183:10-13 (Goulet).

Material information regarding the treatment of management, non-union employees, and contractors was not disclosed prior to filing of the Section 1113 Motion. Most importantly, despite the well-established practice regarding disclosure identifying and valuing management cuts, and the warranted skepticism that the APFA has of blanket promises of equitable treatment, the Company has failed to provide this information. The statute prohibits American's attempt to push through the rejection of the APFA's collective bargaining agreement without a sufficient pre-motion demonstration that other parties will share fairly and equitably in the burden.

B. INFORMATION REGARDING THE PRE-PETITION BUSINESS PLAN.

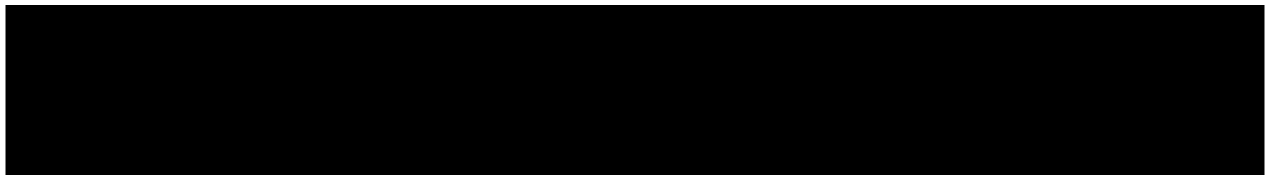
Separately, the Company has failed to provide information regarding its pre-petition business plan sufficient for the APFA to determine whether American was justified in changing its negotiation position so significantly since filing for bankruptcy. Without this information, the APFA is unable to determine that the proposed cuts are not arbitrary, but are in fact necessary. *Mesaba*, 341 B.R. at 715.

As explained above, in the short time between November 2011 and presenting its post-petition proposals on February 1, 2012, the Company dramatically changed its negotiation position for all represented employees. And although American claims in its brief that its change of position occurred because projected "'convergence' did not occur, the economy has remained weak and at risk, and fuel has reached and remained at historically high levels" (Mem. Supp. Mot. Reject, Part One, at 58), these factors have not changed since November 2011, when the Company was still endorsing a business plan that included increasing its labor costs. *See* APFA Ex. 802 at 35-51. Thus, these factors do not explain American's fundamental change in its

negotiation position, which was in fact based on a change in business plan. Tr. 4/24/12, 100:8-101:14 (Goulet); *see also* Tr. 4/25/12, 42:16-25 (Resnick) (pre-petition proposals "were important to the company's viability going forward if you looked at the business plan that existed at the time.")

And while American has provided information regarding its *current* business plan, it has refused to provide information regarding the immediate pre-petition business plan. Recognizing this was essential information to determine whether the level of cuts sought are truly necessary, the APFA specifically requested "[a]ll strategic or business plans" prepared by the Company or its advisors since 2007. AA Ex. 1569 at 3. The most responsive information that was provided regarding the pre-petition business plan was contained in January and November 2011 presentations to the AMR Board of Directors. APFA Exs. 804 & 850. But unlike the presentation made in support of the Company's post-petition Business Plan, APFA Ex. 818, these presentations do not explain how the Company arrived at its financial targets, or how American planned to achieve those goals.

This information, however, plainly existed. For example, Ms. Goulet testified that the Company's pre-petition financial models were capable of assessing American's position vis-à-vis other airlines according to EBITDAR and other financial metrics. Tr. 4/24/12, 214:13-19 (Goulet); *see also* Tr. 4/25/12, 38:10-17 (Resnick) (testifying that the Company had a comprehensive business plan when he began his engagement in late October, 2011); Tr. 4/26/12,



management devised and endorsed both plans, a comparison of the two regarding the difference

in revenue and other expense assumptions must be undertaken.

American's refusal to provide this information foreclosed the ability of the APFA to evaluate whether the Company's drastic change in negotiation position is supported by the changes in its business plan. American has not provided the baseline business plan that the union needed to understand the source of the Company's change in position. American has thus failed to satisfy its burden of providing sufficient information to establish its proposal's "bedrock legitimacy," *Mesaba*, 341 B.R. at 715, and its motion should therefore be denied. *See, e.g.*, *In re George Cindrich Gen. Contracting, Inc.*, 130 B.R. 20, 23-34 (Bankr. D. W. Va. 1991) (denying Section 1113 motion for failure to provide sufficient information even though "[t]here is reason to expect that debtor will not be able to successfully reorganize if it must comply with the terms of the present collective bargaining agreement"); *In re Fiber Glass Indus.,* Inc., 49 B.R. 202, 207 (Bankr. N.D.N.Y. 1985) (denying Section 1113 motion for failure to provide sufficient information even though "[i]t may be that [the company] is correct in [its] contention that without substantial modification of this contract, the debtors face liquidation").

IV. REJECTION WOULD HAVE AN UNDUE NEGATIVE IMPACT ON FLIGHT ATTENDANTS, OTHER CREDITORS AND INTERESTED PARTIES, AND ON THE PROSPECTS FOR A SUCCESSFUL REORGANIZATION.

Finally, the motion should be denied because permitting rejection of the APFA's collective bargaining agreement would have an undue negative impact on Flight Attendants above and beyond the business needs of American; could lead to business disruptions in the event of a National Mediation Board release; and would adversely impact the prospects for a successful reorganization. These impacts defeat American's claim that the balance of equities strongly favors rejection. To the contrary, the equities favor denial of the motion.

1. As set forth in more detail above, rejection of the collective bargaining agreement would have a significant negative impact on American's Flight Attendants. Over 2,000 Flight Attendants would lose their jobs in furloughs. Unlike every other work group, these employees would receive no severance payments. Those Flight Attendants who are not laid off would incur a 16.9% reduction in take-home pay and many would also have to work years longer to maintain their currently expected retirement income. Retirees would be forced to spend up to 74% of their pension income to obtain pre-Medicare coverage for health care in retirement.

In addition, while the Company calculates that its Section 1113 proposal to APFA, if implemented in full, would yield $230 million in annual savings, it has stated that if allowed to reject it will *not* implement various measures which would cost it money (including annual wage rate increases, matching 401(k) contributions, and profit sharing). The flight attendant wage rate increases alone were projected by the company to cost it an average of [redacted] million per year, Tr. 4/26/12, 220:20-221:9 (Brundage); and the 401(k) contributions were projected to cost it [redacted] million per year, AFA Ex. 300 (Condrick Decl.) at ¶ 10. Rejection would provide the company with a windfall of at least those amounts, which is above and beyond what even the company claims it needs going forward.

2. Rejection could also be the unfortunate next step toward a release by the National Mediation Board ("NMB") and a potentially disruptive and costly period of "self help" under the Railway Labor Act ("RLA"). The APFA fully acknowledges the Second Circuit's ruling in the *Northwest Airlines* case that an order permitting contract rejection under Section 1113 does not in and of itself necessarily trigger a right by employees to strike or otherwise engage in job action. *See In re Northwest Airlines*, 483 F.3d 160, 175 (2d Cir. 2007). But the court also held that after rejection, the parties have an ongoing "duty to 'exert every reasonable effort' to make a

new contract," specifically including the process of mediation under the auspices of the NMB. 483 F.2d at 175; *see also id.*, at 177 (advising the company to return to the NMB after rejection and strike injunction). The NMB mediation process is one of the statutory steps in the negotiation of collective bargaining agreements, 45 U.S.C. § 155, First, and here the APFA and American have been in mediation since 2009. NMB mediators have been at the table and involved throughout the Section 1113 negotiations.

Under the RLA, it is within the nearly unreviewable discretion of the NMB to decide whether and when, after mediation has proven unsuccessful in reaching an agreement, to "release" the parties from mediation. *See IAM v. NMB*, 930 F.2d 45, 48 (D.C. Cir. 1991). After a statutory "cooling off" period during which no action may be taken by either party, a release can trigger the right to engage in relatively unfettered "self-help" including full-blown or intermittent strikes. *See Pan American World Airways, Inc. v. Int'l Bhd. of Teamsters*, 894 F.2d 36 (2d Cir. 1990); *Ass'n of Flight Attendants v. Alaska Airlines*, 847 F. Supp. 832 (W.D. Wash. 1993). A strike following release by the NMB would not be contrary to Section 1113 or to the Second Circuit's holding in *Northwest*; rather, it would be the logical outcome of the RLA process should matters proceed to that point.

3. Contract rejection will also not advance the process toward a confirmable plan of reorganization. American has acknowledged that "it cannot exit Chapter 11 or compete effectively without" agreements with its unions. Mem. Supp. Mot. Reject, Part One, at 6; Tr. 4/25/12, 129:3-22 (testifying that the capital markets would evaluate whether American had achieved "labor peace"). Rejection, of course, does not produce a ratified agreement, and there is reason to believe in this case that rejection under these circumstances would not soon yield one. To the contrary, the Company's single-minded insistence on pursuing a "stand-alone plan"

which uses immediate and severe labor cost cuts as a negotiating chip to court potential merger partners, knowing full well that the real business plan for emergence from bankruptcy may not require the depth of cuts sought now, would only hinder the prospect of reaching a ratified agreement following rejection. Rejection, we submit, would set the process back, not move it forward.

Given these consequences of rejection, the Court should conclude that the balance of the equities does not clearly favor rejection. This element of the Section 1113 test includes an analysis of whether or not denying the motion will likely lead to liquidation; whether or not granting the motion will reduce the value of creditors' claims or result in a damaging strike; the extent to which parties can spread their costs; and the good or bad faith of the parties. *Carey*, 816 F.2d at 93.

These factors do not "clearly favor" rejection. American is nowhere near liquidation and has a healthy cash balance which has been increasing during bankruptcy; granting or denying the motion will not at this point have a discernible impact on the value of any creditors' claims because the Company is still in the process of determining what its business plan will be for the purpose of a plan of reorganization; individual flight attendants who will see their income and medical coverage cut and their hours of work increased are among the least able to absorb the cost of rejection, while rejection would provide an economic windfall to the debtor beyond what it claims to be necessary; and there is the real potential that rejection would lead toward release by the NMB and a possible strike. Taken together, these factors counsel against granting the motion; they certainly do not "clearly favor" rejection.

CONCLUSION

The APFA respectfully submits that American's motion for authority to reject its collective bargaining agreement with APFA should be denied.

Respectfully submitted,

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