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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

**ALLIED PILOTS ASSOCIATION'S MEMORANDUM
IN OPPOSITION TO DEBTORS' MOTION TO REJECT
COLLECTIVE BARGAINING AGREEMENTS
PURSUANT TO 11 U.S.C. § 1113**

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INTRODUCTION AND SUMMARY OF ARGUMENT

The Allied Pilots Association ("APA," "Association" or "Union"), on behalf of the approximately 10,000 pilots employed by American Airlines, Inc. ("American" or "the Company"), submits this Memorandum in Opposition to the Debtors' application pursuant to Section 1113 of the Bankruptcy Code ("Section 1113 Motion" or "Application") seeking authorization to reject the collective bargaining agreement between American and the APA.[1]

The Debtors base their Section 1113 Motion on the core premise that "American cannot successfully reorganize" and emerge from this Chapter 11 case with its current collective bargaining agreements in place. Debtors' Memorandum of Law ("Debtors' Mem."), Part I, at 4. In particular, the Debtors assert that their Motion "rests on three unpleasant but undeniable facts:" (1) that "American will not survive if it does not restructure;" (2) that competing legacy carriers have all reorganized and consolidated since 2003, while American has incurred "billions in losses and a crushing debt load;" and (3) that American's current CBAs burden the Company

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[1] The Debtors filed their Application, styled as "Debtors' Motion for Entry of Order Pursuant to 11 U.S.C. §1113 Authorizing Debtors to Reject Collective Bargaining Agreements," on March 27, 2012, together with their Declarations, Exhibits and Memoranda of Law Parts I, II and III (docketed as ECF Nos. 2035, 2041-2043, 2046-2047, 2050). In particular, the Debtors' Application seeks rejection of collective bargaining agreements ("CBAs") between American and the APA, the Association of Professional Flight Attendants ("APFA") and the Transport Workers Union of America ("TWU").

For the reasons detailed in its separate Adversary Proceeding, *Allied Pilots Association v. AMR Corp. and American Airlines, Inc.,* Adv. Proc. No.12-01094 (SHL), the APA contends that its most recent CBA with American (the "2003-2008 CBA") expired by operation of its own terms as of May 1, 2008, that the CBA was not subsequently extended or renewed, and that Section 1113 does not authorize "rejection" of pilots' working conditions that are imposed by law on the parties as the post-expiration status quo solely by virtue of the Railway Labor Act ("RLA"). The APA has filed a Notice of Appeal and Request for Certification (*see* Adv. Proc. ECF Nos. 28-32) seeking direct appeal of the April 20, 2012 decision of the Bankruptcy Court dismissing its complaint (Adv. Proc. ECF No. 27). The APA continues to assert – and hereby incorporates fully by reference in this Opposition to the Debtors' Section 1113 Motion – all the legal grounds and arguments raised in its Adversary Proceeding and its pending appeal.

with above-market labor costs and burdensome work rules, presenting the "greatest single challenge" to American's financial health. *Id.* at 1-3. According to the Debtors, "[t]hese three undeniable facts yield but one irrefutable conclusion: *with these CBAs in place*, American cannot successfully reorganize." *Id.* at 4 (emphasis added). To support this contention, American Airlines filed a mountain of paper on March 27 and then presented the testimony of its key witnesses in the first phase of the Section 1113 hearing, conducted on April 23-27, 2012.

Consistent with its basic premise, the Company has devoted its filings and hearing presentations primarily to showing that American has not been operating profitably as a stand-alone carrier for most of the past decade, and that despite massive bankruptcy-avoidance concessions extracted from the APA, APFA and TWU in 2003, American's *existing CBAs* are not competitive with those of other network carriers.[2] But those assertions are straw men; they are simply not the factors that determine the outcome of this Section 1113 motion.

The issue in this case is not whether American needs *some* contract modifications and *some* reductions in labor costs to be more competitive and emerge from bankruptcy. The pilots have not opposed changes; on the contrary, the APA has proposed two alternative visions that would enable American to restructure successfully. First, it has offered concessions in nearly every aspect of the parties' most recent agreement that, collectively, would save the Company $271 million per year – over $10 million *more* per year than American has stated it needs to be competitive with its network airline peers. Second, it has proposed a consolidation plan between American and US Airways that would allow American to address the fundamental, structural obstacles it faces in competing with the larger network carriers while requiring the pilots to

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[2] The so-called "legacy" carriers (also referred to herein as "network carriers") identified as American's principal competitors and comparators in this proceeding are Delta (including the former Northwest), United (including the former Continental Airlines), and US Airways (including the former America West).

sacrifice only $240 million per year – $130 million per year less than what American demands as a standalone. Both alternatives offered by the pilots would also provide American flexibility to outsource significant flying, which the Company has valued at hundreds of millions per year. Nonetheless, American has refused to engage with the APA on either of its alternative visions for how the Company can successfully reorganize. Instead, it has stuck steadfastly to its non-negotiable demand for $370 million in annual concession from the pilots, a figure rooted in the hopes of achieving unprecedented profit levels through the continuation of the Company's failed limp-along "cornerstone" strategy.

Against that backdrop, the real issue before this Court is the *particular* set of contract modifications demanded by the Company – which they have labeled their "Section 1113 Term Sheet" – and the particular Restructuring Business Plan that drives the Company's concession demands. Specifically, the only question properly before the Court is whether the Company, with that March 21, 2012, Term Sheet in hand, has satisfied each and every one of the statutory tests that must be met in order for the Court to authorize rejection of the APA's collective bargaining agreement under Section 1113.

Section 1113 of the Code prescribes nine statutory criteria that the Debtors must meet in order to prevail on their motion. The Debtors unquestionably have the burden of persuasion on each of these requirements. Moreover, on the last of the listed criteria, the Debtors must meet a heightened standard of proof: they must show by "clear and convincing evidence" (not just a "preponderance of the evidence") that the balance of all equities in this case clearly favors rejection of the pilots' CBA. Each and all of the statutory criteria must be satisfied; if the Debtors' case is deficient on any one of the requirements, the Motion must be denied at this time.

Notably, the Debtors' Memorandum of Law fails to recognize all of Section 1113's distinct requirements. Moreover, even those statutory criteria the Debtors do mention are dismissed with the sweeping, patently erroneous assertion that "the entire § 1113 analysis 'quickly melts down to the one, single question which is almost always controlling: *what effect will rejection of the agreement have on the firm's prospects for reorganization*?'" Debtors' Mem. at 75 (emphasis added). This baseless contention so completely misreads the text of Section 1113 – not to mention its application by the courts in the 28 years since Section 1113's enactment – that it casts doubt on the Debtors' entire case. At the very least, the Debtors' prominent reliance on this distorted view of Section 1113, based on a 1984 article, may explain why they focus so much of their case on the irrelevant point that rejection of the unions' current agreements will facilitate American's reorganization.

To avoid further confusion regarding the legal criteria that actually govern this Motion, the APA's brief begins by reviewing the specific requirements of Section 1113. The APA will address these criteria and the relevant case law at greater length in the Argument that follows.

I. The Controlling Statutory Requirements

The first five statutory requirements must have been satisfied before the filing of the Debtors' Section 1113 Motion on March 27, 2012.[3]

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[3] The APA has previously briefed in detail the *pre-application* requirements of Section 1113. *See* Brief of Allied Pilots Association Regarding Debtors' Proposals To Be Considered Pursuant to 11 U.S.C. § 1113 (ECF No. 2577). The APA maintains that position and incorporates by reference the legal arguments set forth in that May 3, 2012, brief. In any case, American's subsequent proposal on April 19, 2012, has little effect on the arguments presented herein. That proposal demanded more from the pilots with respect to monthly scheduling and outsourcing of regional jets configured with 70 or more seats, although it did moderate the demand from pilots with respect to pay guarantees. *Compare* AA Exhibit 918 (American's March 21, 2012 term sheet) *with* APA Exhibit 2 (American's April 17, 2012, term sheet).

1. **First, the Debtors had to make a valid "proposal" to the union before filing their application to reject**. 11 U.S.C. § 1113(b)(1)(A). In the case of the pilots, the particular proposal that the Court must evaluate under Section 1113 is the Company's "Section 1113 Term Sheet" dated March 21 (AA Exh. 918), the last set of demands presented to APA before the Debtors' March 27 Application.

2. **Second, the Debtors must prove that their March 21 pre-application proposal was "based on *the most complete and reliable information available* at the time of such proposal."** 11 U.S.C. § 1113(b)(1)(A) (emphasis added). Among other things, this statutory provision required the Company to base its Section 1113 proposal on realistic projections, and to consider – not willfully ignore – obvious, reasonable restructuring alternatives that could strengthen this airline and enable successful operations after bankruptcy.

3. **Third, the Debtors must prove that the March 21 Term Sheet seeks only "those *necessary* modifications in the employees' benefits and protections that are *necessary* to permit the reorganization" of the Company**. 11 U.S.C. § 1113(b)(1)(A) (emphasis added). To satisfy this test, American must demonstrate that the overall amount of concessions it seeks from the APA is necessary to reorganize; and, where the APA has made a counterproposal regarding a particular term, the challenged term must itself be necessary for reorganization. Of course, American need not prove that its proposals are essential to stave off imminent liquidation. But the Debtors must do more than show that their proposed modifications would be helpful and improve American's financial profile. Such a degraded standard would render the "necessity" requirement utterly meaningless because *any* proposed labor cut would satisfy that test. On the contrary, Congress used the word "*necessary*" in Section 1113(b)(1)(A) – and used it not once, but twice – because it intended the statute to have real teeth.

4. **Fourth, the Debtors must prove that the March 21 proposal to APA "assures that *all creditors, the debtor and all of the affected parties are treated fairly and equitably*."** 11 U.S.C. § 1113(b)(1)(A) (emphasis added). This means that unionized employees, non-union employees, management, non-labor creditors, and Company owners must all bear proportionate sacrifices. Further, to show that the pain is spread fairly, American's proposal must also account for what can fairly be expected from each constituency in light of that group's pre-petition sacrifices.

5. **Fifth, the Debtors must prove that before filing their Application, they gave the Unions "such relevant information as is necessary to evaluate the [pre-application] proposal."** 11 U.S.C. § 1113(b)(1)(B). This is an affirmative duty that the Company must fulfill on its own initiative; the extent of disclosure required by the statute does not depend on a union making a specific request for specific data. The information that must be shared includes, among other things, forecasting models of the effect of different contractual changes, and analyses underlying the Restructuring Business Plan elements driving the Company's labor concession demands.

The sixth and seventh statutory requirements specify what is required of the Debtors after the March 21 proposal and before the commencement of the hearing on April 23:

6. **The Debtors must prove that American met with the APA at reasonable times**. 11 U.S.C. § 1113(b)(2).

7. **The Debtors must prove that American conferred in "good faith" with the APA "in attempting to reach mutually satisfactory modifications" of the CBA**. 11 U.S.C. § 1113(b)(2). As detailed below, a take-it-or-leave-it approach that treats Term Sheet demands as non-negotiable does not satisfy this statutory requirement. To meet the "good faith" test,

American must have demonstrated a willingness to negotiate over particular terms, once the APA made a counterproposal, as well as over the total amount of concessions sought.

The last two statutory requirements take into account the entirety of the record. As with the other Section 1113 criteria, however, the Debtor must separately meet each of these final statutory tests. The penultimate "without good cause" requirement is of particular significance here, given the circumstances of this case:

8. **The Debtors must prove that the APA refused to accept the March 21 Term Sheet proposal "without good cause."** 11 U.S.C. § 1113(c)(2). Notably, there is no fixed rule limiting what qualifies as "good cause," because a union may have any number of legitimate reasons for refusing to accept a particular Section 1113 Term Sheet, depending on the circumstances presented. For example, when a union offers counterproposals that achieve savings sufficient for effective reorganization, it has good cause to reject the debtor's proposal. Similarly, as discussed below, if there is another reasonable business plan that would allow the Company to reorganize while requiring less severe concessions from relevant stakeholders, a union has good cause to reject the debtor's offer.

9. **Finally, the Debtors must prove by clear and convincing evidence that "the balance of the equities clearly favors rejection" of the pilots' CBA.** 11 U.S.C. § 1113(c)(3). The Court has wide discretion to consider all the circumstances in a given case, including the APA's diligent efforts to reach a compromise and to negotiate in good faith toward that end.

II. The Debtors Cannot Satisfy Section 1113's Requirements Based on American's March 21 Term Sheet and its Related Course of Conduct

As demonstrated more fully in the Argument below, the Debtors' affirmative case fails to satisfy all of the Section 1113 requirements for rejection of APA's collective bargaining agreement. By the conclusion of the hearing in this case, the record will confirm that the

Debtors cannot meet their statutory requirements through American's placeholder Business Plan and its decision to negotiate inflexibly based only on that plan. Notable defects in the Debtors' case include the following, any one of which requires denial of the Debtors' motion at this time.

The Restructuring Business Plan that drove American's March 21 Term Sheet demands was not "based on the most complete and reliable information available." Among other deficiencies, American's own witnesses have testified that the Company not only failed but deliberately refused to consider the obvious possibility of consolidation when it formulated its Restructuring Business Plan (unveiled as the February 1, 2012, "Plan for Success") and resulting Section 1113 Term Sheets. At the same time, the evidence confirms that the Company's Restructuring Business Plan is not the likely template for American's eventual emergence from bankruptcy and its future operation. Rather, that standalone Plan is only an interim means to gut the pilots' and other employees' CBAs, at which point American will then belatedly "consider" and "compare" the alternative of consolidation with another carrier. In short, despite the ample evidence that American is now and has been fully capable of modeling and comparing restructuring alternatives all along, the Company is willfully blinding itself to any and all potential benefits of consolidation. Significantly, by intentionally ignoring the most complete and reliable information until after completing the Section 1113 process, American would effectively deny a share of the potential consolidation benefits to the pilots and other union-represented employees, while reserving the eventual restructuring gains to its management and other stakeholders. Because American did not and will not even consider whether consolidation would allow it to restructure without requiring concessions of the magnitude demanded in its March 21 Term Sheet, the Court must conclude that its placeholder plan and associated

concession demands are not based on the most complete and reliable information as required by Section 1113(b)(1)(A).

American's Business Plan and the labor concessions it prescribes are not "necessary to permit the reorganization" of the Company. On the contrary, the record confirms that American can successfully reorganize while taking significantly less from the pilots than the March 21 Term Sheet demands. On the eve of bankruptcy, American contended that it needed only about $50 million in annual concessions from the pilots to overcome the $260 million competitive disadvantage American faced vis-à-vis other major network airlines. It believed those reductions would bring the Company to market-competitive levels within just two years due to changes in its competitors' cost structures. Now that American has filed its bankruptcy petition, it seeks $370 million per year – a seven-fold increase over its pre-petition demand and a 40% increase over the $260 million cost gap that American itself identified as necessary to achieve market-based pilot labor costs. These excessive post-petition demands fail to account for the full range of sacrifices its Term Sheet would impose upon the pilots: when valued with reasonable assumptions, the Company's Term Sheet would actually require $460 million in annual concessions from the pilots – a nine-fold increase over the $50 million proposal that it thought sufficient to avoid bankruptcy. That figure does not account for American's proposal to eviscerate the job protections contained in the "Scope" clause of the CBA, none of which are necessary to reorganization.

The Company's March 21 Term Sheet is not fair and equitable, especially for the pilots of American Airlines. The evidence shows that above and beyond the $370 million per year in direct labor cost cuts American seeks to extract from the pilots, the Company's proposal to eliminate important Scope protections from the APA's contract would compel pilots to

contribute hundreds of millions annually toward American's bottom-line, according to the Company's own calculations, at an average annual cost to the pilots of at least $21 million. As the evidence further confirms, American has consistently refused to recognize the APA and the pilots for these substantial contributions to restructuring. Instead, the Company's Business Plan and resulting Section 1113 proposals treat those disproportionate contributions as if they count for nothing.

Before filing its Motion the Company failed to provide APA "such relevant information as is necessary to evaluate" the March 21 Term Sheet. In July 2011, American made the largest fleet order in history. Yet, the Company has refused to provide the APA or the other unions with any financial analysis underlying that decision, even though the timing and magnitude of the order could still be modified to require fewer concessions from labor. American has also refused to provide the APA with the Company's valuation of the Association's proposals, with the models that the Company used to determine its manpower needs, and with an accounting of the non-labor savings it intends to achieve through restructuring. All of this relevant information is necessary to evaluate American's proposals.

American's conduct at the bargaining table fell short of good faith negotiations and exacerbated every statutory shortcoming built into its Business Plan. Since presenting American's February 1, 2012, term sheet, the Company's negotiators have refused to negotiate over their demand for $370 million in average annual concessions from the pilots. They have also manufactured valuation disputes through unreasonable assumptions on several specific contract terms as a pretext to avoid genuine bargaining with the Union.

Under the circumstances of this case, APA had "good cause" to reject the Company's March 21 Term Sheet. The pilots' "good cause" is especially clear in the face of

the Company's stubborn refusal to consider a realistic alternative for restructuring that would greatly enhance American's network and improve its ability to compete, while inflicting much less damage on the pilots and other union-represented employees. The APA also has "good cause" because the Company has refused to adopt the Union's fully reasonable counterproposals, particularly on sick leave and Scope, instead insisting on a set of demands that produce far more in both cost savings and revenue enhancements than the Company says it needs for a successful reorganization.

The Company cannot show by clear and convincing evidence that the balance of all the equities clearly favors rejection of APA's agreement. As explained below, no plausible assessment of the equities would require APA to submit to concession demands that are driven by a placeholder Business Plan with no likely future – a dubious plan that depends on disproportionate contributions from pilots, and which serves primarily to divest the APA and the pilots of their contract in the near term while reserving potential future restructuring gains for other stakeholders – when a viable and less harmful alternative is available.

Based on the factual record and legal arguments discussed below, the Court must deny the Debtors' Section 1113 application at this time.

STATEMENT OF FACTS

I. American Seeks Pilot Concessions Far Beyond Competitive Levels to Satisfy a Standalone Restructuring Plan Developed Without Considering Alternatives, and Which Seeks Unprecedented, Unnecessary Profit Margins on the Backs of Labor

A. By American's Own Calculations, It Needs Only $260 Million in Annual Concessions From the Pilots to Make its Pilot Labor Costs Competitive

Since its out-of-court restructuring in 2003, American has employed a sophisticated computational model to project revenue and labor costs for three to four years into the future. *See* Transcript of Hearing on Debtors' Motion to Reject Collective Bargaining Agreements

(April 24, 2012) ("Apr. 24 Tr.") at 129:24-130:18, 199:18-201:16, 201:25-202:21 (Goulet).[4] Beverly Goulet, the Company's Vice President of Corporate Development since 2002 and its current Chief Restructuring Officer, and her staff would update this model in preparation for meetings of the Company's Board of Directors, which occurred approximately eight times per year. *See* Apr. 24 Tr. at 202:22-203:16 (Goulet).

Based on that model, American's senior management reported to its Board of Directors in October 2011 that the Company's labor expenses exceeded those of its peer competitors by approximately $600 million per year. *See* Apr. 24 Tr. at 165:9-13 (Goulet); APA Exhibit 407. Consistent with those reports, American had previously disclosed this $600 million annual labor cost disadvantage in February 2011 as part of its 2010 10-K filing with the Securities and Exchange Commission ("SEC"). *See* Declaration of Andrew Yearley ("Yearley Decl."), APA Exhibit 100 at ¶ 20. According to American's calculations, $230 million of that labor cost disadvantage was attributable to the pilots. *See* Declaration of Neil Roghair ("Roghair Decl."), APA Exhibit 400a at ¶ 26.

In the weeks before filing its petition for Chapter 11 protection on November 29, 2011, American's estimates increased and it reported to the press and at the negotiating table that its labor cost disadvantage was actually $800 million per year. *See* Yearley Decl., ¶ 20 (describing November 29, 2012, press report by AMR's CEO Tom Horton); Roghair Decl., ¶ 26 (describing negotiations). Of that $800 million competitive disadvantage, American determined that **$260 million was attributable to pilot labor costs**. *See* Roghair Decl., ¶ 26; Declaration of Daniel

[4] This memorandum will cite to the transcript of the Section 1113 hearing in this case as follows: "Apr. 23 Tr." will refer to citations to the transcript of the portion of the hearing that took place on April 23, 2012; "Apr. 24 Tr." will refer to citations to the transcript of the portion of the hearing that took place on April 24, 2012; and so forth. Where applicable, citations to the transcripts will also identify the witness who provided the cited testimony.

W. Akins ("Akins Decl."), APFA Exhibit 700 at 77 (Chart 21). In a presentation to the Pension Benefit Guarantee Corporation on March 8, 2012, four months after the filing of the petition in this case and contemporaneous with the development of its Term Sheets, American repeated this analysis and calculated its labor cost disadvantage attributable to pilots at $259 million. *See* APFA Exhibit 4 at 4, 12.

Based on their knowledge and projections of how labor costs at other airlines would change in the coming years, American's senior management contended in October and November 2011, that this cost disadvantage would diminish over time. Specifically, if it could secure between $47 and $55 million in average annual concessions from the pilots, American's projections showed that its labor costs would transform into a substantial *advantage* over its competitors by 2014. *See* Roghair Decl., ¶¶ 27, 30-31; APA Exhibit 410. In fact, Jeffrey Brundage, the then-Senior Vice President of Human Relations for American, conveyed to the pilots' negotiators that concessions of this magnitude would enable the Company to avoid less desirable alternate paths– namely, dramatic downsizing of the airline; a merger with another carrier, most likely US Airways; or restructuring through the Chapter 11 process. *See* Roghair Decl., ¶ 23.

At the time that American developed these analyses showing how its labor costs related to the costs of its competitors, American had a thorough and detailed business planning model, according to its outside financial expert, David Resnick of Rothschild, Inc. *See* Apr. 25 Tr. at 39:4-12 (Resnick). Moreover, Ms. Goulet and other senior managers at the Company had long monitored significant trends in the industry closely and tracked key performance metrics, such as

the Company's profit margins compared to those of its competitors. Apr. 24 Tr. at 213:10-214:20, 216:23-217:10 (Goulet).[5]

B. To Achieve Unprecedented Profits, American's Restructuring Plan Seeks $370 Million in Annual Pilot Concessions, A Demand That Greatly Outstrips Market-Based Labor Costs

1. American's Restructuring Plan Calls for $370 Million in Average Annual Concessions from the Pilots

Just two and a half months after seeking $47-55 million in annual concessions from the pilots, American constructed a Restructuring Business Plan in which it formulated a demand for $370 million per year from the pilots. AA Exhibit 1505.[6] That Plan seeks to improve the Company's financial profile by $3.1 billion as of 2017. *See* Declaration of Beverly Goulet ("Goulet Decl."), AA Exhibit 100 at ¶ 54. None of American's advisors rendered an opinion on the appropriateness, feasibility, or necessity of this goal; instead, American established that goal at its own discretion. *See* Apr. 24 Tr. at 244:21-246:8 (Goulet). American hopes to achieve the improvements called for by that Plan through (1) $1.0 billion incremental enhancements to the Company's annual revenue; (2) $600 million in annual reductions in non-labor costs, achievable through the restructuring tools made available by Chapter 11; and (3) $1.5 billion in annual reductions in labor costs. *Id.*; Apr. 24 Tr. at 116:2-117:16 (Goulet). These figures reflect

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[5] American, like other airlines, often measures operational profits through EBITDAR margins, which measure the ratio of "EBITDAR" (earnings before interest, taxes, depreciation, amortization, and rent) to total revenue. *See* Yearley Decl., ¶ 12 n.13.

[6] American first presented its Restructuring Business Plan (also referred to as the "Plan for Success") to its stakeholders on or around February 1, 2012. *See* Yearley Decl., ¶ 9 n.2. It modified that plan six weeks later, in part, to reflect American's decision to freeze rather than terminate its pension plans, where possible. *Id.* That plan assumed the Company would need to [redacted] *Id.* Three weeks later, American revised its plan again to correct several mathematical errors. *Id.* As used herein, "Restructuring Business Plan," "Business Plan" or "Plan" refers to American's business plan updated as of April 6, 2012.

American's plans as of 2017. Like its overall cash improvement target, American's outside advisors did not make recommendations to the Company as to the appropriateness, feasibility, or necessity of allocating the revenue enhancements and cost savings in the manner that American chose. *See* Apr. 24 Tr. at 246:10-248:11 (Goulet); Apr. 25 Tr. at 90:6-17 (Resnick).

Over the course of the period from 2012 through 2017, American's Restructuring Business Plan calls for average annual labor cost reductions of $1.25 billion per year. *Id.* at ¶ 54 n.21. American plans to allocate those average annual labor cost reductions according to each labor group's pro rata share of the Company's total labor costs. Declaration of Jeffrey Brundage ("Brundage Decl."), AA Exhibit 500 at ¶ 26. Under that formula, American determined the pilots' pro rata share of concessions to be an average of $370 million per year over the six year period American contemplates. *Id.*; AA Exhibit 507.

2. American's Profitability Target Drove its Demand for Labor Concessions Far Beyond Competitive Levels

As described by American's Chief Restructuring Officer and its various advisors, the Company's Restructuring Business Plan has four components: (1) a revenue model that projects the amount of revenue improvements the Company can achieve by 2017; (2) a profitability target that American hopes to achieve by 2017 in order to attain a financial profile that will enable it to have sufficient liquidity to make investments and cope with exogenous shocks to the industry; (3) a non-labor cost structure, which reflects the amount of reductions in non-labor costs it has already achieved and hopes to achieve through the Chapter 11 process; and (4) a target for labor cost reductions. *See* Apr. 24 Tr. at 112:18-16, 196:22-198:16 (Goulet); Apr. 26 Tr. at 72:3-73:23 (Dichter). According to American's managers and advisors, the Company arrived at the specific figures for each of these components by treating the revenue, profitability, and non-labor cost components as fixed inputs to the Plan and then calculating, as a matter of simple

"mathematics," the labor cost reductions that follow once the other components are treated as fixed inputs to the Plan. Apr. 26 Tr. at 75:15-76:11 (Dichter); *see also* Apr. 24 Tr. at 114:2-116:1 (Goulet). In other words, American "backsolved" the hole left in its Restructuring Business Plan by calculating the labor savings that would be needed ***once the other components of the Plan were pre-determined.*** Yearley Decl., ¶ 11; Apr. 26 Tr. at 75:15-76:11 (Dichter).

Although American retained a financial advisor in connection with the development of the Restructuring Business Plan, American established the Plan's profitability targets at its own discretion. In particular, American's Restructuring Business Plan calls for the Company to achieve a ████ EBITDAR margin by 2017. Declaration of David Resnick ("Resnick Decl., ¶ 27), AA Exhibit 300A at 27; AA Exhibit 306A. American established that target, and the Plan's related financial targets, according to its own designs. *See* Apr. 24 Tr. at 113:17-21 (Goulet). American's financial advisor, Rothschild, did not render an opinion to American or during the hearing on this motion as to the appropriateness or necessity of the ████ EBITDAR margin American had established. *See* Apr. 25 Tr. at 95:9-96:11 (Resnick). McKinsey & Company, Inc., the consultants retained by American to advise the Company on strategic and business planning matters, also rendered no such opinion. *See* Apr. 26 Tr. at 129:9-17 (Dichter).

American's plans for non-labor cost reductions fall into two camps: pre-petition initiatives to reduce non-labor costs and additional reductions to non-labor costs that became available only through the Chapter 11 restructuring process. McKinsey reviewed American's pre-petition efforts to reduce non-labor costs, *see* Apr. 26 Tr. at 42:17-44:7, but neither McKinsey nor Rothschild offered an opinion as to whether American's Restructuring Business Plan calls for sufficient levels of reductions to non-labor costs using the Chapter 11 procedures.

See Apr. 25 Tr. at 88:7-89:7 (Resnick) (no such opinion from Rothschild); Apr. 26 Tr. at 74:19-75:2 (Dichter) (no such opinion from McKinsey).

Similarly, American determined the level of labor cost reductions on its own accord. *See* Apr. 24 Tr. at 248:1-8 (Goulet). None of American's outside advisors or experts rendered an opinion on whether American's Plan to achieve $1.25 billion in average annual labor cost reductions for all groups, and $370 million per year for the pilots, was appropriate or necessary. *See* Apr. 25 Tr. at 84:23-85:8, 89:21-90:5 (Resnick) (no such opinion from Rothschild or McKinsey); Apr. 26 Tr. at 114:21-115:9, 116:14-21 (Dichter) (McKinsey had views on competitiveness of overall labor cost reduction target, but American did not request those opinions); Apr. 23 Tr. at 187:12-16 (Kasper) (no such opinion from Daniel Kasper); Apr. 24 Tr. at 44:8-11 (Glass) (no such opinion from Jerrold Glass).

American established the targets under the Restructuring Business Plan at a time when it has nearly $5 billion of cash on hand, no debtor-in-possession financing agreements that subjected it to covenant or liquidity tests, and no current plans to seek a revolving credit facility upon emergence from bankruptcy. *See* Yearley Decl., ¶¶ 9, 38; Apr. 24 Tr. at 259:11-24, 260:11-261:14 (Goulet); Apr. 25 Tr. at 104: 5-105:1, 129:3-12 (Resnick).

Given the methodology that American used to derive its labor cost reduction target, if its profit margin target for 2017 (e.g., EBITDAR margin target) were merely 1% lower, it would "need" ███████ less in 2017 labor cost reductions, thereby reducing the labor concessions American allegedly needs by ███ *See* Yearley Decl., ¶ 16. In short, American – unconstrained by immediate fiscal crisis – selected an EBITDAR margin that, combined with its revenue and non-labor cost reduction targets, yielded an excessive demand for $370 million in annual pilot

concessions. This demand exceeded American's own calculations of the $260 million it needed in concessions to be market competitive by $110 million per year, or by more than 40%.

3. The Profits Sought by American are Unprecedented and Unrealistic

The profitability level that American seeks in its Restructuring Business Plan not only exceeds what it needs to be competitive but also targets a profitability level that ***no network carrier*** has achieved since September 11, 2001. Yearley Decl., ¶ 15. Indeed, in the last eleven years, domestic network airlines have achieved an EBITDAR margin above 15% only 6.7% of the time and have ***never*** achieved an EBITDAR margin above 16.5%. Yearley Decl., ¶ 16.

As noted above, American's financial advisor did not opine that the Company's [REDACTED] target for its EBITDAR margin is either necessary or appropriate. *See supra* at 16-17. Instead, Rothschild simply provided American with profitability and other financial metric targets that other network airlines had ***hoped to achieve*** in their restructuring plans. *See* Apr. 25 Tr. at 95:9-96:11 (Resnick); Resnick Decl., ¶¶ 41-43. While some low cost carriers can achieve higher profit margins, American's actual competitors – Delta, United, and US Airways – have not. Yearley Decl., ¶¶ 17-18.

II. The APA Has Proposed An Alternative Path to American's Successful Restructuring through Consolidation

A. The APA Has Negotiated an Agreement With US Airways that Would Put the Company on a Path to Success While Requiring Significant, but Less Painful, Sacrifices than American Currently Demands from the Pilots

In April 2012, the APA concluded a Conditional Labor and Plan of Reorganization Agreement ("Plan Support Agreement") with US Airways in which the APA expressed its opinion that a US Airways Plan of Reorganization ("POR") "would enhance the prospects of the reorganized Debtors and enhance recoveries for unsecured creditors." Roghair Decl., ¶ 103; APA Exhibit 432. Accordingly, US Airways and the APA negotiated the terms that would

modify the 2003-2008 CBA and create a new CBA with a six year term in the event of a US Airways POR. Roghair Decl., ¶ 103. Under that Plan Support Agreement, the APA agreed to $240 million in annual concessions, made up of changes to benefits and productivity improvements that both parties believe would put the APA at competitive market rates vis-à-vis the pilots at the remaining legacy carriers. *Id.* If disputes over the valuation of specific terms were to arise, the parties have further agreed to arbitrate those disputes on an expedited basis. *Id.*

This Plan Support Agreement provides a "real-time 'market test'" of the competitiveness of the terms that the APA is willing to offer in order to support the Debtors' successful emergence from bankruptcy. Yearley Decl., ¶ 37. Unsurprisingly, the $240 million in annual concessions the APA offered and US Airways accepted falls squarely within the range that American itself estimated as necessary to overcome the competitive disadvantage it faces as a result of its pilot labor costs. *See supra* at 11-13 (calculating pilot labor cost gap to be between $230 million and $260 million per year).

B. Consolidation Would Fix American's Structural Deficiencies and Truly Secure the Company's Long-Term Success

In addition to requiring $130 million less in annual concessions than American is demanding from the pilots, the consolidation contemplated by the Plan Support Agreement between American and US Airways would enable American to emerge from Chapter 11 with the network and synergies it needs to compete successfully against the other network carriers. As explained by Air Transport Economist Daniel Akins,

> [i]f American merged with US Airways, it would become the largest carrier in the world, fix many of the network structure issues which plague its East Coast operation, and most importantly offer the services that would attract high value customers back to AMR. Annual synergy benefits from this merger have already been estimated by US Airways at $1.5 billion, which would allow the carrier to achieve its targeted EBIDTAR margins without having to rely on unrealistic growth and the uncertain assumptions which underlie its stand-alone plan.

Declaration of Daniel Akins ("Akins Decl."), APFA Exhibit 700 at 65.

American's current Restructuring Business Plan, however, does not contemplate consolidation with another airline. Instead, it is based on a strategy in which American continues to operate as a standalone network airline, whose operations would be heavily invested in five "cornerstone" cities: Dallas/Fort Worth, Miami, Chicago, Los Angeles, and New York. Goulet Decl., ¶ 46; Declaration of Virasb Vahidi ("Vahidi Decl."), AA Exhibit 200 at 9. American has followed this "cornerstone" strategy since at least 2009, when it invested 98% of its assets in those five cities. *See* Apr. 25 Tr. at 227:22-228:228:4 (Vahidi); Apr. 24 Tr. at 212:5-213:9 (Goulet). That strategy, however, failed American because it was unable to keep up with its competitors who were able rapidly and dramatically to expand their networks through consolidation. Akins Decl., ¶¶ 16-25.

C. Although American's Leadership Acknowledges that it Must Consolidate to Succeed Over the Long-Term, the Company Has Refused to Consider Consolidation Until After Extracting Concessions from Labor

On the eve of American's bankruptcy filing in November 2011, CEO Tom Horton expressed his view that consolidation has been good for the airline industry and it might have a role for American as it moves forward through the Chapter 11 process. *See* Apr. 24 Tr. at 119:14-120:7 (Goulet). Since then, Mr. Horton has pronounced his views more strongly and declared that American needs to consolidate in order to keep us with industry trends; the only question, according to Mr. Horton, is when to pursue consolidation and with whom. *See* Apr. 24 Tr. at 177:1-9 (Goulet).

In fact, American's own advisors recognize that as a debtor in possession the Company bears a fiduciary obligation to compare its current Restructuring Business Plan, which contemplates that American will emerge from bankruptcy as a standalone entity, with an

alternative business plan in which American consolidates with another airline. *See* Apr. 25 Tr. at 111:11-16, 134:10-22 (Resnick). Only by so doing can American assure its creditors that its reorganization plan maximizes the value of their claims. *Id.*

Yet, in formulating its Restructuring Business Plan, American did not undertake any analysis of a plan that contemplates a merger or consolidation, even though American's current Chief Restructuring Officer, Ms. Goulet, has closely monitored consolidation trends in the airline industry since at least 2000. *See* Apr. 24 Tr. at 120:22-121:2, 213:14-17 (Goulet). American's financial advisors at Rothschild have not attempted to model the financial implications of such a scenario, even though Rothschild acknowledges that such a comparison would normally constitute part of its due diligence in a restructuring. *See* Apr. 25 Tr. at 36:10-15, 36:21-37:13, 155:20-156:20 (Resnick). Notably, Rothschild has a "strategic advice team," which is "integrated" with Rothschild's restructuring team and composed of nine or ten bankers who interact regularly with Ms. Goulet, Mr. Horton and Mr. Vahidi and who have looked at consolidation scenarios since American filed for bankruptcy. Apr. 25 Tr. at 124:4-125:13 (Resnick). Similarly, American's advisors at McKinsey have made no attempt to determine the revenue implications of consolidation because American never asked it to do so, even though McKinsey would normally do so unasked as part of its professional obligation to its clients. *See* Apr. 26 Tr. at 40:12-42:14 (Dichter).

When questioned about its fiduciary obligations to its stakeholders, American and its advisors attempted to explain their persistent deferral of any analysis of consolidation as follows: Mr. Resnick of Rothschild contended that it is appropriate to develop a standalone business plan prior to developing a consolidation plan, so that the standalone plan can serve as a baseline for comparison. *See* Apr. 25 Tr. at 166:3-167:6 (Resnick). And Mr. Dichter of McKinsey

contended that American might have difficulty finding an airline willing to consolidate while American has higher labor costs than its counterpart and, even if the Company could find such a partner, it would have more power in the merger negotiations if it has a viable standalone plan that has actually been or can readily be implemented. *See* Apr. 26 Tr. at 69:12-71:12 (Dichter).

Notwithstanding these contentions, Mr. Resnick acknowledges that a standalone plan can be compared with a consolidation plan virtually, through the modeling capabilities that his firm and American have. *See* Apr. 25 Tr. at 181:22-184: 11 (Resnick). He also acknowledges that a consolidation plan could require fewer labor cost reductions than a standalone plan. *See* Apr. 25 Tr. at 177:18-23 (Resnick).

III. The APA Has Also Offered Tremendous Concessions That Would Enable American to Reorganize Successfully as a Standalone Airline Without Exacting Unnecessary, Punitive Concessions From the Pilots

A. The APA's Proposals Would Save the Company $271 Million Per Year and Make American Competitive by the Second Year of the Agreement

Even though the APA believes that American can generate additional benefits for all stakeholders by emerging from Chapter 11 through a merger with US Airways than as a standalone entity, the APA has bargained diligently with American both prior to the bankruptcy petition in this case and continuing through the present. In fact, the parties have scheduled a negotiating session during the pendency of this hearing. Throughout those negotiations, the APA has put forward counterproposals that address nearly every aspect of the 2003-2008 CBA. Roghair Decl., ¶¶ 29, 54-90; AA Exhibit 916; APA Exhibit 415a. Together, the APA's counterproposals offer American $271 million in average annual cost savings to American. Clark Decl., ¶¶ 4, 17-51. In other words, the APA has offered American ***$ 31 million more*** in annual savings than it has offered to US Airways, an offer that US Airways has accepted. *See supra* at 18-19. The APA has also offered American ***$10 million more*** in annual savings than

American itself has calculated to be necessary to reach competitive, market-based labor costs. *See supra* at 11-13. However, Mr. Resnick of Rothschild did not analyze the effect that reducing pilot labor costs by $270 million per year ($100 million less than the Company's current demand), or by any other amount, would have on the Company's 2017 EBITDAR levels. Apr. 25 Tr. at 99:19-104:2 (Resnick).

As discussed below, these savings exclude additional labor cost reductions and revenue enhancements that result from concessions in the pilots' contractual protections, under the "Scope" clause, against outsourcing.

1. The APA Has Offered American $168 Million Per Year in Benefit Savings

The APA's benefits proposals address every major area of benefits under the 2003-2008 CBA: namely, pensions, medical benefits for active pilots, medical benefits for future retirees, and long term disability benefits. The APA's proposals achieve $168 million in annual savings for the Company by:

- Working with American, the UCC, and the PBGC to freeze (rather than to terminate) pilots' defined benefit pension plans, resulting in $116 million in annual savings. Roghair Decl., ¶ 63; Clark Decl., ¶ 29.

- Increasing pilots' contribution to the medical plan for active pilots to 17%, resulting in $24 million in annual savings. Clark Decl., ¶ 30; APA Exhibit 306; Roghair Decl., ¶¶ 61-62.

- Increasing to 25% the pilots' required contribution to the cost share for the medical plan that future retirees will make, resulting in $25 million in annual savings. Clark Decl., ¶ 31; APA Exhibit 306.

- Modifying the long term disability plan, resulting in $3 million in annual savings. Clark Decl., ¶ 32.

2. The APA Has Offered American $70 Million Per Year in Non-Punitive Productivity Savings

a. Scheduling and related work rules

The APA offers American significant increases in pilot productivity through a combination of changes to current rules governing scheduling and other staffing requirements. These proposals have an interactive effect and are difficult to quantify on their own, but APA's highly sophisticated models can determine the cumulative effect of changes to these work rules on pilot labor costs. Declaration of Lawrence Rosselot ("Rosselot Decl."), APA Exhibit 600 at ¶¶ 6-33. Together with its proposals on sick leave, described more below, the APA's proposals will achieve $70 million in annual savings, Clark Decl., ¶ 35, through several proposals, including:

- Implement a preferential bidding system in which American can schedule pilots in a way that automatically avoids scheduling conflicts while respecting to the extent possible pilots' preferred schedules. Roghair Decl., ¶ 72; Rosselot Decl., ¶¶ 9-10, 35.
- Increase the monthly maximum schedules through a flexible system based on average monthly and yearly schedules. Roghair Decl., ¶¶ 73-76; Rosselot Decl., ¶ 35.
- Modify certain contractual pay guarantees that provide incentives for the Company to schedule pilots efficient by compensating them for inefficient schedules or other unexpected events. Roghair Decl., ¶ 81; Rosselot Decl., ¶¶ 6-7.

b. Sick leave

The APA has also proposed changes to current sick leave provisions, which the APA has designed to achieve the Company's stated goal to reduce the rate of sick leave usage to 7.2%. Rosselot Decl., ¶ 41. The APA's proposals achieve this target through a combination of:

- A sick leave "sellback" program, which would permit pilots to sell unused sick leave to the Company for pay. Roghair Decl., ¶ 57; Rosselot Decl., ¶¶ 42.

- A sequence protection program, which would protect pilot pay in case his sequence of trips gets cancelled for reasons beyond his control, while also giving the Company flexibility to reassign pilots to new sequences during a limited period. Roghair Decl., ¶ 68; Rosselot Decl., ¶ 43.

- The preferential bidding system. Rosselot Decl., ¶ 43.

The APA's sick leave proposals also address the Company's concerns about the potential misuse of sick leave by offering a limited medical verification program that would require a pilot who has used thirty consecutive days of sick leave to provide documentation from his doctor or from American's in-house doctors with whom the pilots already have relationships. Roghair Decl., ¶ 57. This proposal achieves American's legitimate interest in avoiding abuse of sick leave while also recognizing that pilots bear ultimate responsibility as professionals subject to the Federal Aviation Regulations ("FARs") to determine when they are medically unfit to fly. Roghair Decl., ¶ 56.

3. <u>The APA Has Offered Substantial Compensation Concessions</u>

The APA achieves $17 million in annual savings for the Company through its offers to eliminate the lineholder guarantee, under which most pilots receive payment for a minimum of 64 hours of flying per month, the premium for night flying, and the guarantee for pilots who take military leave. Clark Decl., ¶¶ 21-26; APA Exhibit 204; Roghair Decl., ¶¶ 66-67.

4. <u>The APA Has Offered Additional Concessions on Other Contractual Terms, Offset in Part by Minimal Contract Improvements that Increase Labor Costs</u>

The remaining savings achieved by the APA's proposal result from a variety of contract modifications, including to the distance learning program, crew rest seats, and vacation float accrual. Roghair Decl., ¶¶ 69, 90; APA Exhibit 204. *See also* Clark Decl., ¶¶ 45-49 (describing the rationales behind proposals that would impose minimal cost increases).

B. The APA's Proposals Also Offer American Significant Concessions in Protections Against Outsourcing That Would Contribute Hundreds of Millions Per Year to the Company's Profits

The "Scope" clause of the pilots' 2003-2008 CBA is a core provision of that labor agreement because it defines the scope of work and the pilot flying opportunities covered by the agreement. Declaration of James Eaton ("Eaton Decl."), APA Exhibit 500 at ¶ 6. The central provision of that clause requires that, subject to several negotiated exceptions, "[a]ll flying performed by or on behalf of the Company . . . shall be performed by pilots on the American Airlines Pilots Seniority List in accordance with the terms and conditions of this Agreement. . . ." *Id.* This clause prevents American from outsourcing its flying to low-cost subcontractors and from forming a non-union, sister subsidiary to do the flying that would otherwise be performed by American with pilots subject to the pay and work rules negotiated by the Association. Eaton Decl., ¶ 7.

Over time, the pilots and the Company have negotiated exceptions to the Scope clause in response to the Company's needs and changes in the industry. Eaton Decl., ¶ 11. These exceptions permit the Company to outsource the flying of regional jets to "Commuter Air Carriers" that American may own and operate and to outsource additional flying to other carriers through codesharing agreements that permit other carriers to operate aircraft "on behalf of" the Company by carrying American's designator code on flights operated by the other carrier's pilots, rather than American's pilots. Eaton Decl., ¶¶ 11-14.

Under the 2003-2008 CBA, American is allowed to outsource to commuter carriers over 500 50-seat jets and up to 90 70-seat aircraft, jets and propeller-driven aircraft (also known as "turboprops"). Roghair Decl., ¶ 47; Eaton Decl., ¶ 11.[7] Under the terms of that agreement,

[7] Mr. Vahidi's suggestion that the Scope clause prevents American from owning and

American is also allowed to maintain robust domestic codesharing agreements with Alaska Airlines and Hawaiian Airlines. Roghair Decl., ¶ 47. The agreement also permits American to enter new codesharing agreements with domestic carriers as long as it notifies the APA of its intent to do so 30 days before entering the codesharing arrangement. Eaton Decl., ¶ 30. After the notice, the APA and the Company will discuss the codesharing agreement for 30 days, with the facilitation of a mediator or interest-arbitrator who can resolve any outstanding issues at the end of the 30-day period according to industry standards. Eaton Decl., ¶ 30.[8]

In response to American's stated needs, the APA has offered concessions in both protections against outsourced regional jet flying and codesharing. With respect to regional jet flying, the APA has offered to allow American to outsource over 500 regional feed aircraft, including up to 193 aircraft configured with 70 seats. Roghair Decl., ¶ 51.[9] The APA, along with the two other unions who represent American's employees, also offered to fly large regional jets with greater than 50 seats at the mainline at market rates with a competitive cost structure. Roghair Decl., ¶ 60. With respect to codesharing arrangements,

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operating certain aircraft in-house, rather than simply from outsourcing the flying of those aircraft, Apr. 25 Tr. at 228:16-231:3 (Vahidi), is simply mistaken. *See* APA Exhibit 501.

[8] The 2003-2008 CBA directs the interest arbitrator to base those standards on the terms of the United, Delta, Northwest, Continental, and US Airways CBA. *Id.* Aside from Mr. Dichter of McKinsey, Apr. 26 Tr. at 60:5-61:2 (Dichter), American's other witnesses simply misconstrue the effect of this clause. *See* Eaton Decl., ¶ 31. Contrary to the suggestions of Mr. Glass and Mr. Newgren, the clause *does not* prohibit American from entering new domestic codeshare agreements. *Id.*

[9] First Officer Roghair describes the details of the size and configuration of those regional jets in his declaration at paragraph 51.

Roghair Decl., ¶ 59; Eaton Decl., ¶¶ 38-42. The only conditions imposed on the APA's proposed Scope concessions are designed to prevent the Company from using its Scope flexibility to outsource flying currently performed by APA pilots, something that American insists it has no intention to do in any case. *See, e.g.,* Apr. 26 Tr. at 198:13-199:4 (Vahidi) (assertions that the Company will use Scope flexibility to outsource flying are "a complete mischaracterization"). The APA's proposals fall well in line with industry standards on regional jet flying and codesharing agreements. Eaton Decl., ¶¶ 16-45.

According to American's own documents and witnesses, these Scope concessions would contribute tremendously to American's efforts to reorganize. Roghair Decl., ¶ 28; APA Exhibit 407 at 34; Apr. 24 Tr. at 253:18-254:7 (Goulet). And it values the ability to outsource additional regional jets at "up to hundreds of millions annually." Roghair Decl., ¶ 28; APA Exhibit 407 at 34. In fact, Ms. Goulet acknowledged during the hearing that "a substantial majority" of the $1.0 billion revenue improvements that American aims to achieve by 2017 are "attributable to the pilot contributions" American seeks, and the APA has substantially offered, regarding outsourced regional flying. *See* Apr. 24 Tr. at 249:18-252:17 (Goulet).

Nevertheless, American has rejected the APA's proposals. Instead, it has insisted on outsourcing rights that far exceed those enjoyed by other network carriers. Eaton Decl., ¶¶ 16-45. Specifically, American's Term Sheet seeks the right to outsource commuter aircraft configured with up to 88 seats and a take-off weight up to 114,500 pounds. Eaton Decl., ¶ 16. This proposal would allow American to maintain a large fleet of Embraer 190s flown by pilots

not covered by the APA's labor agreement. Eaton Decl., ¶ 16. Based on the Company's current fleet, American's Term Sheet would allow it to outsource up to 536 small regional jets (configured with less than 50 seats) and 305 large regional jets (with 51-88 seats). Eaton Decl., ¶ 23. These proposals far outstrip the outsourcing rights of American's peers. Eaton Decl., ¶¶ 17-20. American's Term Sheet also seeks the complete elimination of pilot protections against domestic and international codesharing. Eaton Decl., ¶¶ 33-35, 43. Those proposals would give American pilots none of the protections enjoyed by their counterparts at Delta, Continental, or US Airways. Eaton Decl., ¶¶ 33-35, 45.

IV. Rather Than Engaging in Good Faith With the Pilots Over Realistic Visions for Success, American Manufactured Valuation Disputes and Steadfastly Clung to its Excessive, Inequitable Demands

A. American Has Manufactured Valuation Disputes in Order to Avoid Bargaining

Although the APA and American do agree on several modifications to the 2003-2008 CBA, the Company has consistently underestimated the amount of sacrifice its proposals would require of the pilots and has insufficiently credited the amount of sacrifice that the pilots are willing to make through the APA's proposals. The declarations of First Officer Roghair, First Officer Rosselot, Ms. Clark and Charles Heppner of The Segal Company describe those disputes in detail. *See* Roghair Decl., ¶¶ 54-90; Rosselot Decl., ¶¶ 39-44; Clark Decl., ¶¶ 10-12, 22-25, 27-28, 30, 31, 33-35, 37-41, 44, 46-48, 62-69; Declaration of Charles Heppner ("Heppner Decl."), APA Exhibit 300 at ¶¶ 9-13. While American has refused to apply reasonable valuation assumptions with respect to numerous APA proposals, its approach has been particularly unreasonable in three areas: Scope, medical benefits, and scheduling.

1. American Refuses to Credit Scope Concessions

American has simply refused to credit any concession by pilots in their Scope protections as part of the pilots' contribution to its effort to reorganize. The Company has taken the position that pilots' Scope concessions enhance revenue without decreasing labor costs and, therefore, should be assigned no value whatsoever. Roghair Decl., ¶ 53. Nonetheless, American's outside labor counsel, Tom Reinert, did acknowledge that Scope concessions *should* count toward the $370 million cost reduction target established by American if the APA could show that those concessions would result in pilot furloughs or other direct impacts on pilots that would reduce the Company's labor costs. *Id.* American was fully capable of performing such an analysis with the sophisticated, driver-based models that calculated the financial impact that particular routes had on Company profits. *See, e.g.*, Apr. 26 Tr. at 25:6-8, 25:25-26:6, 27:23-28:25, 101:19-104:5 (Dichter). Such a model could have been used to compare American 2017 network plan with its current plan and determine the cost to pilots from outsourced routes. Clark Decl., ¶¶ 67-68.

Although American did not perform such an analysis, Ms. Clark did for the APA. *Id.* Using highly conservative assumptions, Ms. Clark determined that such outsourcing would reduce the flying performed by pilots by 536,000 pilot block hours between 2014 and 2017. Clark Decl., ¶ 68.[10] Those lost block hours would cause a headcount reduction of 313 pilots by 2017, resulting in $131 million in wages and benefits that American will not pay to APA members. Clark Decl., ¶¶ 66-68. Those lost wages and benefits amount to $21 million per year, on average, in costs to the pilot group. Clark Decl., ¶ 68. That figure is, of course, wholly

[10] The calculation assumes that that American will outsource only those routes that, though currently flown by American pilots, are projected to be flown by regional jets in 2017 under the plans disclosed by the Company to the APA. Under its proposal, American will have the discretion to engage in significantly greater outsourcing.

separate from the hundreds of millions of dollars that Scope relief would contribute to American's annual revenue.

2. American Significantly Underestimates the Sacrifices Demanded by its Proposals on Medical Benefits Because it Unreasonably Assumes that Increased Medical Costs Will Not Affect How Often Pilots Use Their Benefits

American's Director of Benefits Strategy has acknowledged that pilots, like other people, generally demonstrate "consumer-based employee behavior when using healthcare services." Roghair Decl., ¶ 62; APA Exhibit 424. When a service – such as healthcare – becomes more expensive to a pilot following an increase in his share of the cost of the benefit, the pilot will generally purchase less of that service. American failed to account for this decreased rate of usage of the active employee medical benefit when valuing its proposal. Heppner Decl., ¶ 11; Apr. 26 Tr. at 281:19-285:2 (McMenamy). As a result, the Company underestimated the savings its proposal for changes to the benefit for active employees would generate by $52.5 million over the 2012 – 2017 period, or $8.75 million per year on average. Heppner Decl., ¶ 11.

The Company also made unreasonable assumptions in valuing the medical benefit for future retirees. Because this benefit accrues in the future, a discount rate must be applied to determine the present cost to the Company to provide the benefit. American selected an unreasonable discount rate of 8.25%, based on returns in a pension plan attained through a combination of stock and bond holdings. *See* Apr. 26 Tr. at 290:3-296:14 (McMenamy). The accepted practice in the industry, by contrast, is to use a discount rate that approximates the return a high-quality bond portfolio might generate. Heppner Decl., ¶ 10. Using a discount rate of 5%, an appropriate rate based on industry practice, the Company's proposals for medical benefits for future retirees would generate $106.1 million more savings for the Company than it currently recognizes, or $17.7 million per year on average. *Id.*

3. American Makes Unreasonable Assumptions Regarding Sick Leave

Currently, 8.2% of pilots' paid hours at American are paid on account of sick leave. Rosselot Decl., ¶ 39. American assumes that its proposal would cause the rate of sick leave usage to skyrocket immediately to 9.2%. *Id.* American bases this assumption on the notion that pilots will call in sick excessively in order to retaliate against the Company for implementing contract changes, and, in so doing, will reach the highest rate of sick leave usage in the last decade. Rosselot Decl., ¶¶ 39-40.

On the other hand, the APA has proposed a non-punitive sellback program*, see supra* at 32, to provide pilots with incentives to minimize their sick leave. Roghair Decl., ¶ 57. In October 2011, American's financial analyst, Michael Burtzlaff, acknowledged that the sellback program, by itself, would reduce pilots' rate of sick leave by 10%. *Id.* American's current valuations of the APA's sick leave proposals, however, have abandoned that assumption without explanation. *Id. See also* Rosselot Decl., ¶¶ 34-37 (discussing related scheduling proposals). Instead, the Company inexplicably assumes that sick leave will immediately skyrocket even if the Company fully adopts the APA's proposal, thereby negating any positive impact of the program.

B. American Has Firmly Insisted on its Demand for $370 Million Annually and on the Terms that Must Compose That Demand

There is no dispute that American's negotiators have steadfastly refused to accept any level of cost reductions from the pilots less than the $370 million annual average reductions it seeks. *See* Apr. 26 Tr. at 189:11-25, 191:22-192:20 (Brundage); Roghair Decl., ¶¶ 35-40. To the extent that the pilots had any hope that the $370 million target was negotiable, Mr. Brundage erased it following the Company's decision to try to freeze the pension plan rather than terminate it. *See* Apr. 26 Tr. at 193:15-20 (Brundage).

American has also insisted on the specific form that the pilots' concessions must take. For example, since making its original February 1, 2012, proposal, American has acknowledged that the proposal would actually generate $41 million per year *more* in savings for the Company than it initially recognized. Roghair Decl., ¶¶ 41-43. Instead of bargaining with the pilots about how to allocate those surplus savings, however, the Company's negotiators simply revised the Company's previous term sheet on their own accord and handed the pilots a new term sheet reflecting the new terms that American demanded. Roghair Decl., ¶¶ 43-44; Apr. 26 Tr. at 202:21-203:3 (Brundage).

C. American's Demands Require Far More from the Pilots Than Their Fair Share of Contributions to the Company's Reorganization and Build on Years of Inequities

During the course of this bankruptcy proceeding, American has sought market-based sacrifices from the employees at American Eagle and from its non-labor contractors. *See* Apr. 24 Tr. at 125:20-126:9, 183:10-184:7 (Goulet). As shown above, by American's own calculations, American would need only $230 to $260 million per year in concessions from the pilots in order to achieve competitive, market-based pilot labor costs. *See supra* at 11-13. Yet, American demands at least $370 million per year in concessions from its pilots. *See supra* at 14. Moreover, American's April 5, 2012, valuation of its own proposals shows that the Company thinks those proposals will actually achieve $377 million in annual savings for the Company. APA Exhibit 412.

The APA, however, calculates the sacrifices demanded by American from the pilots to be far greater, even excluding the sacrifices from Scope concessions. Using reasonable assumptions, American's March 21 Term Sheet proposals actually demand $460 million in average annual sacrifices. Clark Decl., ¶¶ 52-55.

These excessive demands come after years of disproportionate sacrifices by the pilots. In 2003, American went through an out-of-court restructuring in which it obtained labor cost reductions that were equivalent to the reductions US Airways obtained in its first bankruptcy and that United Airlines was seeking from its unionized employees at the time. Goulet Decl., ¶ 21. Although pilots accounted for 28.39% of American's labor costs and 12.54% of its workforce, they gave 36.67% of the $1.8 billion in annual concession achieved by the Company. Roghair Decl., ¶ 10; APA Exhibit 401. That disproportionate share of the 2003 sacrifices amounted to $660 million per year. *Id.* At the same time, management gave only 5.56% of the concessions, even though they accounted for 9.86% of American's labor costs and 12.38% of the workforce. *Id.*

Because of the RLA, pilots work today under the concessionary terms and conditions they negotiated in 2003, nine years ago. Roghair Decl., ¶ 14. Because American's pilots took a 23% pay cut in 2003, they now work for the same pay rates that they earned in 1993, measured in nominal dollars. *Id.* American's management, however, has not made the same prolonged sacrifices. On the contrary, on the very day that the pilots ratified their concessionary agreement in 2003, the Company filed statements with the SEC disclosing that management received pensions that were protected against bankruptcy. Roghair Decl., ¶ 15. Although American lost $2.9 billion from 2003 to 2005, the Company announced in 2006 that it would likely pay close to $100 million in cash compensation to a small group of executives under a program that has ultimately paid $359 million in executive bonus compensation since it began. Roghair Decl., ¶ 19.

V. American Has Failed to Provide Relevant Information That is Necessary to Evaluate its Proposals

Both prior to and after filing its Section 1113 Motion, American has failed to provide the APA and other unions with any information relating to analyses of or presentations about potential consolidation. Roghair Decl., ¶¶ 94-95. Concurrently, the Company has also failed to provide meaningful information relating to the Company's major fleet order announced in July 2011, including the "business case," financial analysis or other information enabling the APA to evaluate the magnitude, timing and impact of the capital expenditures involved. Yearley Decl., ¶¶ 33-36 & Appendix B thereto. Notwithstanding the parties' significant valuation disputes, *see supra* at 29-32, the Company has refused to provide information regarding the Company's valuation of the APA's counterproposals. Roghair Decl., ¶¶96-99; Clark Decl., ¶¶ 50-51. It has provided only the most minimal information relating to the accounting of the non-labor savings American has achieved and plans to achieve through restructuring. Roghair Decl., ¶¶ 100-102. And American has consistently refused to share its manpower planning model, a key driver of the Company's valuations. Rosselot Decl., ¶¶ 28-33.

ARGUMENT

As the courts have recognized, a debtor seeking rejection of a collective bargaining agreement has the burden of persuasion to establish compliance with each of Section 1113's substantive and procedural requirements, set forth above at 4-7.[11] Moreover, a debtor faces a

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[11] *See, e.g., Truck Drivers Local 807, Int'l Broth. Of Teamsters, Chauffeurs, Warehousemen & Helpers of AM. v. Carey Transp. Inc.*, 816 F.2d 82, 90 (2d Cir. 1987); *In re Karykeion, Inc.,* 435 B.R. 663, 677 (Bankr. C.D. Cal. 2010); *In re Northwest Airlines Corp.*, 346 B.R. 307, 320-21 (Bankr. S.D.N.Y. 2006); *Ass'n of Flight Attendants-CWA, AFL-CIO v. Mesaba Aviation Inc.*, 350 B.R. 435, 458 (D. Minn. 2006); *In re Maxwell Newspapers, Inc.,* 146 B.R. 920, 931-32 (Bankr. S.D.N.Y. 1992), *aff'd* 981 F.2d 85 (2d Cir. 1992) (noting that the debtor has the burden to show that its proposal was necessary as well as fair and equitable, that it bargained in good faith, and that the union refused to accept the proposal without good cause); *In re American*

heightened burden of proof to establish the final requirement, that the balance of equities "*clearly* favors rejection." 11 U.S.C. § 1113(c)(3) (emphasis added)).[12] For the reasons detailed below, the APA submits that the Debtors cannot satisfy their burden in this case.

I. **The Company's March 21 Proposal Was Not Based On the Most Complete and Reliable Information Available at the Time**

The Debtors cannot prevail if they fail to satisfy the Court that their March 21 proposal was "based on the most complete and reliable information available at the time of such proposal. . . ." 11 U.S.C. § 1113(b)(1)(A). This standard ensures that the debtor's proposal is not "cursory," "arbitrary," or "results-driven" but is, instead, built on a clearheaded assessment of business realities. *Karykeion*, 435 B.R. at 677 (quoting *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 709 (Bankr. D. Minn. 2006)). The requirement is distinct from the Debtors' obligation to provide relevant information to the union. 11 U.S.C. § 1113(b)(1)(B).

The "complete and reliable information" contemplated by the statute extends beyond matters directly at issue in negotiations between the debtor and the union. To satisfy the requirement, American must prove that it thoroughly considered a wide range of business information that could impact the Company's needs with respect to labor. *See Karykeion*, 435 B.R. at 678 (holding that the debtor had satisfied the requirement because it had thoroughly

Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984) (noting that union may have a burden of production regarding good faith and good cause to reject). *See also In re Howard's Express, Inc.*, 151 F. App'x 46 (2d Cir. 2005) ("[T]he bankruptcy court made clear that the Company had to establish its entitlement to rejection, and explicitly held that the '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, survival and potential for a Chapter 11 reorganization.'").

[12] *See Matter of Walway Co.*, 69 B.R. 967, 974 (Bankr. E.D. Mich. 1987) (indicating that this element must be proven by "clear and convincing evidence"); *Matter of K & B Mounting, Inc.*, 50 B.R. 460, 467 (Bankr. N.D. Ind. 1985) (indicating that on this element "a preponderance of the evidence will not be sufficient.").

considered financial metrics in deciding whether to sell its business). One critical type of information under Section 1113 is information about third parties who might be willing to purchase and run the business without extracting the labor cuts outlined in the debtor's application to reject. *See Karykeion*, 435 B.R. at 678.[13]

Here, American must prove that it considered the most complete and reliable information available to determine whether such an alternative existed. In *Karykeion*, for example, the court approved the debtor's application because the debtor had used reliable information to conclude that no buyer would have been willing to purchase the business absent the contract modifications demanded by the one buyer who had expressed an interest. *Id.* at 678. Where a debtor fails to adequately investigate that possibility, *Karykeion* therefore instructs that its application should be denied under the "complete and reliable information" prong of Section 1113.[14]

American must also show that it used the most complete and reliable information available to determine that labor concessions less severe than those requested in its March 21 proposal would have significantly interfered with a successful reorganization. A debtor must use "accurate" and "up-to-date" data in creating the broader business plan on which its labor

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[13] Similarly, the court in *In re Lady H Coal*, 193 B.R. 233 (Bankr. S.D.W. Va. 1996) denied an application to reject because "the [debtor's] officers did not pursue a possible sale to another buyer who was willing to assume" the collective bargaining agreement. *Id.* at 242 (discussing the good faith bargaining requirement of Section 1113).

[14] American may claim that *Karykeion* is distinguishable because the debtor in that case was already investigating a sale of the business. That contention fails as a matter of both law and fact. Legally, the "complete and reliable information" requirement does not permit the court to defer to the debtor's judgment as to business options; indeed, the element is designed precisely as a check against that judgment. Factually, although American has so far declined to "focus on" consolidation with another airline, American's own witnesses indicate that the Company assembled an integrated team of outside experts and senior management experienced in M&A issues and competent to guide American in dealing with consolidation, that the Company has had preliminary discussions on that topic, and that American will continue to consider consolidation before it exits from this bankruptcy. *See, e.g.,* Apr. 25 Tr. at 134:10-22 (Resnick).

proposal is founded. *In re Mesaba,* 341 B.R. at 709. If American failed to investigate whether its Restructuring Business Plan would have been viable with a smaller "ask" from the pilots, then it has failed to consider the most complete and reliable information available.

American's Memorandum of Law fails to make any showing that the Company satisfied the "complete and reliable information" test. But the testimony of American's own witnesses demonstrates that the Company has fallen short of its burden on at least two grounds.

A. American Did Not Consider the Most Complete and Reliable Information Available Regarding Potential Consolidation With Another Airline

The Company has admitted that at no point between its bankruptcy filing and its March 21 proposal to the APA did American consider consolidation with another airline.[15] *See supra* 20-22. That failure is fatal to American's application under the "complete and reliable information" prong of Section 1113. The "standalone" nature of American's Restructuring Business Plan generates every element of that plan, especially its revenue projections and targeted labor cost reductions. If, for example, consolidation would improve American's network reach and therefore increase revenue – an assumption that many of American's own witnesses believe is likely – then consolidation would have a corresponding effect on American's need for labor savings, decreasing its "ask" to the APA. Similarly, consolidation would allow American to attain a large network without endangering job protections related to codesharing and outsourcing of regional flying.

Section 1113 is designed to prevent debtors from ignoring reasonable options such as this. As the *Karykeion* court recognized, corporate transactions often deeply impact labor relations. 435 B.R. at 678. It was therefore critical for the debtor in that case to consider

[15] If American did, in fact, perform an analysis of consolidation, Section 1113(b)(1)(B) obligated the Company to provide that analysis to the APA and the other unions. *See infra* at 53-55.

whether a buyer existed who would not demand severe modifications of the collective bargaining agreement. *Id.* American failed (and continues to fail) to engage in a similar analysis. Its proposal, therefore, was not based on the most complete and reliable information available.

B. American's Proposal Was Not Based on the Most Complete and Reliable Information Available Because the Company Has Failed to Analyze the Impact of a Smaller Labor "Ask" on its Business Plan

American claims that it needs $1.5 billion annually in labor cost reductions, including $370 million annually from pilots. One might naturally assume that, in order to determine its need, American would have examined whether its Business Plan would succeed with only $1.4 billion in labor cost reductions or only $350 million per year from pilots. That was not the case. As American's witnesses admitted, the Company never analyzed the impact of a smaller labor "ask." *See supra* at 23. The Company did not, therefore, test whether the APA's proposal to cut $271 million in pilot labor costs would have met the Company's needs. It would not have been burdensome to undertake these analyses. According to Mr. Dichter, the Company could have done it in one and a half to three weeks. Apr. 26 Tr. at 119:5-122:23 (Dichter).

Information about the effect of a smaller labor "ask" is a paradigmatic example of the "complete and reliable information" required under Section 1113. American cannot reliably claim that it needs at least $370 million in annual cost reductions from the APA if it has never assessed the impact of cost cuts less severe than that magic number. The Company's application fails because it had not performed that analysis as of the day it filed its application. Indeed, the Company indisputably made no such evaluation as of the day the Section 1113 hearing began, and there is no indication that it has deigned to consider the effect of a lesser number even today.

II. The Company's March 21 Term Sheet Does Not Seek Only Those Necessary Modifications That Are Necessary to Permit American's Reorganization

To prevail under Section 1113, the Debtors must propose only those "necessary modifications in the employees' benefits and protections that are necessary to permit the reorganization of the debtor." 11 U.S.C. § 1113(b)(1)(A). Thus, this Court must scrutinize the specific proposal made by the Company to determine if *that proposal* is "necessary." The question is not, as the Creditors' Committee has suggested, whether *abrogation* of a "collective bargaining agreement[] in existence at the moment" is necessary. Apr. 23 Tr. at 110:5-12. Nor is the test whether American requires *some* degree of relief from current labor costs to reorganize. Congress could have written the statute that way; it chose not to.

Instead, in accordance with the text of Section 1113, this Court must assess whether the specific terms of the Debtors' March 21 proposal are "necessary" for reorganization. And the Court must deny the motion *even if* the record proves that American's current labor costs are unsustainable unless American proves that its specific proposals are necessary. *See In re Sun Glo Coal Co., Inc.*, 144 B.R. 58, 63 (Bankr. E.D. Ky. 1992) (denying application under the "necessity" requirement although debtor had shown that it needed "major economic concessions" to avoid liquidation); *In re Fiber Glass Indus.*, 49 B.R. 202, 206-08 (Bankr. N.D.N.Y. 1985) (denying application under the "necessity" requirement although the record indicated a possibility that "without substantial modifications of this contract, the debtor faces liquidation").

The Court must scrutinize each relevant proposal on two dimensions. First, as the APA and American agree, the Court must examine the proposal as a comprehensive package. Debtors' Mem., Part I at 76-77. In this "global phase" of the analysis, courts ordinarily focus on the total "ask" reflected in the debtor's package – that is, the sum of savings generated by the

debtor's proposal. In this case, American's "ask" from the pilots is $370 million in average annual savings over six years,[16] rising by almost a hundred million over that target by 2017. But one of the most critical components of American's proposal to the APA – its revision to the pilot Scope clause – is not incorporated into that $370 million target because American claims that it will generate no savings. Thus, to assess the extent of the restructuring contributions extracted from pilots in American's comprehensive Term Sheet package, this Court must review the $370 million "ask" in conjunction with American's Scope proposal.

The Court must assess whether this package, as a whole, is driven by true need. In order to prevail, the Company must make a "significant showing," *UAW v. Gatke Corp.*, 151 B.R. 211, 213 (N.D. Ind. 1991), that its demands are truly necessary and that American did not simply "predetermine what concessions [it] wanted from the union," *Fiber Glass Indus.*, 49 B.R. at 207. The necessity inquiry would be simplified if, as in many prior cases under Section 1113, external factors required the Debtors to achieve a set amount of labor cost reductions in order to, e.g., secure DIP financing or complete a corporate transaction. Here, however, that is *not* the case, and the Court must engage in a more searching analysis.

To assess the necessity of American's demands, the Court may analyze the effect of the Company's comprehensive proposal on the debtor's labor costs as compared to its industry peers. If American's peers are able to operate profitably with a certain cost structure, then the Court may infer that cuts below that cost structure are not "necessary" to a successful reorganization. *See, e.g., In re Express Freight Lines, Inc.*, 119 B.R. 1006, 1016 (Bankr. E.D. Wis. 1990) (denying an application under Section 1113 because other companies operated under contract terms similar to those the debtor sought to modify).

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[16] As explained below, by American's own admission, its March 21, 2012 proposal would have generated $377 million in average annual savings.

American wrongly suggests that the relevant question under the necessity prong of Section 1113 is whether the debtor's "ask" would "increase the likelihood of a successful reorganization." Debtors' Mem. at 76. That is inconsistent with the text of Section 1113 and the applicable precedent.[17] As a matter of text, the debtor's interpretation would read the necessity standard out of the statute, since *any* reduction in costs will increase the probability that a company will be successful in the future. It would further reduce the necessity requirement to nothing more than the superseded "business judgment" standard for rejection of an executory contract under *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984), and Section 365 of the Code.[18]

American's labor demands are not "necessary to permit the reorganization," whether the Company's proposal is assessed globally or by specific disputed terms:

A. American's Demands Should be Presumed Unnecessary Because the Company Seeks <u>Seven Times</u> More in Annual Labor Cuts Than its Pre-Petition Contract Proposal, Although Nothing Material Has Changed

The Company's claim to need $370 million in average annual cuts to pilot labor costs is implausible on its face in light of the proposal the Company made to the APA just two weeks before it filed for bankruptcy. On November 14, 2011, the Company's comprehensive contract

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[17] In *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs*., 484 U.S. 365, 375-76 (1988), decided after *Carey*, the Supreme Court interpreted "necessary" in Section 362(d) of the Code as meaning "essential" for an effective reorganization. Given the basic principal of statutory construction "that language used in one portion of a statute . . . should be deemed to have the same meaning as the same language used elsewhere in the statute," *Mertens v. Hewett Assocs.*, 508 U.S. 248, 260 (1993), the term "necessary" in Section 1113 should likewise mean "essential," not merely helpful, for reorganization of the debtor.

[18] To make its point, the Company takes language out of context from *Howard's Exp.*, 151 F. App'x 46. The issue there was whether the bankruptcy court's approval of an application under Section 1113 was clearly erroneous due to the debtor's subsequent liquidation, which, according to the union, proved that the debtor's labor proposal was never "necessary" to an already doomed reorganization. *Id*. at 48-49. In that context, the Second Circuit held that hindsight could not supplant the bankruptcy court's ex-ante assessment as to the necessity of the debtor's proposal. *Id.* The court used the word "likelihood" to emphasize that necessity must be assessed ex-ante, when the debtor's prospects remain somewhat uncertain. *Id*.

proposals called for $47 million to $55 million in average annual cost reductions from pilots. *See supra* at 13. That number was the product of a thorough and detailed planning model and reflected the Company's analysis of industry and economic trends. *See supra* at 11-13. American's leadership – which included, at that time, Beverley Goulet, Virasb Vahidi, Jeff Brundage and Brian McMenamy – had determined that $47 million to $55 million in cuts to pilot labor costs would be sufficient to avoid bankruptcy. The Company was well aware of each factor affecting American's competitive position and its prospects for success. *See, e.g.,* Apr. 24 Tr. at 213:10-214:20 (Goulet).

Nothing changed in the airline industry between November 14, 2011 and February 1, 2012. There was no shock in the economy, no catastrophic weather event, no terrorist attack, no unexpected spike in fuel prices, and no announcement of a new airline merger. Those events last occurred *years* before American's bankruptcy. Indeed, each and every industry trend discussed by American's experts has, by the expert's admission, been evident for several years. *See* Kasper Decl. at ¶¶ 40-50 (steady expansion of "Low Cost Carriers" over the past decade), 58-62 (airline consolidation in 2008 and 2010), 72-73 (fare-finding websites); Resnick Decl. at ¶¶ 21 (the economic recession beginning in 2008), 22 (fuel prices steadily increasing since 2009).[19] Only one thing has changed since November 2011: the Company's bankruptcy filing has given it access to Section 1113.

American's witnesses claim that the Company's pre-petition proposals were built on erroneous assumptions that the economy would "recover steadily," that the price of fuel would stabilize, and that pilots at other airlines would receive pay increases. *See* Brundage Decl. at

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[19] Tellingly, the Company insists that the business analysis supporting its most significant pre-bankruptcy business decision – its June 2011 aircraft fleet order – remains the same today as a year ago.

¶ 33. But American has presented no evidence that any of those assumptions were any more or less plausible in March 2012 than they were in November 2011. Meanwhile, the Company seeks to take advantage of bankruptcy to shed $600 million in annual non-labor costs that were apparently weighing down the airline when it made its November 2011 proposals.

Even if this Court were to credit the implausible testimony of American's witnesses that the Company had not accounted for obvious industry trends before filing for bankruptcy, it would still not be enough to account for a *sevenfold* increase in American's "ask" to its pilots, a figure completely unprecedented in prior Section 1113 cases. At most, the Company's supposedly mistaken projection of pilot compensation increases at other airlines would support an "ask" of $260 million in pilot cost reductions. That was the cost gap identified by American for 2011 based only on current contracts, not any expectations of future raises for pilots at the Company's competitors. American presented its estimate of the labor cost gap in a 2011 SEC filing, Yearley Decl. at ¶ 20, in which the Company was barred under federal law from making any material omission. *See* 15 U.S.C. § 78r.

B. The Agreement Between the APA and US Airways Demonstrates That American's Demands Fail the Test of the Market and Are Unnecessary

While American insists that it must achieve $370 million in annual cuts from the pilots in order to operate a successful airline, the Company's rival, US Airways, has placed a multi-billion dollar wager that those cuts are vastly excessive. Under an agreement negotiated between US Airways and the APA, the parties would agree to cut pilot labor costs by $240 million annually if US Airways acquired American.[20] *See supra* at 18-19. Over the course of that agreement, pilots would therefore retain many hundreds of millions of dollars in wages and benefits that would be

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[20] Pay rates and work rules would be specifically indexed to terms in place at Delta and United, American's closest competitors. Meanwhile, disputes over valuation, if not solved through consensus, would be resolved by a panel of arbitrators.

annihilated under American's proposal. By the test of the market, American's cuts are demonstrably unnecessary.

It is no coincidence that US Airways agreed to labor cuts approximately equal to the pilot labor cost gap between the APA's current contract and those in place at the other network carriers. American itself calculated that gap to be $260 million dollars. It presented the figure at a November 2011 meeting of the Board of Directors and again in March 2012 to the PBGC. *See* APA Exhibits 410 and 201. Ignoring its own calculation, the Company has demanded over a hundred million more in annual cuts than are necessary to reach market levels. American seeks to lower its labor costs to levels drastically lower than those under which American's peers have attained strong profitability.

C. American's Case for Necessity is Based on An Earning Target That the Company Cannot Justify

American says it needs to implement its labor demands so that it can achieve its 2017 target of $3.1 billion in earnings before interest, taxes, depreciation, amortization, and rent (EBITDAR).[21] *See supra* at 15-16. That would give the airline an EBITDAR margin of [redacted], which the Company says is crucial to its future success. American's labor demand hinges entirely on this earning target. If the Company had set its target [redacted] for example, it could have achieved the target while requesting over [redacted] less per year from pilots, all else being equal.[22]

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[21] Although the Company's financial expert also refers to a smattering of other financial metrics, these metrics do not drive American's business plan and could not reasonably do so. *See* Yearley Decl. at ¶ 27.

[22] A one percentage point decrease in the EBITDAR target leads to a [redacted] decrease in American's labor ask, all else being equal. *See* Yearley Decl. at ¶ 16.

But American's earnings target is completely outside the norms of the airline industry. Over the last two years, the average EBITDAR margin of American's closest competitors has been 13%. *See* Yearley Decl. at ¶ 15. In only a handful of instances since 2001 has any network carrier achieved an EBITDAR margin of 15% in a year. *Id.* None of those airlines have come within [redacted] *See* APA Exhibit 101. To try to portray its target as reasonable, the Company uses reference points including vastly smaller airlines like Allegiant Air. *See* AA Exhibit 305A. That comparison is not so much "apples to oranges" as apples to beach balls. American and Allegiant both fly airplanes, but their business models and financial profiles differ in virtually every other important way. *See* Yearley Decl. at ¶17. The same is true of the other non-network carriers cited by American. *Id.*

American's own paid consultants have refused to validate the Company's earnings target as appropriate or necessary. One by one, Mssrs. Kasper, Resnick, Dichter and Glass all testified that they had not rendered an opinion as to the necessity of the earnings target or of the resulting labor ask. *See* Apr. 25 Tr. at 88:7-89:7, 84:23-85:8, 89:21-90:5 (Resnick) (no opinion from Mr. Resnick or Rothschild on the necessity of the earnings target); Apr. 26 Tr. at 129:9-17 (Dichter) (no such opinion from Mr. Dichter or McKinsey); Apr. 23 Tr. at 187:12-16 (Kasper) (no such opinion from Mr. Kasper or his firm on the necessity of American's labor "ask"); Apr. 24 Tr. at 44:8-11 (Glass) (no such opinion from Jerrold Glass or his firm). Instead, the Company developed its earning target at its own discretion. *See supra* at 15-17. Because American has not demonstrated that its target is reasonable, the Court must reject the Company's application.

D. Even Accepting the Company's Financial Targets, American's Failure to Justify the Planned Capital Expenditures Associated With its Recent Fleet Order – the Largest in History – Means it Has Not Established That it Needs the Requested Labor Savings to Meet its Targets

A major source of American's costs over the next six years will be the 460 aircraft it currently has on order from Boeing and Airbus. To pay for those aircraft, American plans capital expenditures amounting [redacted] billion over the next six years. *See* Yearley Decl. at ¶ 29. That equals the Company's annual "ask" from the pilots [redacted] *times over*. The fleet order therefore is a critical force driving the Company's self-imposed "need" to cut labor costs in order to pay for new aircraft.

American claims that the fleet order will have a net positive effect on the Company's earnings. But if the fleet order is even slightly financially disadvantageous, then American could be better off modifying its (presumptively executory) contracts with Boeing and Airbus to diminish or slow the order, thereby freeing it to demand much less from labor while meeting the range of financial metrics provided for reference by the Company's financial advisor, Mr. Resnick.

American has failed to meet its burden on necessity because it has produced no evidence to justify the fleet order or the magnitude and timing of the planned capital expenditures. The APA's advisors at Lazard have sought such substantiation from the Company since February 2012. *See* Yearley Decl. at ¶¶ 31-16. Lazard principal Andrew Yearley has explained that, although new aircraft may be more efficient as a general matter, it is entirely unclear whether an order of this size and pace is necessary or wise for the Company at this time. *Id.* American may have had a number of options, but the APA's lack of information foreclosed any meaningful evaluation and exploration of possible alternatives to the size and timing of refleeting expenditures driving the Company's pre-application concession demands.

The Company's failure to show that the planned fleet order yields a significant net benefit, or that the scope and schedule of capital expenditures cannot reasonably be modified, thus precludes a finding that the associated labor cuts in the March 21 Term Sheet are necessary. This failure is yet another fatal flaw in the Company's case.

E. American's Demands Will Produce Much Greater Labor Cuts Than the Company Claims to Need

In reality, American's March 21 Term Sheet produces much more than the Company's target of $370 million in annual savings. American admits that its proposal actually produces $377 million in average annual cuts and that those cuts rise to $451 million by the sixth year of the proposed agreement. Yet, the magnitude of cost cuts demanded by American is still greater. American undervalues its proposals by over $80 million per year, as calculated by the APA using more realistic assumptions and more sophisticated models. *See supra* at 33. And those calculations do not include Scope concessions, which American implausibly claims will produce *no* savings for the Company even though American has proposed practically limitless flexibility to outsource flying to cheaper regional airlines. Because the APA's calculations exclude Scope concessions, $460 million should be considered a conservative estimate of the annual savings American will realize if it implements it demands.

F. American's Specific Demands on Scope, Sick Leave and Other Areas Are Wholly Unnecessary to Reorganization in Light of APA Counterproposals

American asserts that the Court's inquiry should end at the global phase, arguing that "'[n]ecessity' is judged as a whole, not proposal by proposal." Debtors' Mem., Part I at 76-77. In fact, the applicable precedent indicates that this Court must also assess the necessity of each *individual proposal* that APA has chosen to dispute and negotiate over. *See, e.g., Carey Transp.*, 816 F.2d at 86 (indicating that the debtor's Section 1113 proposal must "contain[] *only necessary*

modifications of the existing agreements") (emphasis added).[23] In a variety of cases, courts have denied applications under Section 1113 because a *particular element* of the debtor's proposal was not needed for reorganization.[24] That rule prevents debtors from gratuitously extracting contract modifications that are not truly necessary.

To argue that this Court cannot examine its individual proposals, American relies on a selective quotation of *In re Royal Composing Room, Inc.*, 848 F.2d 345 (2d. Cir. 1988). In that case, the union had adopted a "stonewall position," refusing to make any counterproposal until just three days before the rejection hearing. *Id.* at 347. Consequently, the court refused to allow the union to "belatedly attack[]… specific element[s]" of the debtor's proposal and engaged only in a holistic analysis. The court stated its holding as follows: "*where a union refuses to negotiate in order to obtain a different combination of modifications*, it may not challenge the particular combination, or any vital element, contained in the debtor's proposal." *Id.* at 349.[25] Here, because the APA has bargained vigorously over each element of the Company's proposal, the Court must review the necessity of those elements individually.

The test for the necessity of an individual proposal is whether "reorganization would be unlikely absent" the debtor's proposed modification. *Express Freight Lines,* 119 B.R. at 1014. Several courts have denied rejection applications under that approach. In *Express Freight Lines*,

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[23] *See also In re Mile Hi Metal Sys., Inc.*, 899 F.2d 887, 897 n.8 (10th Cir. 1990) (noting the "majority view" that "each proposed modification be necessary to the reorganization").

[24] *See, e.g., In re Valley Kitchens, Inc.*, 52 B.R. 493, 497 (Bankr. S.D. Ohio 1985) (rejecting the view that an 1113 proposal need not be limited to items that are necessary for reorganization and denying the debtor's rejection application on the grounds that some proposals did not produce any specific savings); *Express Freight Lines*, 119 B.R. 1014 (rejecting an application for rejection under Section 1113 in part because a proposal related to grievance procedures was not necessary to a successful reorganization).

[25] *See also id.* at 348 (declining to "focus[] on a particular element vital to the proposal when the union does not bargain to change that element").

the bankruptcy court applied Second Circuit precedent to deny a debtor's application because certain proposed terms were not necessary to reorganization. 119 B.R. at 1014-15. Similarly, the court in *Valley Kitchens*, 52 B.R. at 497, denied a rejection application because the debtor had assigned no cost saving value to some of its proposals, making those proposals unnecessary for reorganization.

Even if American's comprehensive proposal satisfied the test for global necessity, the Company's application would still fail because American proposes numerous terms that are not necessary to its reorganization. First, with regard to the pilot Scope clause, American's Section 1113 proposal would give the Company the right to outsource up to 304 EMB-190 aircraft or their equivalent, and over 530 50-seat aircraft – flown by a separate group of pilots at non-CBA rates under non-CBA work rules. In other words, the Company could create and separately operate an air carrier over four times the size of JetBlue – which does in fact fly the EMB-190 and currently has a fleet of 172 aircraft – and then shift flying from Company pilots to pilots at that separate airline. In addition, American is demanding the right to enter into *completely unrestricted* codesharing with other Domestic and International carriers; such carriers would fly "on behalf of" American with no contractual job protections for Company pilots. This Scope demand is completely inconsistent with the standards in the industry and represents such an extraordinary over-reach from what is "necessary" to the Company's business plan that it is alone sufficient grounds to deny this motion. In contrast, as shown *infra* 69-71, the APA's counterproposal on Scope would meet all of the Company's stated needs.

Second, American demands contract modifications that serve little or no economic purpose and therefore suggest that the Company's proposals are more punitive than economic. The Company proposes elimination of a clause in the current contract that limits pilot furloughs.

Roghair Decl., ¶ 85. But American admits that clause is so permissive that the Company will only need to exceed current limitations in the case of an "unforeseen catastrophic event[] such as the September 11 terrorist attacks." Newgren Decl. at ¶ 156. American's proposal is wholly unnecessary because the contract already contains a *force majeur* exception, which the Company did in fact successfully utilize after September 11. *See* Roghair Decl. at ¶ 85, n.12. The Company assigns no value to this proposal. *Id.* The Company also proposes to eliminate the pay protection for reserve pilots who report too fatigued to fly. *See* Roghair Decl. at ¶ 84. That proposal encourages unsafe behavior while generating only $100,000 in average annual savings by the Company's calculation.

Finally, as described below, the APA's counterproposal on sick leave would fully satisfy the Company's goals with respect to a reduction in the amount of sick leave used by pilots. *See infra* at 71-72. American cannot show that "reorganization would be unlikely absent" its proposals on sick leave because the alternatives offered by the APA would be equally effective in meeting the Company's own targets. *See Express Freight Lines,* 119 B.R. at 1014.

III. American's March 21 Proposal Does Not Treat Pilots "Fairly and Equitably"

An application under Section 1113 must be denied if the debtor's proposal does not "assure[] that all creditors, the debtor and all of the affected parties are treated equitably and fairly." 11 U.S.C. § 1113(b)(1)(A). The "fair and equitable" requirement is intended to "spread the burden of saving the company to every constituency *while ensuring that all sacrifice to a similar degree*." *In re Century Brass Prods., Inc.*, 795 F.2d 265, 273 (2d Cir. 1986) (emphasis added). Thus, the Court should deny the Company's application if the contributions demanded from the pilots are disproportionate to those borne by other stakeholders.

In determining whether the debtor's proposal asks for commensurate sacrifices from all stakeholders, the court should compare the contributions of each unionized labor group,[26] management,[27] creditors[28] and shareholders.[29] Moreover, the court should consider contributions to the reorganization effort *in whatever form*, including both diminished compensation and increased productivity. *See Carey Transp.*, 816 F.2d at 91 (affirming grant of 1113 order as fair because business plan required management to sacrifice through increased productivity). In this case, for example, the Court must consider the contributions demanded from American pilots through decimation of the principal provision of their collective bargaining agreement, the Scope clause. If the aggregate contribution demanded from pilots is disproportionate to the contribution demanded from other constituencies, American's application to reject must be denied.

In determining what can fairly be expected from each group in bankruptcy, the Court must also consider the magnitude of each constituency's pre-petition sacrifices. *See id.* at 91 (considering pre-petition sacrifices by a union and two creditors in assessing fairness). If a group

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[26] *See, e.g., In re Delta Air Lines, Inc.,* 342 B.R. 685, 698-99 (Bankr. S.D.N.Y. 2006) (denying application under Section 1113 in part because debtor asked flight attendants to bear disproportionate share of burden in comparison to other employee groups, including pilots and mechanics).

[27] *See, e.g., In re Jefley, Inc.*, 219 B.R. 88, 94 (Bankr. E.D. Pa. 1988) (denying application under Section 1113 where Debtor's proposal left "the potential for more sacrifice on the part of management").

[28] *See, e.g., Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1092-93 (3d Cir. 1986) (reversing grant of application under Section 1113 because absence of snapback provision meant that workers would bear disproportionate share of burden in comparison to creditors if debtor did better than expected post-bankruptcy).

[29] *See, e.g., AFA v. Mesaba ,* 350 B.R. at 460-61 (reversing grant of application under Section 1113 and remanding to determine whether holding company – debtor's sole shareholder – had been asked to make its share of sacrifices).

has sacrificed prior to bankruptcy in excess of other stakeholders, fairness would dictate that the group need be asked for less within bankruptcy.

American's demands are not "fair and equitable" for two reasons:

A. American Has Demanded Unique and Enormous Contributions From Pilots With Respect to Scope

American claims that its labor proposals are fair because the costs for each labor group will be cut by twenty percent. Under that formula, American calculates the pilots' share of concessions to be $370 million per year. But American admits that the $370 million is exclusive of changes to the pilot Scope clause. From pilots' perspective, that clause is the most important in the entire contract. *See supra* at 26. It has been the most contentious issue in negotiations between the APA and the Company over the last decade.

As a result of the Company's demands on Scope, pilots are being asked to contribute much more than $370 million. Under the Company's business plan, Scope changes will generate at least half a billion dollars annually in revenue for the Company. This revenue will be a direct result of the near total evisceration of the pilot Scope clause. Moreover, Scope changes will almost certainly allow the Company to eliminate flying by American pilots, thereby reducing the number of pilots employed by the Company. A very conservative estimate places the impact of this elimination at $131 million over the next six years. No other constituency is being asked to make sacrifices of this kind.

B. American's Allocation of Demands Ignores the Extraordinary Pre-Petition Sacrifices by Pilots and the Lack of Similar Sacrifices by Management

American's proposal is not fair and equitable because it ignores a decade of history in which pilots have borne a disproportionate burden for the Company's difficulties. When the Company engaged in an out-of-court restructuring in 2003, pilots provided 37% of the cost cuts

while management and support provided 6%, even though the two groups constituted approximately the same portion of the Company's workforce. The Company's executives, however, recouped their losses through a series of bonuses, totaling $360 million since 2006. In contrast, hourly rates for pilots are much lower than they were in 2003 and the same, in nominal dollars, as they were in 1993. Recognizing this history, American should not have demanded the same percentage in cuts from pilots as the Company has said it plans to impose on management. The Company's failure to do so makes its proposal unfair and inequitable.

IV. American Failed to Provide All Relevant Information Needed to Evaluate its March 21 Proposal

To prevail under Section 1113, the debtor must provide "the representative of the employees with such relevant information as is necessary to evaluate the proposal." 11 U.S.C. § 1113(b)(1)(B). The debtor's disclosure must be "full and detailed," sufficient to "justify each of its proposed modifications." *K & B Mounting*, 50 B.R. at 467-68.[30] The information requirement creates an affirmative duty that the Company must fulfill on its own initiative and the extent of which does not depend on the APA's specific requests for information. *See* 11 U.S.C. § 1113(b)(1)(B); *Fiber Glass Indus.,* 49 B.R. at 203 ("It is the debtors' burden to provide the employee representative 'with such relevant information as is necessary to evaluate the proposal.'"). Indeed, the statute requires the debtor to fulfill its disclosure obligation contemporaneously with its legally sufficient proposal, in "the time period 'prior to filing an application seeking rejection.'" *Teamsters Airline Div. v. Frontier Airlines, Inc.*, 09 CIV. 343 (PKC), 2009 WL 2168851, at *11 (S.D.N.Y. July 20, 2009) (citing 11 U.S.C. § 1113(b)(1)(B)).

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30 *See In re Carey Transp., Inc.,* 50 B.R. 203, 208 (Bankr. S.D.N.Y. 1985) (citing *K & B Mounting* approvingly on the issue of information provision); *Century Brass*, 795 F.2d at 273-74 (suggesting that the Second Circuit follows the "same approach" as *K & B Mounting*).

As used in Section 1113, "relevant information" includes information about the debtor's business plan, not just its labor proposals. *See, e.g., In re Mesaba*, 341 B.R. at 717. Prior to filing its application, American was obligated to provide the models supporting its business plan, including such aspects as the airline's fleet decisions. *See id.* (denying an application under Section 1113 because the debtor did not provide such information). It is not sufficient to provide the output of such models; rather, the actual calculations and methods must be shared. *See id.* Similarly, American was required to provide a detailed account of the savings that the Company expected to achieve outside of labor as part of its business plan.[31] APA needed all of that information to determine whether American's demands were rooted in a reasonable business plan.

In addition, American was obligated to provide information describing the Company's assessment of the APA's counterproposals. That information is a critical factor in the union's assessment of whether it has sufficient justification to reject the debtor's proposal. *See Carey Transp.*, 816 F.2d at 92 (indicating that "a union's counterproposal of an equally effective set of modifications might justify its refusal to accept management's proposal.").

American failed to provide several critical pieces of information to the APA: (1) the model used by American to calculate the impact of workrule changes, (2) company valuations of APA proposals, (3) critical information about American's business plan, including an analysis of the non-labor savings that the Company hoped to achieve and an analysis of the Company's fleet plan.

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[31] Such information is relevant to whether American's labor proposals treat pilots "fairly and equitably" when compared to the sacrifices of other stakeholders, as well as whether American's proposals were "necessary" and based on the "most complete and reliable information available." 11 U.S.C. § 1113(b)(1)(A). *See, e.g., In re Cook United, Inc.,* 50 B.R. 561, 564 (Bankr. N.D. Ohio 1985) (finding that non-labor savings and revenue enhancements mitigated the debtor's need for labor savings through Section 1113).

A. The Company Failed to Provide the Model it Used to Calculate the Impact of Changes to Work Rules

"Relevant information" under Section 1113 includes mathematical models used by the debtor because thorough review of those models is critical to a union's assessment of the Company's proposals, as well as counterproposals contemplated by the union. *See In re Mesaba*, 341 B.R. at 717. In evaluating contract proposals, American has relied heavily on its Manpower Planning Model, referred to as "AAMPL." *See* Rosselot Decl. at ¶ 28. Given a specified set of contract modifications, together with a fleet and network plan, the model predicts how many active pilots American will need to employ for the following four years. *Id.* That figure, in turn, is used to estimate the magnitude of savings associated with American's contract proposals. *Id.* Because bargaining between the Company and the Union has centered on valuation disputes – and especially valuation disputes related to work rules – the APA needed access to the model in order to fully vet American's proposal.

Critically, the AAMPL model reveals information about how many pilots could be laid off under various contract proposals. *See id.* The APA needed to fully review and test those numbers in order to evaluate the Company's proposal and engage in meaningful bargaining. *See Fiber Glass Indus.*, 49 B.R. at 207 (denying an application under Section 1113 in part because the debtor did not provide information about anticipated layoffs, which the court held to be "relevant information" under Section 1113).

American has refused to share the AAMPL model with APA. *See* Rosselot Decl. at ¶¶ 29-30. The Company first disclosed the existence of the model in early March and allowed the APA to run just four scenarios on the model on March 27, 2012. *Id.* The Company has never provided the Union with the full output of those scenarios. Nor has it ever allowed the APA or its advisors to review the mechanics of the model, including the critical assumptions that

affect its calculations. *Id.* Consequently, the APA is unable to determine whether the Company's valuations are credible.

B. The Company Failed to Provide its Latest Valuations of APA Proposals

In communications with APA, the Company has refused to share its valuations of APA proposals because "American's obligation is to provide information necessary to evaluate its own proposals, and it is for the APA to validate proposals" made by the Union. APA Exhibit 429. This longstanding position has interfered with negotiations since before American filed for bankruptcy. American does not routinely share valuations of APA proposals and last offered a comprehensive valuation on March 5, 2012, prior to several changes to the parties' proposals. *See* Clark Decl. at ¶¶ 50-51.

The Company's flat refusal to provide and explain its analysis of APA proposals violates the Company's obligations under Section 1113. That information is obviously relevant to negotiations and to the APA's evaluation of the necessity of the Company's proposal. For example, if the APA's proposal will produce the same savings requested by American under the Company's own calculations, then the Union would know that it is justified in refusing to adopt the Company's proposal. American's obstinance made it impossible for the Union to determine whether that was the case.

C. The Company Failed to Provide Critical Information About its Business Plan

As discussed above *supra* 45-46, American's labor proposals are inextricably linked to its broader business plan. The Company calculated its "ask" by evaluating the gap between its earnings target ($3.1 billion by 2017) and the sum of planned revenue enhancements ($1 billion) and non-labor cost savings ($600 million). In order to evaluate the "ask," then, the APA needed to analyze the non-labor aspects of the business plan.

American has refused to provide information critical to that analysis. First, although the Company has offered a total target for non-labor savings, the Company has refused to disclose any projection of the magnitude of cost-savings achieved from non-labor creditors such as suppliers, vendors, and professionals. *See supra* at 35. Without that analysis, the Company cannot evaluate whether American might achieve more or less than its targeted $600 million in non-labor savings. Greater non-labor savings would lessen the need for labor cuts. The APA has also been hamstrung in in its ability to assess whether the Company's proposal treats the Union equitably as compared to other stakeholders.

Second, the Company has refused to disclose the business analysis used to justify its June 2011 aircraft order – the largest such order in the nation's history. *See supra* at 35. The APA's advisors at Lazard have tirelessly sought this information as part of their diligence on American's business plan. *See* Yearley Decl. at ¶¶ 34-35. Lazard has been rebuffed at every turn. *See id.* Without this information, the APA cannot assess the reasonableness of American's business plan and therefore cannot determine whether American's labor proposals, as part of that business plan, will facilitate a successful organization.[32]

[32] American claims that its information-sharing "compares favorably" to debtors whose rejection applications were approved, citing two cases from the bankruptcy court of the Western District of Pennsylvania. Debtors' Mem. at 86, n.74 (citing *Bowen Enters., Inc.*, 196 B.R. 734 (Bankr. W.D. Pa. 1996) and *In re Sol-Sieff Produce Co.*, 82 B.R. 787, 794 (Bankr. W.D. Pa. 1988)). This case, however, is a very different from *Bowen* and *Sol-Sieff* for the simple reason that American Airlines is a vastly larger and more complicated enterprise than the debtors in those cases. The debtor in *Bowen* was a single supermarket with annual sales of $11.4 million, 196 B.R. at 738; the debtor in *Sol-Sieff* was a produce distributor that had generated $3.7 million in revenue in the ten months prior to filing for bankruptcy, 82 B.R. at 790. In contrast, American takes in nearly four hundred million dollars *in a single week*. *See* Apr. 26 Tr. at 105:2-3 (Dichter) (describing American's annual revenue as approximately $20 billion). The complexity of American's business heightens its obligation to provide information that would allow the APA to fully understand the Company's business plan.

V. **The Company Failed to Bargain in Good Faith**

A debtor may not obtain approval to reject a labor contract unless, "[d]uring the period beginning on the date of the making of a [1113] proposal . . . and ending on the date of the hearing," the debtor has "confer[red] in good faith in attempting to reach mutually satisfactory modifications" of the collective bargaining agreement. 11 U.S.C. § 1113(b)(2). In the context of Section 1113, good faith bargaining means that the debtor must not adopt a take-it-or-leave-it approach, whether on its total "ask" or its package of particular terms. *See Northwest*, 346 B.R. at 327 ("The 'good cause' and good faith requirements have been held to preclude a debtor from simply offering a 'take it or leave it' proposal.").[33] Such a take-it-or-leave-it approach would be incompatible with the goal of Section 1113 to facilitate consensual agreements.[34]

This Court has established a "general rule" that a debtor's application should be denied under the good faith requirement if the debtor has insisted that the total amount of labor savings reflected in its proposal is non-negotiable. *See Delta* 342 B.R. 685, 697 (Bankr. S.D.N.Y. 2006) (denying an application under Section 1113 because the debtor made a non-negotiable demand for $8.9 million in concessions). Similarly, where the debtor refuses to engage in a genuine back-and-forth over the particular terms in its proposal, the debtor has failed to satisfy its statutory obligation, and its application must be denied. *See AFA v. Mesaba* 350 B.R. at 459 (denying an application under Section 1113 where debtor made a non-negotiable demand that no snapback be included in the modified agreement).

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[33] *See also Liberty Cab & Limousine*, 194 B.R. at 777 (holding that the debtor failed to negotiate in good faith due to its "take it or leave it" attitude).

[34] *See* 130 Cong. Rec. S8898 (daily ed. June 29, 1984) (quoting Senator Packwood, the sponsor of the language later enacted as Section 111, as stating, "this provision encourages the collective bargaining process, so basic to federal labor policy").

As a rare exception to this rule, a debtor may insist on a non-negotiable total "ask" or particular set of terms where the debtor has proven that its proposal is *absolutely essential* for reorganization – or, in the words of this Court, the "*sine qua non* of the debtor's reorganization." *Delta*, 342 B.R. at 697.[35] That bar, higher than the ordinary necessity test under Section 1113, has not been met or even approached by American. Thus, American's burden is to show that it did not treat its total "ask" or any particular term as non-negotiable.

In spite of the rule established by this Court in *Delta* and the commonsense meaning of "good faith" bargaining, American contends that a debtor is generally entitled to make its proposal non-negotiable and still satisfy the requirement. Debtors' Mem. at 90-92. To support that claim, American cites several cases decided under the National Labor Relations Act (NLRA). But American completely misconstrues the law under the NLRA.

To assess whether an employer has bargained in "good faith" under the NLRA, the court must analyze the "totality of the circumstances." *NLRB v. Ins. Agents' Int'l Union, AFL-CIO*, 361 U.S. 477, 508 (1960); *NLRB v. Suffield Acad.*, 322 F.3d 196, 198 (2d. Cir 2003). American's citations must be read in light of that principle. Thus, while a debtor's adoption of an "intransigent position" on an issue in negotiations might not in itself indicate bad faith, Debtors' Mem. at 91, a broader pattern of intransigent behavior may indeed constitute strong evidence that the debtor has failed to meet its statutory obligation.

Cases are legion under the NLRA in which an employer's refusal to budge on *nearly all key issues* in a labor negotiation has been considered nearly incontrovertible evidence of bad

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[35] *See also AFA v. Mesaba*, 350 B.R. at 458 (holding that a debtor may refuse to negotiate over one of its proposal only when that proposal is "essential" to reorganization).

faith bargaining.[36] The First Circuit explained that rule in upholding a finding of bad faith issued by the National Labor Relations Board:

> [I]f the employer makes not a single serious proposal meeting the union at least part way, then certainly the Board must be able to conclude that this is at least some evidence of bad faith. . . . In other words, while the Board cannot force an employer to make a concession on any specific issue or to adopt any particular position, *the employer is obliged to make some reasonable effort in some direction to compose his differences with the union. . . .*

Reed, 205 F.2d at 135.

In a similar case, the court found bad faith largely because "[t]he parties began to reach agreement only when the union gave way to [the employer's] demands." *Ass'n of Flight Attendants, AFL-CIO v. Horizon Air Indus.*, 976 F.2d 541 (9th Cir. 1992). That case is one of American's own citations. Debtors' Mem. at 91. And American's citation to *NLRB v. Advanced Bus. Forms Corp.*, 474 F.2d 457 (2d Cir. 1973) is the exception that proves the rule. In *Advanced Bus. Forms*, the employer was found to have negotiated in good faith even though it had refused to compromise on its opposition to a union security clause. *Id.* at 467. However, that refusal was considered in the broader context of the company's "entire course of conduct" – which included tentative agreements between the company and the union on "most of the economic issues" on the table. *Id.* at 466. American cannot claim those circumstances here.[37]

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[36] Cases finding bad faith under the NLRA on the basis of refusal to compromise include *Sparks Nugget, Inc. v. NLRB.*, 968 F.2d 991, 995 (9th Cir. 1992); *NLRB v. Reed & Prince Mfg. Co.*, 205 F.2d 131, 135 (1st Cir. 1953); *NLRB v. Columbia Tribune Pub. Co.*, 495 F.2d 1384, 1391 (8th Cir. 1974); *NLRB. v. Tower Hosiery Mills,* 180 F.2d 701, 705 (4th Cir. 1950). In one recently decided example, the federal district judge upheld a finding of bad faith bargaining by the employer where "nearly all of the provisions of [the employer's] final offer were identical to [the employer's] first offer." *Paulsen v. Renaissance Equity Holdings*, 2012 WL 1033339 (E.D.N.Y. Mar. 27, 2012).

[37] American also suggests it was hamstrung by the necessity requirement of Section 1113. *Id.* at 90-91. Because American's initial proposal had to be "necessary," the Company says, it was impossible for American to then "collapse towards some smaller package of concessions." *Id.* Yet, although the necessity standard is much more rigorous than American admits in its

Furthermore, an employer may be held to have violated its duty to bargain in good faith even where the employer makes concessions, where those concessions are trivial in the context of broader negotiations. *See Columbia Tribune Pub. Co.,* 495 F.2d at 1391. Accordingly, this Court must determine whether American has made a *meaningful* effort to compromise with the APA.

Here, American has violated its obligation to bargain in good faith because it has failed to engage in genuine dialogue over both its $370 million "ask" and its particular package of proposals to the APA. Instead, American has prevented genuine bargaining by creating needless and meritless disputes over valuation.

A. American Has Refused to Consider Compromise Over its $370 Million "Ask"

American has been quite clear, both in its negotiations with APA and in this Court, that the Company views its $370 million demand as non-negotiable. *See supra* at 32-33. That approach is incompatible with the "good faith" requirement of Section 1113, as this Court held in *Delta Air Lines, Inc.*, 342 B.R. at 697. Here, as in *Delta*, the Company has not revised its "ask" or demonstrated any willingness to consider doing so. American could not bargain in good faith while it stood unwilling to consider any package of proposals that did not meet or exceed the $370 target for concessions, as measured by the Company.

American's former labor chief, Mr. Brundage, claimed at trial that the Company would have considered a smaller "ask" if only the union had "made a suggestion to modify the business plan." Apr. 26 Tr. at 191:22-192:20 (Brundage). Yet, the APA in fact presented the Company

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separate discussion of the element, Debtors' Mem. at 76, it is not so rigid that it prevents subsequent compromise in the debtor's total ask or its specific package of modifications. *See Carey Transp.*, 816 F.2d at 89 (holding that "necessary" does not mean "bare minimum"). In light of *Carey*, American cannot claim that it had no room to revise its ask downward or engage in a true dialogue with the APA over particular terms in its proposal.

with a comprehensive and specific counterproposal that would have closed the labor cost gap previously quantified by American, while meeting three quarters of the Company's savings target and granting extraordinary concessions on Scope and productivity. That proposal was, of course, an alternative approach that American was obligated to consider sincerely under the "good faith" requirement. Instead, the Company stuck to its $370 million demand without ever analyzing the impact of even a slightly smaller cost cut.

American's bargaining stance does not satisfy the exception articulated in *Delta* that may apply when the debtor's demands are the "*sine qua non*" of reorganization. *Delta Air Lines, Inc.*, 342 B.R. at 697. Had the Company shown that its reorganization would undoubtedly be doomed if it achieved less than $370 million in annual savings from pilots, then it might have been justified in standing firm on that number. But as detailed *supra* 39-51, American has failed to satisfy even the ordinary necessity test of Section 1113. Moreover, even if American had satisfied that ordinary necessity standard, it still would have failed to make the more rigorous showing required for a debtor to claim that it had no room at all to consider compromise over its "ask." *Compare Delta Air Lines, Inc.*, 342 B.R. at 697, *with Carey Transp.*, 816 F.2d at 89. Indeed, American's own expert testified that the Company had never assessed whether reorganization might be successful with something less than $370 million in pilot labor savings. *See supra* at 22-23.

B. American Has Made Only Unilateral Changes to its Particular Package of Terms

In its briefs and declarations, American claims that it made meaningful concessions in negotiations with the APA. *See, e.g.,* Newgren Decl. at ¶ 40. In fact, these so-called "concessions" were nothing of the sort. Instead, after disclosing errors resulting in undervaluation of its own cost-cutting demands, American unilaterally altered the terms of its

package so that the total savings would realign with the unmovable $370 million target. *See supra* at 32-33. The Company did not consult the Union in making those modifications to its proposal. The Company never asked, for example, which proposals the Union would prefer as a means to recoup the additional $22 million discovered by American on February 10, 2012, e.g., added benefits or increased hourly wage rates.

American's unilateral moves were not true "concessions" because they did not emerge from discussion with the APA. Instead, they served only American's goal of hewing to its $370 million cost reduction target for the pilots. Indeed, at no point in these negotiations has American made a genuine concession. Each change to American's proposal has been carefully calculated to serve only the Company's interests.

C. American Has Prevented Genuine Bargaining by Creating Needless and Meritless Disputes Over Valuation

As both sides acknowledge, bargaining between the APA and American has been bogged down in disputes over valuation. Discussions over valuation have been especially intractable and unproductive for three reasons: (1) the Company has taken positions that are unwarranted and implausible, such as valuing the APA's work rules and sick leave proposal at only $22 million while valuing its own proposal at $100 million, even though the parties agree on many of the same approaches; (2) the Company has refused to share critical valuations and valuation models, so that the parties have been unable to engage in a genuine back-and-forth over the value; and (3) the Company has constantly changed its positions on the valuation of both parties' proposals. These facts support an inference that the Company has used valuation disputes as a way to avoid discussion on other issues and prevent real progress towards a mutually-agreeable contract.

First, as detailed in the declarations of First Officer Rosselot and Ms. Clark, the Company has made valuation assumptions that have not been and likely cannot be justified. The Company

assumes, for example, that use of sick leave will skyrocket after adoption of either party's proposal, and they justify that assumption by cherry picking data from the twelve month period with the highest sick usage in American's recorded history. *See* Rosselot Decl. at ¶¶ 39-40. The Company also assumes an unreasonably high discount rate, leading it to overestimate the present cost of future expenditures. *See* Clark Decl. at ¶ 48. The net result of the Company's mistaken valuations is that the Company fails to acknowledge about $100 million of additional savings created by each package put forth by the parties. *Id.* at ¶ 4. That amount excludes Scope concessions, on which the Company refuses to admit that *any* cost reductions can be realized.

Second, as detailed above, the Company has refused to share critical information and models with the APA. The Company knows that valuation is a critical roadblock in these negotiations and that the roadblock will never be overcome so long as Company refuses to disclose the bases for its positions. The parties cannot have a productive conversation about valuation because the Company refuses to share this information. American's obstinacy suggests that the Company is not truly interested in reaching consensus with the APA.

The Company's constantly changing valuation numbers have likewise impeded negotiations. Over the course of post-petition bargaining, for example, the Company has significantly revised its projection of headcount reduction associated with its Term Sheet, but has not provided any explanation for this change. The net result of these fluctuations has been a change of around 300 pilots from February 1, 2012, to the present, although the Company has made only minimal changes to its scheduling proposal that cannot account for this change. *See* Rosselot Decl. at ¶¶ 31-33. A difference of 300 pilots for a year has a huge impact on costs and productivity.

VI. The APA Had Good Cause For Refusing to Accept the Company's Term Sheet

The court must deny an application for rejection if the union has "good cause" for refusing to accept the debtor's proposed terms 11 U.S.C. § 1113(c)(2). Notably, the statute does not articulate or limit the circumstances that may constitute "good cause"; a union can have any number of legitimate reasons for refusing to accept a particular Section 1113 proposal. *Id.*

American concedes that a union has "good cause" to reject if the union has "offer[red]… alternatives focusing on the needs of the employer's reorganization" and compatible with a "successful reorganization." Debtors' Mem. at 94. Indeed, this Court has acknowledged that a union has "good cause" if it has offered "alternatives that would permit the debtor to reorganize." *Northwest*, 346 B.R. at 328. As part of American's burden of persuasion, then, the Company must prove that the alternatives offered by the APA would doom a successful reorganization. *Id.*; *Maxwell Newspapers*, 146 B.R. at 932 (holding that, once the union has produced evidence of its reasons for declining to accept the debtor's proposal, the debtor has the burden to prove that these reasons are inadequate).

The alternative offered by the union may take one of several forms:

- For example, the union may respond to a particular element of the debtor's proposal by offering an equally effective counterproposal on that term. If the debtor fails to adopt that specific counterproposal as part of its broader package of modifications, then the union has "good cause" to decline the debtor's proposal. *See In re Bruno's Supermarkets, LLC*, 09-00634-BGC-1, 2009 WL 1148369 (Bankr. N.D. Ala. Apr. 27, 2009) (denying a rejection application under the "good cause "standard because the debtor refused to adopt the union's equally effective counterproposal on a specific term).[38] Thus, in each area on which the APA has

[38] The court in *Bruno's Supermarkets* applied Second Circuit precedent in rejecting a debtor's Section 1113 application under the "good cause" standard. 2009 WL 1148369, at *16-19 (applying *In re Maxwell Newspapers, Inc.*, 981 F.2d 85 (2d Cir. 1992). The debtor had proposed to eliminate a successorship clause in the parties' agreement, offering "uncontroverted" evidence that the clause would lead to liquidation by preventing a sale. *Id.* The union countered with a proposal that would have made the collective bargaining agreement binding on a successor only if the successor chose not to negotiate a new deal with the union. *Id.* at 18.

made a counterproposal – scope, work rules, and the like – American has the burden to show that it could not adopt that counterproposal consistent with a successful reorganization.

- Relatedly, the union may make a comprehensive counterproposal that would permit the debtor to reorganize successfully. If the debtor continues to insist on its own proposal in light of this counter, then the union has good cause to reject. *See Carey Transp. Inc.,* 816 F.2d at 92 ("[A] union's counterproposal of an equally effective set of modifications might justify its refusal to accept management's proposal"). Thus, American has the burden to show that the APA's comprehensive proposal would not permit reorganization.

- Third, if the union has suggested an alternative business plan that would permit the debtor to reorganize without concessions as extensive as those entailed by the debtor's proposal, then the union has good cause to reject. Again, after the union has presented an alternative business plan, the debtor has the burden to show that the plan is incompatible with a successful reorganization.

In addition, a union has "good cause" to reject where, due to the debtor's use of inaccurate assumptions, the debtor's proposal will produce savings greater than those the debtor has claimed it needs. *See Delta*, 342 B.R. at 701 (denying an application under Section 1113 because the debtor's "cost savings will materially exceed the $8.9 million target" under the debtor's proposal). Here, if American's demands impose more than the $370 million in average annual reductions to American's pilot labor costs that the Company insists is necessary, then the APA has "good cause" to reject the Company's proposal.[39]

As demonstrated below, the APA had "good cause" to reject American's March 21 Term Sheet demands for at least four distinct and compelling reasons.

Finding that the counterproposal addressed the debtor's needs, the court ruled that the union had good cause to refuse the debtor's proposal. *Id.* at 19.

[39] To the extent that the debtors suggest that the Court's analysis under the "good cause" prong of Section 1113 is identical to the analysis under the necessity prong, that suggestion must be dismissed. *See* Debtors' Mem. at 93. As demonstrated above, numerous courts have held that a union has "good cause" to reject if the union has offered an alternative that is compatible with a successful reorganization – an inquiry that is independent of whether debtor's own proposal satisfies the separate necessity standard of Section 1113.

A. The APA's Comprehensive Proposal Would Have Closed the Pilot Labor Gap Between American and its Competitors While Providing American the Scope Flexibility and Productivity Enhancements it Claims to Need

As detailed in the Declarations of First Officer Roghair and Ms. Clark, the APA made a comprehensive counterproposal to American which was last amended on April 9, 2012. That proposal would have produced a net annual cost savings of $271 million, excluding any cost savings attributable to modifications to the pilot Scope clause. *See* Clark Decl. at ¶¶ 17-20. On Scope, the union agreed to give American substantial flexibility to both outsource regional flying and enter into codesharing agreements with domestic and international partners. *See* Roghair Decl. at ¶¶ 50-51. Meanwhile, the APA, along with American's unions, took the unprecedented step of offering to fly regional jets at rates based on those in place at small regional carriers like American Eagle. *See id.* at ¶ 60.

APA's comprehensive counterproposal is easily sufficient to "permit the debtor to reorganize," thereby giving the Union "good cause" to reject the debtor's more aggressive proposal. *Northwest*, 346 B.R. at 328. First, the proposal produces $271 million in annual average savings, about three quarters of the $370 million target that American created after filing for bankruptcy.[40] Through these savings, APA's proposal would entirely close the pilot labor cost gap, calculated by American at $260 million dollars. *See supra* at 11-13. Thus, the APA's proposal would give American a cost structure competitive with its peers. This is true even if one assumes that the costs of American's competitors will not naturally increase from the current status quo over time, and even if one assumes that APA's proposal will produce *no* savings from the easing of Scope restrictions.

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[40] *See supra* 42-48 for a full argument that $370 million in annual cost reductions are not necessary for reorganization.

Although competitive pilot labor costs should be enough for American, the APA's proposal goes farther. The APA has offered extraordinary concessions on the Scope clause of the current collective bargaining agreement. These concessions match the terms in place at American's peers and would allow substantial flexibility in outsourcing and codesharing.

Although American has offered no evidence indicating that the APA's proposals are insufficient for reorganization, the Company may argue in its rebuttal case that the Union lacks "good cause" because it failed to fully satisfy the Company's $370 million "ask." But a union's "good cause" should not hinge on whether the union jumps to meet an arbitrary target that the debtor has set unilaterally. Rather, the APA has good cause to refuse the Company's demands because the Union's own proposal would "permit the debtor to reorganize" by putting American's pilot labor costs on par with the airline's peers. *Northwest*, 346 B.R. at 328.

B. The APA's Counterproposals on Scope and Sick Leave Would Have Fully Satisfied American's Needs, but the Company Refused to Accept Those Proposals

Although American refused to accept APA's comprehensive counterproposal, it could have at least accepted some of the Union's counterproposals on specific terms. In particular, the APA made counterproposals on Scope and sick leave that would have fully satisfied American's needs. Rather than adopt those proposals, the Company steadfastly maintained its own position. Consequently, the Union had "good cause" to reject.

1. Scope

On Scope, American claims that current contractual restrictions prevent the airline from expanding its network by outsourcing regional flying and entering into codeshare agreements with other airlines. The Company claims it needs this flexibility to expand its network in two ways: (1) by deploying outsourced regional jets on routes that are currently uneconomical to

operate with AA pilots, and (2) by entering into codeshare agreements [redacted]

[redacted]. *See, e.g.*, Newgren Decl. at ¶¶ 52-87. Notably, the Company has claimed that it intends to use Scope flexibility not to *replace* any work currently performed by AA pilots but rather to *supplement* the current network, thereby bringing additional traffic to the Company's "cornerstone" hubs. *See, e.g.*, Apr. 26 Tr. at 198:13-199:4 (Vahidi) (rejecting claims that the Company will use Scope flexibility to outsource flying as "a complete mischaracterization").

The APA's counterproposals fully satisfy the Company's goals while limiting the Company only from doing what it claims it has no intention to do: replacing flying currently done by American pilots. With respect to regional jets, the APA has first taken the unprecedented step of proposing that American pilots fly these aircraft at *the same or similar pay rates* as pilots at the regional airlines at which American would otherwise outsource. *See* Roghair Decl. at ¶ 60. That proposal, combined with American's current ability to purchase and operate any size aircraft with AA pilots, would remove the need for outsourcing by allowing the Company to operate large regional jets just as economically with its own pilots.[41] If that is not enough, the APA has also proposed allowing the Company to outsource more regional jets than the Company itself projects that American will need. American's projections call for 109 regional aircraft between 70 and 99 seats. *See* APA Exhibit 515. The APA's offer would allow the Company to outsource 150 aircraft in that range. *See* Eaton Decl. at ¶ 25. Those proposals

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[41] Company witness Virasb Vahidi testified that regional carriers may be able to operate routes more cheaply for reasons other than their labor costs, namely more favorable aircraft financing agreements and lower maintenance costs. Apr. 25 Tr. at 295:13-301:8 (Vahidi). In fact, the Transport Workers Union has agreed to perform maintenance on regional aircraft at regional rates. Moreover, regional carriers now are not able to secure favorable leasing terms because their financial profiles are much weaker than American's will be when it emerges from this bankruptcy. American currently owns all of the regional jets on which it is outsourcing flying. *See* APA Exhibit 512.

are eminently reasonable, particularly when compared to the Company's more drastic demand to obtain the ability to outsource 305 of these aircraft.

With respect to codesharing, the APA has proposed to allow the Company to enter into the [redacted] codeshares that American claims to need. The APA has proposed conditions on those codeshares only to the extent needed to prevent the Company from using its codesharing discretion to *replace* flying currently performed by AA pilots – limits that will not impede reorganization in any way under the Company's claim that it will not engage in that form of replacement. *See id.* at ¶¶ 36-41. For example, under the APA's proposal, as long as American maintains its total number of departures out of JFK, it can enter into a codeshare [redacted]. *See id.* at ¶¶ 38-39. The APA has made similar proposals [redacted]. *See id.* at ¶¶ 40-41

The Company has refused to adopt the APA's proposals because it has insisted on securing flexibility *that it claims it will never use* to replace current flying. In the face of that unreasonable position, the APA has "good cause" to refuse to accept the Company's proposal until the Company either modifies its scope demand or admits that Scope flexibility will lead to lost flying and therefore credit savings from Scope towards the $370 million target.

2. <u>Sick Leave</u>

On sick leave, American complains that its pilot productivity has suffered because pilots take more sick leave than their peers at other airlines. The APA has offered a responsive counterproposal that fully addresses the issue by reducing sick usage in three ways. *See supra* at 24-25. First, the APA's proposal creates a sick leave sellback program that would incentivize pilots to build a large bank of unused sick leave and exchange a portion of that bank for cash. The Company originally put this proposal on the table, and the Company's own financial analyst

has admitted that it will decrease sick usage by 10%. *See Roghair* Decl. at ¶ 57. That alone would almost entirely meet American's stated goal of reducing current sick hours from 8.2% of paid hours to 7.2% of paid hours – the same goal the Company says will be achieved under its own more punitive proposal.

The APA's proposal would further decrease sick usage in two other ways. The APA's proposed "sequence protection" system would remove the incentive for pilots to call in sick when a flight has been cancelled. Again, American agrees that this proposal will significantly reduce sick usage. *See* Newgren Decl. at ¶¶ 101-102. Furthermore, the APA's proposed Preferential Bidding System will prevent pilots from being required to fly schedules that conflict with important personal obligations, thereby further reducing the incentive to call in sick to attend to those obligations. *See* Rosselot Decl. at ¶ 43.

American should have adopted the APA's proposal on sick leave. Instead, without justification, the Company has demanded a system that is all stick and no carrot. The Company proposes to dock pilots' pay while on sick leave by 40% in certain circumstances – and pay nothing at all to pilots on longer leave if the pilots do not obtain corroboration through American's outside vendor. American insists on this program even though the Company says that it will initially cause sick usage to *increase* rather than decrease. *See id.* at ¶ 39. Because American has refused to adopt the APA's less punitive and more effective counterproposal, the Union had good cause to reject the Company's demands. *See In re Bruno's Supermarkets,* 2009 WL 1148369.

C. American's Demands Produce More in Average Annual Savings and Revenue Enhancements Than American Says it Needs

The APA also had "good cause" to reject American's demands because the Company's proposal exceeds the Company's own target for labor cost savings. *See Delta*, 342 B.R. at 701.

First, *by American's own admission*, its March 21, 2012, proposal would have produced $377 million in average annual savings, excluding the Company's proposal on crew rest seats, which American had previously valued at $9 million annually. *See* Clark Decl. at ¶ 53. Those figures also exclude the Company's proposal on Scope, which American insists does not count towards the target.

In fact, this admitted undervaluation is only a small portion of the excess savings that will result from American's proposals. As demonstrated in the Declarations of Ms. Clark, Mr. Heppner and First Officer Rosselot, American has made a series of errors in valuing its demands. The most significant of these errors include (1) making unreasonable assumptions related to discount rate and medical utilization, leading to savings undervaluation of almost $30 million annually, and (2) using flawed scheduling and pricing models, leading to savings undervaluation of almost $20 million annually. *See supra* at 30-32.

As for revenue, American claims that it needs unlimited discretion to codeshare in order to generate [REDACTED] in incremental revenue as part of its business plan. In fact, although revenue resulting from codeshares is difficult to predict, American's own evidence suggests that its proposal will generate much more than [REDACTED] annually. Several of the Company's witnesses testified that American's proposed Scope concessions would likely lead to new or expanded codeshare agreements [REDACTED]. *See, e.g.,* Newgren Decl. at ¶ 72. Further, the Company acknowledges that a codeshare with each of these partners would produce significant revenue. *See, e.g.,* Debtors' Mem. at 17 (claiming that an expanded codeshare [REDACTED] "immediate, direct impact on revenue").

But American's projections indicate that the Company will achieve [REDACTED] [REDACTED] According to Ms. Goulet, the

revenue projection in the current Restructuring Business Plan assumed no new codeshare agreement [REDACTED]

[REDACTED] *See* Apr. 24 Tr. at 225:2-24 (Goulet). If those additional codeshare arrangements materialize – and the Company has built part of its argument for Scope changes on the theory that they will – then American's proposal will produce significantly greater revenue enhancements than the Company's Business Plan requires.

D. A Merger With US Airways Would Facilitate A Successful Reorganization While Requiring Lesser Pilot Sacrifice

The APA has "good cause" to reject American's demands because the Union reasonably believes that consolidation with US Airways offers a better path forward for all stakeholders at less cost to employees. Consolidation can be accomplished now without pushing American's labor contracts below market. US Airways and the APA have agreed that, should the airline be successful in acquiring American, the new airline will implement market-based contract terms with the pilots. *See supra* at 18-19. The APA and US Airways have agreed to $240 million in annual average cost cuts and, in particular, a market-based approach to compensation, productivity, and Scope, among other areas. *Id.* The agreement was concluded in a matter of days, as were the similar deals between US Airways and American's other employee unions. *Id.* All three unions agree that consolidation with US Airways is the best path forward for American, and all three unions are willing to sacrifice to make consolidation a reality.

American's management admits that consolidation is inevitable, *see* Apr. 24 Tr. at 177:1-9 (Goulet), and American's top financial advisor, Mr. Resnick, testified that the Company will consider consolidation before it exits bankruptcy, Apr. 25 Tr. at 134:10-22 (Resnick). Thus, there can be no serious dispute that the Company's current business plan is a temporary placeholder while the Company develops its real long-term strategy. But the Company

nevertheless maintains that it must first extract its concession demands from the APA or abrogate the pilots' CBA, even though the Company knows that consolidation may lessen labor sacrifices. *See* Apr. 25 Tr. at 177:18-23 (Resnick). In the face of that unreasonable position, the APA is justified in insisting that the Company consider consolidation before implementing hundreds of millions of dollars in unneeded labor cuts.

VII. The Balance of the Equities Does Not Clearly Favor Rejection of APA's Contract

The Court must deny a Section 1113 application if the debtor has not proven that "the balance of the equities clearly favors rejection" of the collective bargaining agreement. 11 U.S.C. § 1113(c)(3). Because the legislators used the word "clearly" in Section 1113(c)(3), the debtor has a heightened burden of proof on this element of the statute. American must prove by "clear and convincing evidence" that the balance of the equities favors rejection of its agreement with the APA. *Walway*, 69 B.R. at 974 (indicating that the element must be proven by "clear and convincing evidence"); *K & B Mounting*, 50 B.R. at 467 (indicating that on this element "a preponderance of the evidence will not be sufficient.").

Although a number of factors may be considered in assessing the balance of the equities, two criteria are particularly important.[42] First, "the balance of the equities nearly always will tip in favor of the party that seeks to reach a compromise." *Royal Composing Room*, 848 F.2d at

[42] As a non-exclusive list of factors, courts may consider: (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 Transp.*, 816 F.2d at 93.

349. Thus, to prevail on its Motion, American must establish by clear and convincing evidence that it sought to compromise in negotiations with the APA over its contract proposal.

Second, the Court must focus on how the Debtors' requested concessions, in the context of its broader business plan, would "relate to the success of reorganization" and thereby impact stakeholders such as creditors, employees, and customers. *See Carey Transp.*, 816 F.2d at 92-93. *See also* Debtors' Mem. at 96 (analyzing the "balance of the equities" by discussing the impact of rejection on employees, creditors, and the "flying public"). American must prove by clear and convincing evidence that these stakeholders will be best served by a rejection of the APA's collective bargaining agreement.

As shown below, American has failed to meet its burden the "balance of the equities" requirement.

A. Consolidation With Another Airline Would Require Smaller Labor Costs While Leading to Better Value for Nearly All Stakeholders

The evidence is undisputed that American is at a severe competitive disadvantage because its network is significantly smaller than that of its two main competitors, Delta and United. *See, e.g.,* Kasper Decl. at ¶¶ 61-62. Delta combined with Northwest in 2008. United combined with Continental in 2010. As a direct result of those mergers, American went from having the largest network in the world to a distant third. Consequently, American has struggled in recent years while Delta and United thrived.

Nearly every analyst who has considered the issue has concluded that American's best path forward is to consolidate with another airline, most likely US Airways. American's own CEO, Tom Horton, has acknowledged that consolidation is inevitable. *See* Apr. 24 Tr. at 177:1-9 (Goulet). The Company's financial expert, Mr. Resnick, testified in court that American would

consider consolidation once it resolved its labor cost issues, presumably by prevailing on this Section 1113 application. Apr. 25 Tr. at 134:10-22 (Resnick).

Consolidation with US Airways would substantially mitigate American's draconian labor demands, thereby returning fair and productive labor relations to the airline. It would also be in the best interest of nearly all stakeholders, excluding current Company management. Consolidation would make "new American" the largest airline in the world, allowing it to compete effectively with Delta and United. Among the many benefits of consolidation articulated by the Company's own experts, new American's larger network would make it more attractive to business passengers and thereby allow it to achieve a higher fare premium and more revenue. *See* Apr. 23 Tr. at 171:22-172:10 (Kasper).

B. The Company's Insistence on Achieving Draconian Labor Cuts Through Section 1113 Before Consolidating Serves Only the Interests of Current Executives

American's pursuit of its unfounded and unnecessary rejection application at this time is not driven by regard for the best interest of all stakeholders in this bankruptcy. Rather, it is an obvious attempt to disadvantage employees while benefiting American's management. First, as Mr. Dichter admitted, the Company's executives believe they will have more bargaining power in negotiations with other airlines once they have slashed their labor costs to below-market levels. *See* Apr. 26 Tr. at 69:12-71:12 (Dichter). Second, American believes that under applicable precedent, the APA will have no entitlement to an unsecured claim against the estate if this Court approves the Company's rejection application. *See In re Northwest Airlines,* 366 B.R. 270, 277 (Bankr. S.D.N.Y. 2007).

The Company's strategy thus allows management to use the bankruptcy process as an entrenchment device.[43] American's executives have significant personal incentives for deferring a consolidation plan until after rejection of the Company's labor contracts. Management's enhanced bargaining power post-rejection will allow them to either resist a takeover altogether or, at the least, negotiate larger personal monetary payments in connection with a combination with another airline.[44] Neither outcome is in the best interest of other stakeholders.[45] Labor unions, creditors, and equity holders will all be better served by pursuit of a viable consolidation prospect without delay and on terms that do not disproportionately enrich current executives.

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[43] In *Samuel M. Feinberg Testamentary Trust v. Carter*, 652 F. Supp. 1066 (S.D.N.Y. 1987), the Court highlighted the impropriety of the entrenchment motive in evaluating management's resistance to a potential takeover:

> For, if Icahn in fact had consummated his proposed takeover, a change in Goodrich management, including the board of directors, was possible. With such a turnover, board members would lose the benefits they receive as Goodrich directors. Not only did such directorships carry with them an intangible benefit of prestige, they included significant financial rewards as well. Each of the directors received more than $20,000 in annual salary, with Defendants Carter and Patrick Ross receiving more than $300,000, and Defendant Ong receiving more than $500,000. . . .

Id. at 1074.

[44] *See, e.g. International Insurance Co. v. Johns,* 874 F.2d 1447, 1459 (11th Cir. 1989) (indicating that "[b]ecause of the desire for entrenchment" takeover defenses warrant close scrutiny). The size of severance payments to top management has been extensively documented. *See, e.g.,* H.R. Rep. No. 111-236, at 7 (2009) (listing prominent CEOs receiving severance payments as high as $210M and $160M, even if the company's survival hinged on government largesse).

[45] *See, e.g., Norlin Corp. v. Rooney, Pace Inc.,* 744 F.2d 255, 265 (2d Cir. 1984) (finding potential breach of fiduciary duty when the Boards actions gave rise to a "strong inference that the purpose of the transaction is not to benefit the employees but rather to solidify management's control of the company")*; In re Ames Dept. Stores, Inc.*, 115 B.R. 34, 38 (Bankr. S.D.N.Y. 1990) ("[E]ntrenchment of management may not be in the best interests of the estate. . . .").

CONCLUSION

For the foregoing reasons, and based on the evidence that the APA will present in Court, the APA respectfully submits that the Debtors' motion must be denied at this time.

Respectfully submitted,

/s/ Edgar N. James

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