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American Airlines' Bankruptcy - Is American Ready for Takeoff after Rejecting Its Collective Bargaining Agreement

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AMERICAN AIRLINES' BANKRUPTCY—IS AMERICAN READY FOR TAKEOFF AFTER REJECTING ITS COLLECTIVE BARGAINING AGREEMENT?

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ANOTHER BANKRUPTCY, another defeat for organized labor. In the latest courtroom saga pitting management against organized labor, the U.S. Bankruptcy Court for the Southern District of New York initially denied debtor American Airlines, Inc.'s (American's) motion to reject its collective bargaining agreement (CBA) with its pilots' union;[1] however, that labor victory was short-lived, as the judge granted American's renewed motion less than one month later.[2] The court originally denied American's motion on two narrow grounds: that American's proposed changes to codesharing[3] and pilot furloughs went too far.[4] What some initially thought was "a rare Chapter 11 victory for labor" and "a significant setback for management,"[5] actually turned out to be a victory for American when the court properly granted the renewed motion under Section 1113 of the Bankruptcy Code.[6] Yet, the court should have gone further: it should have granted the original motion.

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[1] *In re* AMR Corp., 477 B.R. 384, 394 (Bankr. S.D.N.Y. 2012).

[2] *In re* AMR Corp., 478 B.R. 599, 602 (Bankr. S.D.N.Y. 2012).

[3] Codesharing is an "arrangement where two or more airlines share the same flight," in which "a seat can be purchased on one airline but is actually operated by a cooperating airline under a different flight number or code." *In re AMR Corp.*, 477 B.R. at 402. It permits "single bookings across multiple planes." *Id.*

[4] *See id.* at 454.

[5] Associated Press, *Federal Judge Bars American Airlines from Dropping Pilots' Contract, for Now*, NEWSON6.COM (Aug. 16, 2012, 8:41 AM), http://www.newson6.com/story/19292878/federal-judge-bars-american-airlines-from-dropping-pilots-contract.

[6] *In re AMR Corp.*, 478 B.R. at 602; 11 U.S.C. § 1113 (2006).

American, founded in 1934, is the principal subsidiary of AMR Corporation.[7] It is known as a "network carrier," a term that also describes Delta Air Lines, United Airlines, and US Airways.[8] American has approximately 65,000 employees, 70% of whom are represented by three unions—the Association of Professional Flight Attendants (APFA), the Allied Pilots Association (APA), and the Transit Workers Union of America, AFL CIO (TWU)—under nine separate CBAs.[9]

American has struggled to compete in the market due to high labor costs coupled with low productivity, mergers and restructurings among its competitors, and increased competition from low-cost carriers.[10] American's poor financial performance is borne out in its "costs per available seat mile," which is significantly higher than most of its competitors.[11] The primary reason is labor costs, which are "approximately 24% higher than the average of the other network carriers and 79% higher than the average of the [low-cost carriers]."[12] American also faces low productivity among its pilots, whose labor costs total $1.8 billion per year and are among the highest of American's network competitors—"a fact essentially conceded by the APA."[13]

In 2011, not only did American lose over $1 billion, but it was also the only network carrier that failed to earn a profit that year.[14] In fact, American has lost more than $10 billion since 2001.[15] By 2011, however, every other major network carrier had undergone reorganization through bankruptcy at least once.[16] Continental Airlines filed for bankruptcy in 1990, United and US Airways in 2002, US Airways (again) in 2004, and both Delta and Northwest Airlines in 2005.[17] In addition to these reorgani-

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[7] *In re AMR Corp.*, 477 B.R. at 395.

[8] *Id.* (identifying a "network carrier" as an airline among "the surviving set of large carriers, most of which were established long before deregulation, that operate on a hub and spoke traffic model, service a wide variety of both domestic and international destinations using multiple aircraft types, and have workforces relatively more senior than the newer entrants").

[9] *Id.* at 393, 395.

[10] *Id.* at 398.

[11] *Id.* at 399.

[12] *Id.*

[13] *Id.* at 400.

[14] *Id.* at 397.

[15] *Id.*

[16] *See id.* at 400.

[17] Associated Press, *American Joins Long List of Airline Bankruptcies*, BOSTON.COM (Nov. 29, 2011), http://www.boston.com/business/articles/2011/11/29/american_joins_long_list_of_airline_bankruptcies/.

zations, Delta recently merged with Northwest, and United recently combined with Continental.[18] American finally filed for Chapter 11 bankruptcy on November 29, 2011.[19]

American unveiled its new six-year business plan approximately two months later.[20] The plan included setting up a sustainable cost structure and attracting "high value" customers since the airline could not compete with low-cost carriers on price.[21] American provided term sheets based on its business plan, which contained modifications to each CBA and asked for a 20% reduction in costs across the board, $1.25 billion of which would be from labor.[22] American entered into negotiations with its unions regarding the modifications, even offering a new term sheet on March 21, 2012.[23] Unable to reach an agreement, however, American filed a motion to reject the CBAs on March 27, 2012.[24] After a three-week trial, but before the court made its ruling, American reached an agreement for a new CBA with the TWU and made enough progress with the APEA that it asked the court to rule on the motion only with respect to the APA.[25]

Therefore, the sole issue before the court was whether American could reject its CBA with the APA under Section 1113 of the Bankruptcy Code.[26] Section 1113 was enacted in 1984 in response to the Supreme Court's decision in *NLRB v. Bildisco & Bildisco*[27] and sought to replace *Bildisco*'s generous standard with one more favorable to upholding CBAs.[28] Even though Congress enacted this section to be more labor-friendly than *Bildisco*, one recent study of over 300 large Chapter 11 bankruptcies found that courts have rejected thirty-two out of thirty-two CBAs in contested Section 1113 motions.[29]

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[18] *In re AMR Corp.*, 477 B.R. at 395.

[19] *Id.* at 401.

[20] *Id.*

[21] *Id.* at 401–02.

[22] *Id.* at 403.

[23] *Id.* at 404.

[24] *Id.*

[25] *Id.* at 393.

[26] *Id.*

[27] 465 U.S. 513, 526 (1984) (holding that a CBA may be rejected by a showing that the agreement "burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract").

[28] *In re AMR Corp.*, 477 B.R. at 405.

[29] Andrew B. Dawson, *Collective Bargaining Agreements in Corporate Reorganizations*, 84 AM. BANKR. L.J. 103, 116 (2010).

The debtor must meet seven requirements to reject its CBA under Section 1113. Before filing the motion, it must have proposed to the union modifications that: (1) are "necessary" to its reorganization; (2) treat all parties "fairly and equitably"; and (3) are "based on the most complete and reliable information available."[30] In addition, the debtor must show that: (4) it has shared with the union all information necessary to evaluate its proposal; (5) it has negotiated in good faith; (6) the union has rejected the proposal without "good cause"; and (7) the "balance of the equities clearly favors" the motion.[31]

The court denied American's Section 1113 motion on the grounds that the airline failed to establish that its proposed changes to codesharing and pilot furloughs were "necessary" for reorganization, even though the remaining six requirements of Section 1113 were met.[32] The court began its analysis by considering the APA's objections that several of the proposed changes were not "necessary" for reorganization, breaking the objections down into three groups: (1) blanket objections; (2) objections to proposed changes in benefits; and (3) objections to proposed changes relevant only to pilots.[33] For its motion to succeed, American had to "show that its proposed modifications to the [CBA were] necessary for reorganization."[34] But, in this instance, "'necessary' should not be equated with 'essential' or bare minimum."[35] The court's "focus should be on the long-term economic viability" of the debtor rather than on short-term economics.[36] That is, American was entitled to more than bare minimum changes in the CBA; it was entitled to make changes that would result in its long-term economic viability.[37]

With respect to the blanket objections, the APA argued that a merger between American and US Airways was inevitable, "given recent consolidation in the airline industry," and American was

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[30] *In re AMR Corp.*, 477 B.R. at 393; *see also* 11 U.S.C. § 1113(b)(1) (2006).

[31] *In re AMR Corp.*, 477 B.R. at 393; *see also* 11 U.S.C. § 1113(b)(2)–(c).

[32] *In re AMR Corp*, 477 B.R. at 454.

[33] *Id.* at 411.

[34] *Id.* at 407.

[35] Truck Drivers Local 807, Int'l Bhd. of Teamsters v. Carey Transp., Inc., 816 F.2d 82, 89 (2d Cir. 1987); *but see* Wheeling Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074, 1088–89 (3d Cir. 1986) (holding that "necessary" is synonymous with "essential" and that the court should focus on the "shorter term goal of preventing . . . liquidation . . . rather than the longer term issue of the debtor's ultimate future").

[36] *In re* Delta Air Lines, Inc., 359 B.R. 468, 477 (Bankr. S.D.N.Y. 2006).

[37] *See In re AMR Corp.*, 477 B.R. at 407.

obligated "to pursue such a merger before availing itself of Section 1113 relief."[38] The court disagreed, noting that "there [was] no evidence before the [c]ourt of a proposed merger between the two airlines," "[n]or [was] there evidence that the two airlines ha[d] reached an agreement in principle."[39] The court overruled the APA's objections regarding the new business plan—finding testimony from American's experts to be more credible—and also overruled an argument that labor costs would converge with American's competitors by 2014—finding it unpersuasive in light of the airline's $1 billion loss the previous year.[40] With respect to the second group of objections (changes in benefits), the APA argued that American should seek fewer concessions because it undervalued those savings. The court once again found the APA's argument unavailing.[41]

The third group of APA objections under the "necessary" prong dealt with proposed changes affecting only pilots—changes regarding regional jets, codesharing, furloughs, scheduling, and sick leave.[42] Regional jets are not flown by APA members, so it was not surprising that the APA objected to American's plan to use regional jets with larger seating capacity despite the fact that "smaller regional jets of [fifty] seats or less are not fuel efficient and are no longer manufactured due to a lack of commercial viability."[43] In fact, all of American's major competitors—each of whom earned a profit last year—use regional jets with more than fifty seats.[44] The APA also objected to American's plan to increase the maximum number of hours pilots can work in one month, even though American "ha[d] the lowest schedule maximum among network carriers."[45] Even more, the APA objected to American's plan to decrease sick leave pay, even though "American's pilots also use[d] more sick leave than any of their network airline peers."[46] The court, following industry standards, overruled the APA's objections regarding regional jets, scheduling, and sick leave.[47]

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[38] *Id.* at 411.

[39] *Id.* at 412.

[40] *Id.* at 417, 422.

[41] *Id.* at 425–26.

[42] *Id.* at 411. The APA also had an objection to the valuation of American's March 21 proposal, but this objection was overruled by the court. *Id.* at 436.

[43] *Id.* at 427–29.

[44] *Id.*

[45] *Id.* at 435.

[46] *Id.*

[47] *Id.* at 428, 435, 436.

Industry standards worked in favor of the APA on the two remaining objections, however: codesharing and furloughs. The court upheld the APA's objection to codesharing because American's attempt to expand the practice would have resulted in no specific limits and "no other network carrier currently has such unlimited codesharing."[48] Looking to industry standards for guidance, the court concluded this time that American's proposal went too far.[49] Similarly, the court agreed with the APA's objection to American's plan to eliminate all restrictions on the company's ability to furlough pilots, noting that such a proposal was not in line with industry standards.[50]

For the remaining six requirements of the Section 1113 motion, the court found that American met its burden.[51] Although American complied with six out of the seven requirements, and although the court rejected the overwhelming majority of the APA's arguments and objections, the court ultimately denied the motion because of the proposed changes to codesharing and furloughs.[52] The court reached this result by analyzing the industry standards for each of American's proposed changes to the CBA, overruling objections where the changes fell within industry norms and upholding objections where the changes were inconsistent with industry standards.[53] Since the proposal would have resulted in nearly unlimited codesharing and a sweeping ability to furlough pilots, the court rejected the motion because the proposed changes were not within industry norms, and therefore not "necessary" for American to successfully reorganize.[54]

The court could have overruled the APA's objections to those two changes, however, by focusing on the "long-term economic

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[48] *Id.* at 432, 433.

[49] *Id.* at 433.

[50] *Id.* at 434–35.

[51] *Id.* at 437 (finding the modifications were "fair and equitable"); *id.* at 439 (finding the modifications were based on the "most complete and reliable information" and rejecting the APA's contention that it was not provided with relevant information); *id.* at 446 (finding the APA had not shown American failed to negotiate in good faith); *id.* at 447 (finding the APA did not have a good cause for rejecting the modifications); *id.* at 450 (concluding that "the balance of the equities clearly favor[ed] rejection of the APA agreement").

[52] *Id.* at 454.

[53] *See id.* at 433, 435.

[54] However, the judge granted American's renewed motion less than one month later after the airline limited its codesharing proposal and dropped its furlough request altogether. *In re* AMR Corp., 478 B.R. 599, 603–04 (Bankr. S.D.N.Y. 2012).

viability" of American.[55] The court observed that "the pattern appears the same: the airline enters bankruptcy with labor costs that are at or near the top of the industry and then emerges with costs at or near the low end of the group. American now seeks to follow in the same path."[56] Airline bankruptcies appear to be a never-ending cycle; American's filing is the 100th time a U.S. carrier has filed for bankruptcy since 1990, including several airlines filing multiple times.[57] If history provides a lesson, there is a reasonable chance American could find itself back in bankruptcy in the near future. So, why not let American delay the inevitable bankruptcy a few more years by permitting the company to make the proposed changes to codesharing and furloughs that would place it *above* industry norms?

By granting the original motion, the court could have enabled American to emerge from bankruptcy with a slight market advantage. While some might argue that debtors should not look to the bankruptcy court to gain market advantages, these two proposals are relatively minor issues compared to the entire proceeding and the modest advantages would likely be negotiated away each time the CBA expires. In fact, given that American has lost $10 billion since 2001, it will take quite a few years for these market advantages to even result in a profit.[58] In the long-term, allowing the proposed changes to codesharing and furloughs could allow American to avoid a subsequent bankruptcy for a few additional years, until its labor costs are once again too high to be profitable. Given the never-ending cycle of airline bankruptcy and a stated focus on the long-term economic viability of the airline, the court should have permitted American's proposed changes to codesharing and furloughs even though they went beyond industry norms.

This case, along with the recent history of Section 1113 cases involving major corporations, demonstrates the uphill battle unions face when a debtor moves to reject its CBA during bankruptcy. However, the ruling offers key insight into how unions can succeed on Section 1113 motions in the future. "[A]s was the case in the Section 1113 proceeding in [the] Northwest [bankruptcy], the [u]nions here did not offer an alternative

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[55] *See In re* Delta Air Lines, Inc., 359 B.R. 468, 477 (Bankr. S.D.N.Y. 2006).

[56] *In re AMR Corp.*, 477 B.R. at 419.

[57] Tom Bemis, *AMR is 100th Airline Bankruptcy Since 1990*, WALL ST. J. MARKETWATCH (Nov. 29, 2011, 11:18 AM), http://blogs.marketwatch.com/thetell/2011/11/29/amr-is-100th-airline-bankruptcy-since-1990/.

[58] *See In re AMR Corp.*, 477 B.R. at 397.

stand-alone model to American's Business Plan. . . . The [u]nions' inability to articulate a different overall vision of a stand-alone airline is telling."[59] If unions want to succeed on these motions in the future, they need to offer viable alternative economic models, unlike the APA simply offering $260 million in annual savings without a business plan when American stated that it needed $370 million in savings to successfully reorganize and proffered such a model to obtain these savings.[60]

What gets lost in the Section 1113 argument is the bigger picture, however, and perhaps the more important question: whether American will emerge from bankruptcy and begin operating as a profitable airline. As of the date of this note, American has yet to emerge from bankruptcy.[61] Furthermore, even though the APA's arguments over codesharing and furloughs are what convinced the court to initially deny the motion, the APA also devoted substantial time arguing that the court should deny the motion because a merger with US Airways was inevitable.[62] While the court dismissed that argument for reasons mentioned above, that does not mean a merger between the two airlines will not happen. In fact, it appears American purposefully waited until the court ruled before exploring a merger, as the airline began negotiations with US Airways a few days before the court granted the renewed motion.[63] Subsequently, on February 14, 2013, American and US Airways entered an all-stock merger agreement, pending approval from regulators and the court, which would leave AMR creditors owning 72% of the combined carrier and US Airways' management team in charge of operational control.[64]

Nevertheless, American's future still remains uncertain because it appears the APA did not take its loss in court well. In

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[59] *See id.* at 418.

[60] *See id.* at 445.

[61] On March 13, 2013, American filed a request to extend its period of exclusivity from April 15 to May 29. *American Airlines Requests More Time to File Reorganization Plan*, REUTERS (Mar. 13, 2013, 9:53 PM), http://www.reuters.com/article/2013/03/14/us-american-reorganization-idUSBRE92D03K20130314.

[62] *See In re AMR Corp.*, 477 B.R. at 416.

[63] *See* Gregory Karp, *American, US Airways, British Air in Merger Talks*, CHI. TRIB. (Aug. 31, 2012), http://articles.chicagotribune.com/2012-08-31/news/chi-american-us-airways-say-they-are-evaluating-potential-merger-20120831_1_merger-talks-ceo-tom-horton-american-airlines.

[64] Soyoung Kim & Karen Jacobs, *American to Unite with US Airways to Create No. 1 Carrier*, REUTERS (Feb. 14, 2013, 6:19 PM), http://www.reuters.com/article/2013/02/14/us-americanairlines-merger-idUSBRE91D0MF20130214.

September 2012, only about 50% of American's flights arrived on time due to a massive increase in the number of maintenance write-ups by the pilots just before take off, leaving American threatening further legal action.[65] One must wonder if the relationship between the pilots and American management is simply beyond repair. As a result, this author would hypothesize that unless the merger is consummated with US Airways or new management takes over at American, it is unlikely that the airline will return to profitability.

Ultimately, the court reached the correct result by granting American's renewed motion to reject its CBA with the pilots' union, but it should have gone further by granting the original motion because the proposed changes to codesharing and furloughs can be seen as necessary under the long-term economic viability analysis. Only time will tell whether granting the renewed Section 1113 motion will spare American from collapse and allow the airline to successfully emerge from bankruptcy.

. [65] Terry Maxon, *American Airlines Hit by More Delays*, DALLAS MORNING NEWS (Sept. 28, 2012, 9:36 PM), http://www.dallasnews.com/business/airline-industry/20120928-american-hit-by-more-delays-despite-pilot-leader-s-chiding-of-his-members.ece.


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