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Bankruptcy of Airlines: Causes, Complaints, and Changes

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BANKRUPTCY OF AIRLINES: CAUSES, COMPLAINTS, AND CHANGES

MARK C. MATHIESEN

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I. INTRODUCTION

ON AUGUST 25, 1994, America West Airlines emerged from a three-year stay in bankruptcy court.¹ This day marked the first time in the 1990s that none of the nation's major airlines

¹ *America West Emerges from Bankruptcy*, L.A. TIMES, Aug. 26, 1994, at D2 [hereinafter L.A. TIMES].

were under Chapter 11 bankruptcy protection.² Does this mean the major airlines are no longer threatened with bankruptcy? Hardly. The airline industry is still in rather poor shape.³ A return to Chapter 11 protection for some of the weaker airlines is just a recession or fuel crisis away.⁴

Despite the positive economic news that all major airlines are out of bankruptcy, Chapter 11 protection for airlines remains an important issue. Bankruptcy of airlines has been a newsworthy topic since industry deregulation in 1978. Of particular interest has been the large number of airlines seeking bankruptcy protection, and the length of time they stayed in Chapter 11. Braniff, Pan Am, Eastern, Continental, TWA, Midway, and America West have all filed for bankruptcy since 1978—the list reads like the roll call for the airline hall of fame. Besides being some of the most successful U.S. airlines at one time or another, they also share the dubious honor of undergoing the Chapter 11 experiences. Some of these airlines were able to reorganize into more efficient operators.⁵ Others are dead and buried, only to be revived in the annals of the U.S. airline industry.⁶ Two airlines became so familiar with Chapter 11 that they decided to return for a second visit.⁷

² *Id.*

³ The U.S. airline industry lost \$10 billion from 1990 to 1992 and “is only now showing signs of partial fitful and inadequate recovery.” THE NATIONAL COMMISSION TO ENSURE A STRONG COMPETITIVE AIRLINE INDUSTRY, CHANGE, CHALLENGE AND COMPETITION, 2 (1993) [hereinafter COMMISSION REPORT]. “This [loss] exceeds all the profits the industry has realized from its inception.” H.R. REP. NO. 22, 103d Cong., 1st Sess. 2 (1993), *reprinted in* 1993 U.S.C.C.A.N. 83 [hereinafter HOUSE REPORT].

⁴ “In four of the first ten deregulation years, the industry as a whole operated at a net loss.” Michael A. Katz, *The American Experience Under the Airline Deregulation Act of 1978—An Airline Perspective*, 6 HOFSTRA LAB. L.J. 87, 96 (1988). In 1987 the industry recorded net profit margin of only 1.1%, very low by American business standards. *Id.*

⁵ Continental emerged from Chapter 11 in April 1993. America West emerged in 1994. L.A. TIMES, *supra* note 1, at D2.

⁶ Eastern lasted in Chapter 11 for three years and went out of business in 1991. Pan Am went out of business in 1991 after filing for bankruptcy in the same year. Midway failed in 1991. *Id.*

⁷ Continental Airlines entered Chapter 11 in 1983; emerged in 1986, re-entered in 1990, and emerged for the second time in 1993. *Id.* Braniff filed for Chapter 11 in 1982, emerged in 1984, and filed for bankruptcy protection again in 1989. Athanassios Papaioannou, *The Duty to Bargain and Rejection of Collective Agreements Under Section 1113 by a Bankrupt Airline Trying to Reconcile R.L.A. with Bankruptcy Code*, 18 TRANSP. L.J. 219, 220-21 n.17 (1990). That same year, Braniff put itself on the auction block and never resumed operations again as Braniff

Most segments of American society are touched in some way or another by airline bankruptcy.⁸ From pilots to passengers, baggage handlers to business travelers, a large percentage of the American population is affected. Because air travel is such an essential part of American society,⁹ and airlines employ so many people,¹⁰ it is headline news every time an airline files for Chapter 11.

Airline bankruptcies produce headlines for another reason. The ongoing debate among those within the airline industry is whether Chapter 11 protection affords bankrupt airlines too many unfair operating advantages and thus contributes to the financial woes of the industry.¹¹ Airlines not in bankruptcy protection argue that Chapter 11 airlines are allowed to defer debt payments and cut labor costs by breaking union agreements, while the viable airlines must compete without these advantages.¹² The viable airlines also argue that Chapter 11 airlines are allowed unfair advantages, such as lower operating costs, over too long a period of time.¹³ Meanwhile, the Chapter 11 airlines dispute these contentions.¹⁴ They argue that there are major disadvantages to Chapter 11, "such as the need to make cash payments, and consumer resistance."¹⁵ They contend that

Airways (although a different management group resumed under the name Braniff International Airlines, operations were again suspended in 1993). *Id.*

⁸ Worldwide, travel and tourism is a \$3 trillion annual business "employing approximately 127 million people and providing tax revenues exceeding \$300 billion." COMMISSION REPORT, *supra* note 3, at 5.

⁹ Tourism, much of which depends upon air travel, is among the top three employers in 37 states and employs 8% of the total population. Tourism also contributes 6.4% of the gross domestic product. *Id.* Airports serving the 30 largest metropolitan areas in the U.S. "generate more than \$250 billion in economic activity, \$80 billion in wages and four million in direct and indirect jobs." *Id.*

¹⁰ From 1982 to 1992, airline employment increased by 64% to 540,000 people. *Id.*

¹¹ HOUSE REPORT, *supra* note 3, at 3, 1993 U.S.S.C.A.N. 85. "One important task of the Commission will be to resolve a major area of disagreement among the expert witnesses-at the hearings concerning the extent to which airlines in Chapter 11 bankruptcy are responsible for the industry's financial problems. This disagreement led to substantial disagreements over recommendations for legislative action." *Id.* at 4, 1993 U.S.S.C.A.N. 86.

¹² See, e.g., Thomas W. Gerdel & Sandra Livingston, *Bankruptcy Laws Create Unfair Competition, Airline Says*, CLEVELAND PLAIN DEALER, June 4, 1992, at 2D (referencing complaints by industry leader American Airlines); Asra Q. Nomani, Sr. & Bridget O'Brian, *Healthy Airlines Lash Out at Their Struggling Rivals*, WALL ST. J., Mar. 17, 1992, at B4.

¹³ Nomani & O'Brian, *supra* note 12, at B4.

¹⁴ HOUSE REPORT, *supra* note 3, at 4, 1993 U.S.S.C.A.N. 86.

¹⁵ *Id.*

the stronger airlines still hold the overall advantage and that the extra time is necessary for a proper recovery.¹⁶ This debate is unresolved and remains an area of major disagreement.¹⁷

This Comment discusses the extensive use of Chapter 11 protection in the airline industry. Part II begins with a short history of the Chapter 11 proliferation in the airline industry, detailing the two major causes, deregulation and the recent worldwide recession. Part III provides an overview of the Chapter 11 bankruptcy code and relevant case law involving airlines. Part IV addresses the complaints lodged by both sides in the debate over the widespread use of Chapter 11 and its effects on the airline industry. Part V includes a summary of expert opinions, both for and against changes to the bankruptcy laws.

II. CAUSES OF AIRLINE BANKRUPTCY: A HISTORICAL BACKGROUND

That airlines have gone bankrupt or spent time in Chapter 11 reorganization should come as no surprise. Since the airline industry developed in the 1920s and 1930s, a number of airlines have collapsed due to competition, economic recessions, and industry scandals.¹⁸ More than 120 airlines have gone bankrupt¹⁹ since the Airline Deregulation Act of 1978.²⁰ In the post-deregulation era there have been two major waves of Chapter 11 filings by airlines. The first was a product of the Deregulation Act it-

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ See Katz, *supra* note 4, at 87, 94-95, 100. During the development of the industry as a means of intercity passenger travel, some scandals surfaced in the award of airmail contracts by the U.S. Post Office. All of the contracts were cancelled in 1934 by order of President Roosevelt, and "the job of flying the mail was assigned to the Army Air Corps." Exec. Order No. 6591 (1934); see Katz, *supra* note 4, at 87. "The economic losses which resulted almost brought about the demise of the airline industry," but a later decision again assigned the job of airmail delivery to the private sector, though in a more regulated environment. *Id.* See also Lawrence E. Gesell & Martin T. Farris, *Airline Deregulation: An Evaluation of Goals and Objectives*, 21 TRANS. L.J. 105, 114 (1992).

¹⁹ Papaioannou, *supra* note 7, at 220. Of the 22 new major carriers which entered the industry after deregulation, all but one have disappeared. HOUSE REPORT, *supra* note 3, at 2, 1993 U.S.S.C.A.N. 84.

²⁰ Airline Deregulation Act of 1978, Pub. L. No. 95,504, 92 Stat. 1705 (codified as amended in scattered sections of 49 U.S.C.) [hereinafter Deregulation Act]. For legislative history see H.R. REP. NO. 1211, 95th Cong., 2d Sess. 4 (1978), reprinted in 1978 U.S.C.C.A.N. 3737.

self.²¹ The second resulted from a combination of the 1990-91 economic recession and higher fuel prices brought on by the Gulf War.²² These two major trends are developed below.

A. THE DEREGULATION ACT OF 1978

In 1978 Congress acted to deregulate the airline industry for the first time in fifty years.²³ A number of major policy goals supported the Deregulation Act,²⁴ but the overall objective was to "return the industry to competitive capitalism with many competing airlines, where none could control the market and where all would have to actively participate in price competition."²⁵ Several of the enumerated goals cited in the Deregulation Act specifically mention "competition."²⁶

Prior to deregulation, the airline industry was carefully controlled by the federal government.²⁷ The government regulated the number of airlines and the routes these airlines could fly.²⁸ Certification through the Civil Aeronautics Authority (CAA), later renamed the Civil Aeronautics Board (CAB), was required for operation.²⁹ New airlines could be added to the industry only on the basis of proving a need for their services.³⁰ Conse-

²¹ Major airlines filing for bankruptcy protection during this time included Braniff (in 1982), Continental (in 1983), Air Florida (in 1984), and Frontier (in 1986). Papaioannou, *supra* note 7, at 220.

²² Major airlines filing during this period included: Eastern (in 1989), Continental (in 1990—for the second time), Pan American (in 1991), TWA (in 1992), Midway (in 1991), and America West (in 1991). L.A. TIMES, *supra* note 1, at D2.

²³ The first comprehensive law passed by Congress to regulate the economic and safety interests of airlines was the Civil Aeronautics Act of 1938, Pub. L. No. 706, 52 Stat. 973, 49 U.S.C. §§ 401-722 (establishing the Civil Aeronautics Authority, which became the present day Civil Aeronautics Board (CAB)), *repealed by* Federal Aviation Act of 1958, Pub. L. No. 85-726, 72 Stat. 731 (1958) (codified as amended at 49 U.S.C. §§ 1301-1552 (1958)). See Katz, *supra* note 4, at 88; COMMISSION REPORT, *supra* note 3, at 4.

²⁴ The goals behind the Deregulation Act include: maintaining safety as the top priority; allowing market forces to predominate; developing/maintaining a sound regulatory scheme; preventing unfair trade practices; encouraging new entrants into the industry; and maintaining service in the smaller markets. Deregulation Act, *supra* note 20, § 102, 92 Stat. at 1706-07.

²⁵ Gesell & Farris, *supra* note 18, at 108.

²⁶ Deregulation Act, *supra* note 20, § 102, 92 Stat. at 1706-07.

²⁷ The Civil Aeronautics Board (CAB) was the administrative agency responsible for regulating the airline industry. See *supra* note 23 and accompanying text.

²⁸ Katz, *supra* note 4, at 87-88.

²⁹ *Id.* at 88.

³⁰ *Id.* Airlines had to prove that their proposed service would serve "the public convenience and necessity." See Federal Aviation Act of 1958, *supra* note 23, § 401(d), 72 Stat. at 755.

quently, regulation limited the number of airlines in the industry.³¹ Fares were also strictly regulated. Passenger ticket prices had to be approved by the CAB, based on cost projections provided by the airlines.³² The regulatory scheme tended to favor the status quo and discourage competition, and for the airlines lucky enough to be in existence, regulation provided a fairly comfortable operating environment.

The Deregulation Act, however, brought drastic changes. New airlines entered the industry to challenge the existing carriers. Prior to deregulation, new entrants had to prove their proposed service would serve "the public convenience and necessity."³³ Today a new entrant need only show that "it can meet minimum standards of operational and financial responsibility."³⁴ The burden of proof has shifted from the parties proposing service to the parties opposing new service.³⁵ Whereas thirty-six airlines were in existence prior to deregulation, 134 new airlines formed in the first six years after deregulation.³⁶ Airlines are now allowed to compete for new markets previously limited to only a handful of airlines.³⁷ Airlines are free to set their own rates.³⁸ The airline that operates more efficiently can gather a larger market share, forcing its competitors to cut back.

The very nature of a free market system suggests competition will increase between the parties involved. The hallmark of a market-based economy, such as that of the United States, is that some firms will inevitably fail.³⁹ The more efficient will succeed, and the poorly managed will fail, allowing others to take their place.⁴⁰ Thus, in theory, an existing airline will be able to suc-

³¹ Katz, *supra* note 4, at 88. Not one new airline began operations as a large passenger air carrier between 1938 and 1978. *Id.*

³² *Id.*

³³ Federal Aviation Act, *supra* note 23, § 401(d), 72 Stat. at 755.

³⁴ Katz, *supra* note 4, at 93.

³⁵ *Id.*

³⁶ *Id.*

³⁷ Contrast the rapid formation of major airlines after deregulation with the virtual nonformation of such airlines between 1938 and 1978. *Id.* at 88.

³⁸ The CAB, which previously set air fares, was abolished and its remaining duties picked up by the Department of Transportation. *Id.* at 93.

³⁹ Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. ILL. L. REV. 1, 9.

⁴⁰ Of the 22 airlines that entered the industry following deregulation, "only two are now operating. The rest have either gone out of business or merged with other carriers." COMMISSION REPORT, *supra* note 3, at 33. Since 1985, the market share of the three largest carriers has risen from 35% to 56%, with the market

ceed as long as it is operated and managed efficiently; if it fails, a more efficient airline will replace it.

It is no surprise that many airlines either sought Chapter 11 protection or completely failed in the wake of deregulation.⁴¹ Aware of the potential consequences, Congress deemed deregulation worth the quest for free markets and lower fares for the consumer.⁴² The magnitude and frequency of airlines filing Chapter 11, however, may have come as a surprise.

B. RECESSION AND HIGHER FUEL PRICES

The second major wave of Chapter 11 filings resulted from the economic pressures brought on by the worldwide recession of 1990-91 and the higher fuel prices caused by the Gulf War.⁴³ Throughout the 1980s, a proliferation of corporate mergers and acquisitions occurred, many financed by highly leveraged debt including junk bonds.⁴⁴ The airline industry was no stranger to this activity. Notorious corporate raider Carl Icahn purchased TWA in this manner.⁴⁵ In addition, numerous other airlines undertook aggressive expansion plans⁴⁶ to take advantage of the booming economy,⁴⁷ often taking on massive debt to finance their expansion.⁴⁸

When the recession hit, airline growth came to a screeching halt. The resulting debt loads and depressed asset values crippled once profitable airlines.⁴⁹ As the public tightened its spending and cut out recreational travel, businesses were also cutting back on travel. The 1988 bombing of Pan Am flight 103

share of the eight largest carriers increasing from 74% to 96%. HOUSE REPORT, *supra* note 3, at 2, 1993 U.S.C.C.A.N. 84.

⁴¹ "[O]ver one hundred airlines have now ended up either bankrupt or merged with other carriers." Katz, *supra* note 4, at 94.

⁴² See H.R. REP. NO. 1211, *supra* note 20, at 4, 1978 U.S.C.C.A.N. 3739-40.

⁴³ See Stanley Ziemba, *America West Joins 3 Other Big U.S. Airlines in Bankruptcy*, CHI. TRIB., June 29, 1991, at C1.

⁴⁴ The estimated level of this debt is now more than \$35 billion. COMMISSION REPORT, *supra* note 3, at 2.

⁴⁵ See *TWA Plans to Buy Back Much of Debt; Airline's Offer Meant to Avoid Bankruptcy*, WASH. POST, May 16, 1991, at B10.

⁴⁶ "Between 1988 and 1992, the three largest carriers, American, United, and Delta, increased their fleets by 445 aircraft." HOUSE REPORT, *supra* note 3, at 2, 1993 U.S.S.C.A.N. 84.

⁴⁷ Airline traffic grew 43% from 1983 to 1988. *Id.*

⁴⁸ Annual interest and rental expenses increased from \$2 billion in 1982 to \$8 billion in 1991. *Id.* at 3, 1993 U.S.S.C.A.N. 85.

⁴⁹ COMMISSION REPORT, *supra* note 3, at 12.

over Lockerbie, Scotland further discouraged air travel.⁵⁰ Consequently, airlines were operating with empty seats, far from being efficient operators. Airlines that had planned on future rates of air travel growth consistent with the high rates of the mid-1980s were faced with the reality of less travel and struggled to make debt payments.

Meanwhile, the price of jet fuel more than tripled during this time due to unrest in the Middle East brought on by Iraq's invasion of Kuwait and the ensuing Gulf War.⁵¹ Higher operating costs coupled with fewer passengers spelled trouble for the airlines. Debt payments which were barely manageable in an expanding economy were now impossible.⁵² For many airlines, Chapter 11 provided the only alternative.⁵³ Fledgling airlines such as Midway and America West filed for, and received, Chapter 11 protection.⁵⁴ Continental filed bankruptcy for the second time within four years.⁵⁵ Braniff also re-entered.⁵⁶ Pan Am, the flagship of the American airline industry, entered Chapter 11 and never recovered.⁵⁷ Eastern, the nation's oldest airline, ceased operations.⁵⁸

The larger number of post-deregulation airlines were chasing fewer passengers. Competition increased, profits dipped, and angers flared. Airlines not in Chapter 11 complained that those afforded the reorganization protection had unfair advantages in lower operating costs.⁵⁹ Bankrupt airlines responded that the stronger airlines were taking advantage of their Chapter 11 predicament, trying to force them out of business by waging airfare

⁵⁰ HOUSE REPORT, *supra* note 3, at 2, 1993 U.S.S.C.A.N. 84.

⁵¹ Fuel prices for jet fuel nearly tripled during the Gulf War build-up before settling at double their previous price. This increase added about \$4 billion to industry expenses. *Id.* at 3, 1993 U.S.S.C.A.N. 85.

⁵² *See id.* at 2-3, 1993 U.S.S.C.A.N. 84-85.

⁵³ "Indeed the three major airlines with the highest debt/equity ratios, Braniff, Continental and Eastern, all declared bankruptcy. The fourth highest, Western, merged with Delta." Jeffrey S. Heuer & Musette H. Vogel, *Airlines in the Wake of Deregulation: Bankruptcy as an Alternative to Economic Deregulation*, 19 TRANSP. L.J. 247, 280 n.213 (1991).

⁵⁴ Midway and America West entered Chapter 11 in 1991. *See* Ziemba, *supra* note 43, at C1; Paul S. Dempsey, *The State of the Airline, Airport & Aviation Industries*, 21 TRANSP. L.J. 129, 173 (1992).

⁵⁵ *See id.*

⁵⁶ *See id.*

⁵⁷ Pan Am ceased operations on December 5, 1991. *See id.*

⁵⁸ Eastern, which began operations as Pitcairn Aviation on May 1, 1927, ceased operations on January 18, 1991. *See id.*

⁵⁹ *See* Nomani & O'Brian, *supra* note 12, at B4.

wars⁶⁰ and cutting into their markets.⁶¹ How did so much blame focus on Chapter 11, a tool designed to help the public interest? The specifics of the Bankruptcy Code provide a clue.

III. THE BANKRUPTCY CODE—CHAPTER 11

The United States Bankruptcy Code, enacted in 1978, centers around Chapter 11 reorganization.⁶² The purpose of the Bankruptcy Act is to help financially troubled companies stay in business by giving them time to reorganize their finances.⁶³ By relieving the debtor from its repetition debt, reforming burdensome contracts, and consolidating its finances, a Chapter 11 reorganization plan can help return the debtor to the marketplace as a viable enterprise.⁶⁴ In doing so, the Bankruptcy Act provides continued employment to the debtor's workforce, treats creditors in an even-handed manner, and attempts to ensure a fair return to stockholders on their investment.⁶⁵ Overall, the Bankruptcy Code reflects the consistent interest of Congress over the last sixty years in providing a mechanism for a viable transportation system.⁶⁶

Briefly, a Chapter 11 proceeding is initiated when a struggling entity files a voluntary petition for Chapter 11 reorganization.⁶⁷ The qualifications to file are not great, and, in fact, almost any entity can file as long as the filing is in good faith.⁶⁸ The bankruptcy court, upon accepting the filing, appoints a debtor-in-possession⁶⁹ or a trustee.⁷⁰ The entity must then draft a plan for

⁶⁰ HOUSE REPORT, *supra* note 3, at 4, 1993 U.S.S.C.A.N. 86; *see also* *Jury Acquits American in Air Price War*, L.A. TIMES, Aug. 11, 1993, at 1.

⁶¹ *See* Peter S. Greenberg, *The Savvy Traveler*, L.A. TIMES, Mar. 11, 1990, at 2.

⁶² 11 U.S.C. §§ 101-1330 (1994).

⁶³ *See* H.R. REP. NO. 595, 95th Cong., 2d Sess. 5 (1978), *reprinted in* 1978 U.S.S.C.A.N. 5963.

⁶⁴ 11 U.S.C. §§ 362, 365 (1994).

⁶⁵ *In re Certified Corp.*, 51 B.R. 768, 768 (Bankr. D. Haw. 1985); *see also* Heuer & Vogel, *supra* note 53, at 257-58.

⁶⁶ The first legislative enactment dealing with transportation companies in the context of bankruptcy was the 1933 Amendment to the Bankruptcy Act which added § 77 specifically for the railroads, which were in financial trouble. Prior to this time transportation companies, mainly railroads, had relied on Federal Equity Receivership. *See* Bankruptcy Act, ch. 204, § 77, 47 Stat. 1467, 1474 (1933).

⁶⁷ 11 U.S.C. § 301 (1994).

⁶⁸ *Id.* § 1129(a)(3). A filing will be thrown out if it was in bad faith. *See infra* note 105.

⁶⁹ The "debtor-in-possession is generally the best entity to run the business during the pendency of the bankruptcy." Heuer & Vogel, *supra* note 53, at 270.

reorganization within 120 days.⁷¹ However, this 120-day period is often extended by the court based on requests from the debtor.⁷² The reorganization plan is then submitted to the creditors for approval.⁷³ The creditors or other interested parties can voice their complaints, but each class of creditors must approve it by a vote.⁷⁴ Once the plan has been accepted, it is confirmed by the bankruptcy court, and the debtor begins a new life.⁷⁵

Administratively speaking, this process can take a significant amount of time. When Chapter 11 filings increase during economic downturns, the bankruptcy courts get backlogged. In corporate America, filings, hearings, meetings, and obtaining judicial approval take time. Getting numerous unrelated parties, all with different interests and agendas, to agree on a reorganization plan is difficult. Because of the length of time it takes to put a reorganization plan in place, some argue airlines are allowed too much time to "sink or swim."⁷⁶ This debate is analyzed more thoroughly in Part V.⁷⁷

A. SECTION 362

For purposes of this Comment, the first key section of Chapter 11 worthy of mention is section 362—the automatic stay provision.⁷⁸ This provision creates an automatic stay for all legal actions affecting the bankruptcy estate.⁷⁹ In practice, this provision is extremely broad and advantageous for debtors. Among other things, the stay functions to defer debt payments on any liabilities that arose before commencement of the proceeding.⁸⁰

⁷⁰ Normally the debtor stays in control of the assets and business as the debtor-in-possession. In the case of a corporation, the management would thus stay in place. A trustee may be appointed, however, where "fraud, dishonesty, incompetence, or gross mismanagement" has occurred or in the best interests of the creditors. 11 U.S.C. § 1104(a)(1), (2).

⁷¹ *Id.* § 1121(b). The 120-day window is exclusively for the debtor. If this time lapses, creditors and other interested parties may file their own plans. *Id.*

⁷² *Id.* § 1121(d).

⁷³ *Id.* § 1129(a).

⁷⁴ *Id.* § 1126(a).

⁷⁵ *Id.* § 1141.

⁷⁶ See COMMISSION REPORT, *supra* note 3, at 15.

⁷⁷ See *infra* notes 193-202 and accompanying text.

⁷⁸ 11 U.S.C. § 362.

⁷⁹ *Id.* § 362(a)(1)-(8).

⁸⁰ See generally *id.* § 362(a). But see *id.* § 1110(a). The Code makes special provisions for the secured creditors of aircraft equipment. Section 1110 is a limited exception to the automatic stay for the secured creditors of "aircraft, aircraft en-

A bankrupt carrier only has to make current expense payments⁸¹—a significant reduction in its operating costs. Deferral of debt payments is especially significant to the airline industry because of the large debt carried by most major carriers.⁸² Much of this debt was incurred in the 1980s due to the large expansion and merger and acquisition activities.⁸³ Because the airline business is capital intensive, the automatic stay provision affords ailing airlines significant advantages. Airplanes are extremely expensive and must be replaced or upgraded relatively often in comparison to their cost.⁸⁴ Airlines must often borrow the money necessary to buy them. When these debts are suspended, it gives the Chapter 11 airline the advantage of lower operating costs, even if only over the short term. As a result, section 362 is one of the major sections of Chapter 11 over which cries of unfair advantage have been heard.⁸⁵

B. SECTION 365

Section 365 also generates many protests of unfairness. This section allows the debtor to reject executory contracts on unexpired leases.⁸⁶ This specifically helps airlines which tend to operate a large number of their airplanes through lease payments. During the mid-1980s expansion, many airlines chose to obtain new airplanes through leases rather than by outright purchases.⁸⁷ By applying the provisions of section 365, airlines

gine[s], propeller[s], appliance[s] or spare part[s].” *Id.* The purpose of § 1110 is to “encourage new financing in the transportation industry and to promote industry modernization of the industry by protecting equipment financiers.” See Glenn S. Gerstell & Kathryn Hoff-Patrinou, *Aviation Financing Problems Under Section 1110 of the Bankruptcy Code*, 61 AM. BANKR. L.J. 1, 6 (1987). The creditor may repossess aircraft equipment without seeking the lifting of the automatic stay. 11 U.S.C. § 1110(a).

⁸¹ See 11 U.S.C. § 362(a).

⁸² The airline industry has \$35 billion of debt. COMMISSION REPORT, *supra* note 3, at 2.

⁸³ See *supra* notes 44-48 and accompanying text.

⁸⁴ Heuer & Vogel, *supra* note 53, at 263.

⁸⁵ See, e.g., *infra* notes 159-63 and accompanying text.

⁸⁶ 11 U.S.C. § 365. In the context of the Bankruptcy Code, an executory contract is “a contract under which the obligation of both the bankrupt and other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of either.” See *Knutson v. Klinger*, 563 F.2d 916, 917 (1966) (quoting Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973)).

⁸⁷ America West, for example, leases 80% of its planes. See Ziemba, *supra* note 43, at C1.

in financial trouble can postpone their lease payments.⁸⁸ Airlines which can postpone their lease payments temporarily gain unfair operating advantages over airlines which must remain current on their lease payments. Until 1984 section 365 also involved labor contracts⁸⁹ which were treated as any other executory contract under section 365. Thus, labor contracts, including collective bargaining agreements, were subject to rejection by an employer immediately upon filing a petition for reorganization under Chapter 11.⁹⁰ The holding of *NLRB v. Bildisco & Bildisco*,⁹¹ the landmark case involving section 365, confirmed this treatment.

In *Bildisco*, the Supreme Court held that a collective bargaining agreement should be rejected under section 365(a) as long as the debtor shows the agreement burdens the estate and the equities balance in favor of rejection.⁹² The Court also concluded that the Bankruptcy Code allows the debtor "to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing."⁹³ Justice Rehnquist stated that "the filing of the petition in bankruptcy means that the collective-bargaining agreement is no longer immediately enforceable, and may never be enforceable again."⁹⁴ As a result of *Bildisco*, a "bankruptcy court could nullify a collective bargaining agreement merely upon a showing that the employer could operate more cheaply without it."⁹⁵ Thus, airline labor agreements could be rejected immediately upon filing Chapter 11 as long as management could show that the airline would be better off and able to operate more cheaply without the labor agreement. This was not a difficult burden to overcome.

⁸⁸ See, e.g., *In re Airlift Int'l, Inc.*, 26 B.R. 61, 63 (Bankr. S.D. Fla. 1982).

⁸⁹ 11 U.S.C. § 1113 was added on July 10, 1984, specifically to deal with labor contracts. Bankruptcy Amendments and Federal Judgeships Act of 1984, Pub. L. No. 98-353, § 1113, 98 Stat. 390-91 (1984). See *infra* notes 110-20 and accompanying text for further discussion of § 1113.

⁹⁰ Jonni Walls, *Airline Mergers, Acquisitions and Bankruptcies: Will the Collective Bargaining Agreement Survive?*, 56 J. AIR L. & COM. 847, 848 (1991).

⁹¹ 465 U.S. 513, 516 (1984) ("We decide that the language 'executory contract' in 11 U.S.C. § 365 of the Bankruptcy Code includes within it the collective-bargaining agreements subject to the National Labor Relations Act.").

⁹² *Id.* at 526.

⁹³ *Id.* at 528.

⁹⁴ *Id.* at 532.

⁹⁵ Walls, *supra* note 90, at 882.

The *Bildisco* decision outraged labor unions.⁹⁶ Congress acted swiftly⁹⁷ in response to public pressure and submitted an amendment to a pending bankruptcy reform bill, making it more difficult to unilaterally abrogate a labor contract upon the filing of a bankruptcy petition.⁹⁸ Before the amendment was enacted, however, enough damage had already been done because some airlines had used the Chapter 11 provisions to cancel or change their labor contracts.⁹⁹

This technique of rejecting labor contracts under the guise of section 365 led to some of the most controversial and outrageous uses of Chapter 11 by airlines, eventually resulting in an amendment to the Bankruptcy Code.¹⁰⁰ The most flagrant example of this conduct was by Frank Lorenzo, Chairman of Continental Airlines, the first time Continental filed for Chapter 11. On September 24, 1983, Continental filed a voluntary Chapter 11 petition in bankruptcy.¹⁰¹ Immediately after the filing, Continental terminated two-thirds of its unionized employees, unilaterally abrogated its union contracts, and implemented wage and benefit cuts of fifty percent.¹⁰² Continental also eradicated seniority and established work rules never before discussed with its unions.¹⁰³ Three days after the Chapter 11 filing, Continental resumed operations on its own take-it-or-leave-it terms.¹⁰⁴

The major unions at Continental subsequently challenged the Chapter 11 filing on the basis that it was in bad faith,¹⁰⁵ but to

⁹⁶ For a discussion of labor's reaction to the *Bildisco* decision, see Mark S. Pulkam, *The Collision of Labor and Bankruptcy Law: Bildisco and the Legislative Response*, 36 LAB. L.J. 390 (1985).

⁹⁷ "[L]egislation which would have reversed *Bildisco* was introduced on the very day the decision was announced." Joseph L. Manson, III & Douglas W. Hall, *Labor Regulations in the Airline and Railroad Industries Under the Bankruptcy Code*, ALI-ABA Course of Study: Airline and Railroad Labor and Employment Law (1993), available in WESTLAW, C823 ALI-ABA 483 at *487.

⁹⁸ This amendment was codified in 11 U.S.C. § 1113. See *supra* note 89.

⁹⁹ See, e.g., *In re Continental Airlines Corp.*, 38 B.R. 67 (Bankr. S.D. Tex. 1984); *A.L.P.A. v. Eastern Airlines, Inc.*, 703 F. Supp. 962 (D.D.C. 1988).

¹⁰⁰ 11 U.S.C. § 1113 was added in response to flagrant abuse of § 365 by certain airlines.

¹⁰¹ *In re Continental Airlines Corp.*, 38 B.R. at 69.

¹⁰² Walls, *supra* note 90, at 883-84.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ The initial question interested parties may pose is whether a Chapter 11 case was filed in bad faith. If it is filed in bad faith, the Chapter 11 proceeding may be dismissed by the bankruptcy court. See Heuer & Vogel, *supra* note 53, at 260. 11 U.S.C. § 1129(a) (1974) sets forth the requirements that must be met

no avail.¹⁰⁶ The unions also went on strike, perhaps the industry's longest and fiercest since deregulation.¹⁰⁷ The strike ultimately ended with the defeat of the unions. Only twenty percent of Continental's employees remained unionized as of December 31, 1987.¹⁰⁸ This action was possible due to the bankruptcy laws in place at that time.¹⁰⁹

C. SECTION 1113

Unilateral rejection of labor contracts by managers such as Continental Chairman Frank Lorenzo are no longer possible under section 1113, the final relevant section of the Bankruptcy Code.¹¹⁰ This section regarding labor contracts was enacted in response to the *Bildisco*¹¹¹ decision and Continental's treatment of its employees.¹¹² While this section continues to allow debtors some room to ultimately modify existing labor contracts,¹¹³ the decision cannot be made unilaterally.¹¹⁴ To use section 1113 to modify labor contracts, debtors must first comply with the terms and conditions of the statute and get court ap-

before a Chapter 11 reorganization plan may be approved. Section 1129(a)(3) requires that the plan be proposed in good faith.

¹⁰⁶ The Airline Pilots' Association (ALPA), the Union of Flight Attendants (UFA), and the International Association of Machinist and Aerospace Workers (IAM) challenged the bankruptcy filing of the airline. The court found that Continental did not file bankruptcy solely or primarily to modify its collective bargaining agreement. *In re Continental Airlines Corp.*, 38 B.R. at 71.

¹⁰⁷ Papaioannou, *supra* note 7, at 220.

¹⁰⁸ *Id.* at 220-21.

¹⁰⁹ Continental was not the first airline employer to use this tactic to rid itself of labor obligations. In 1933 Century Air Lines announced it would carry air mail at one-half the going rate. It then announced a cut in pilots' pay of \$200 per month. Pilots were ordered to resign and reapply for employment at the new rate. This led to ALPA's first strike and eventually resulted in a bill submitted April 1, 1933, to include air transport under the Railway Labor Act. See Mark L. Kahn, *Airlines*, in *COLLECTIVE BARGAINING: CONTEMPORARY AMERICAN EXPERIENCE*, 315, 339-40 (Gerald G. Somers ed., 1980).

¹¹⁰ 11 U.S.C. § 1113. "No provision of this title shall be construed to permit a trustee [including debtor in possession] to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of this section." *Id.* § 1113(f).

¹¹¹ *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984).

¹¹² See 130 CONG. REC. 6247 (1984). "We are all familiar with Continental Airlines' recent flagrant abuse of the bankruptcy and labor laws by rejecting its contract . . ." *Id.* (statement of Rep. Florio).

¹¹³ 11 U.S.C. § 1113(c)(3) provides: "The court shall approve an application for rejection of a collective bargaining agreement only if the court finds that . . . the balance of the equities clearly favors rejection of such agreement." *Id.*

¹¹⁴ *Id.*

proval.¹¹⁵ The statute imposes an affirmative duty on employers to bargain with the union prior to modifying or rejecting any contracts or agreements.¹¹⁶ Essentially, a labor contract can only be changed if the airline can show the court that the action is necessary to save the airline from going out of business.¹¹⁷ A court will still apply the "balancing of the equities"¹¹⁸ standard adopted in *Bildisco*,¹¹⁹ but the notion that a debtor may unilaterally breach a collective bargaining agreement is rejected.¹²⁰

Section 1113 involving labor contracts is significant because labor is the largest single operating cost of airlines.¹²¹ The cost of labor is often the greatest difference in operating costs between Chapter 11 and non-Chapter 11 airlines.¹²² For example, in 1977 the difference in the monthly average cost to employ one flight captain between major carriers was \$467 (between \$6837 and \$6370).¹²³ In 1988 a captain employed by American Airlines earned on average \$12,386 per month, while a captain employed by Continental earned only \$5480.¹²⁴ Continental

¹¹⁵ 11 U.S.C. § 1113(b) provides, in part:

(1) Subsequent to filing a petition and prior to an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee (hereinafter in this section "trustee" shall include a debtor in possession), shall

(A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees benefits and protection that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and

(B) provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal.

(2) During the period beginning on the date of the making of a proposal provided for in paragraph (1) and ending on the date of the hearing provided for in subsection (d)(1), the trustee shall meet, at reasonable times, with the authorized representative to confer good faith in attempting to reach mutually satisfactory modifications of such agreement.

¹¹⁶ *Id.*

¹¹⁷ Walls, *supra* note 90, at 883.

¹¹⁸ 11 U.S.C. § 1113(c)(3).

¹¹⁹ 465 U.S. at 527.

¹²⁰ Walls, *supra* note 90, at 884.

¹²¹ Richard L. Merrick, *The Bankruptcy Dynamics of Collective Bargaining Agreements*, 91 COMM. L.J. 169, 170 (1986).

¹²² Heuer & Vogel, *supra* note 53, at 273.

¹²³ Katz, *supra* note 4, at 97.

¹²⁴ *Id.*

achieved this difference of almost \$7000 through its bankruptcy filing.¹²⁵

Even with the more restrictive amendment, the Chapter 11 provisions can still be used to great advantage by struggling airlines. A large percentage of the major Chapter 11 cases involve airlines with significant unionized labor.¹²⁶ Airlines that can show that a change to their labor contracts is necessary to save the airline may be able to renegotiate their labor agreements with the unions. Often, just by filing for Chapter 11, an airline may get concessions from its employees that it would ordinarily not be able to get under normal circumstances.

D. BANKRUPTCY COURTS

Bankruptcy courts are courts of equity and may issue any order, process, or judgment in order to carry out the Bankruptcy Code.¹²⁷ The bankruptcy courts have been given wide power to decide all "core proceedings" concerning a debtor's estate.¹²⁸ These core proceedings are so broad, however, that they encompass nearly every conceivable relationship and function affecting a debtor.¹²⁹ Judges are given wide latitude in accordance with the Bankruptcy Code.¹³⁰

Several of the panelists brought together by the National Commission to Ensure a Strong Competitive Airline Industry to discuss recommendations on bankruptcy reforms point to this broad discretionary power as a major problem.¹³¹ One pertinent example came from the Eastern Airlines bankruptcy.¹³² In the view of one panelist, "one of the big problems . . . was actually the judge and the bankruptcy bar."¹³³ This panelist's view came from his experience as a member of the Eastern Airlines creditors' committee.¹³⁴ In this panelist's opinion, the bankruptcy judge saw himself as a "good fairy who wanted to ensure

¹²⁵ *Id.*

¹²⁶ Heuer & Vogel, *supra* note 53, at 273-74.

¹²⁷ 11 U.S.C. § 105.

¹²⁸ 28 U.S.C. § 157(b) (1994).

¹²⁹ 28 U.S.C. § 157 includes a long, but non-exhaustive, list of possible core proceedings.

¹³⁰ Heuer & Vogel, *supra* note 53, at 258.

¹³¹ See, e.g., *The Financial Strength and Competitiveness of the Airline Industry, A Look at the Recommendations On Bankruptcy Reforms and the Tax Burden*, 40 FED. B. NEWS & J. 637, 640-43 (1993) [hereinafter *Bankruptcy Reforms*].

¹³² *Id.* at 640-41.

¹³³ *Id.* at 640.

¹³⁴ *Id.*

that all of the poor widows and orphans who lived in Brooklyn got down to Miami Beach on the tickets that they had bought on Eastern Airlines, and he was going to keep all of the employees working" to see this happen.¹³⁵ The judge even told the creditors' committee that this "was a public interest issue and that the creditors really didn't have a lot of business expressing views about it."¹³⁶

One does not have to be a bankruptcy expert to raise an eyebrow to such judicial comments. A plain reading of the Chapter 11 code suggests that creditors are to play a significant role in the Chapter 11 proceedings.¹³⁷ Creditors take part in reorganization plan meetings and must vote their final approval of the plan.¹³⁸ A review of the legislative history of the Bankruptcy Code makes it clear that part of its purpose is to satisfy the creditors.¹³⁹ A major part of a Chapter 11 proceeding is to have the creditors accept the reorganization plan.¹⁴⁰ When a bankruptcy judge comments that it is none of the creditors' business while discussing a Chapter 11 matter,¹⁴¹ one cannot help but question whether too much latitude has been given to these administrative law judges.

One interesting aspect of the first Continental Airlines bankruptcy was the close ties of the bankruptcy judge to Continental management. As previously noted, the airline shut down for three days after filing Chapter 11 in 1983.¹⁴² The pilots filed suit for "furlough pay" attributable to these three days based on their collective bargaining agreement.¹⁴³ The bankruptcy court granted Continental's motion for summary judgment and valued the pilots' claims at zero.¹⁴⁴ Shortly after the bankruptcy judge granted summary judgment, the judge accepted an offer for partnership in the law firm representing Continental.¹⁴⁵ The Fifth Circuit reversed the decision and found that the bank-

¹³⁵ *Id.*

¹³⁶ *Id.* at 640-41.

¹³⁷ *See, e.g.*, 11 U.S.C. §§ 1121(b), 1126(a).

¹³⁸ 11 U.S.C. § 1126(a).

¹³⁹ *See supra* notes 62-75 and accompanying text.

¹⁴⁰ *Id.*

¹⁴¹ *See Bankruptcy Reforms, supra* note 131, at 640-41.

¹⁴² *See supra* notes 101-04 and accompanying text.

¹⁴³ *In re Continental Airlines Corp.*, 64 B.R. 882 (Bankr. S.D. Tex. 1986), *rev'd*, 981 F.2d 1450 (5th Cir. 1993).

¹⁴⁴ *Id.* at 890.

¹⁴⁵ *Law and Motion, Judges—Recusal—Bankruptcy*, 8 NO. 7 FED. LITIGATOR 197, 197 (1993).

ruptcy judge should have recused himself from the case. The court noted that the judge had publicly praised Continental's president and had received an offer of employment from the very law firm to which the judge had awarded \$700,000 in legal fees the previous day.¹⁴⁶

Another interesting feature of the bankruptcy process is that judges defer to the declaring company's management. Consequently, management usually stays on as a debtor-in-possession;¹⁴⁷ thus, ironically, judges rely on the input and advice of the same management that failed in the first place. While their advice is not taken as an absolute and a receiver is appointed by the court,¹⁴⁸ the current management is still given considerable decision-making power.

It can be argued that this unofficial grant of power takes away much of the incentive to stay out of Chapter 11 in the first place. While management may be removed in a Chapter 11 proceeding,¹⁴⁹ there is a good chance it will be allowed to stay on and wield almost as much power. This argument concedes that the current management knows the most about the airline.¹⁵⁰ By allowing management to stay on with no repercussions, however, there is less incentive to stay out of Chapter 11 as a way to cover managerial mistakes.

IV. COMPLAINTS

The debate continues as to how much Chapter 11 has contributed to the current state of the airline industry. Most concede that the Bankruptcy Code affords some advantages to Chapter 11 airlines that yield lower operational costs.¹⁵¹ But are these advantages unfair? It all depends on whom you ask.

A. ARGUMENTS OF AIRLINES NOT IN CHAPTER 11

Robert Crandall, Chairman of American Airlines, has lead the assault against Chapter 11 airlines.¹⁵² Most other healthy airlines, including United, Delta, and USAir, have joined in the

¹⁴⁶ *In re Continental Airlines*, 981 F.2d 1450, 1462-63 (5th Cir. 1993).

¹⁴⁷ See *supra* notes 70-72 and accompanying text.

¹⁴⁸ 11 U.S.C.A. § 1129(a) (West 1993 & Supp. 1995).

¹⁴⁹ A trustee can be brought in, effectively removing the control of the debtor's management. In addition, management can always be removed by a vote of directors. 11 U.S.C. § 1104(a)(1), (2) (1994).

¹⁵⁰ See *supra* note 70.

¹⁵¹ See *infra* notes 154-58 and accompanying text.

¹⁵² Nomani & O'Brian, *supra* note 12, at B4.

chorus, crying unfair competition.¹⁵³ Their argument is as follows: Generally, Chapter 11 carriers do not have to service all of their debt payments like the other airlines.¹⁵⁴ Furthermore, Chapter 11 carriers can postpone lease payments on airlines,¹⁵⁵ postpone pension payments¹⁵⁶ and pension funding;¹⁵⁷ and renegotiate labor agreements.¹⁵⁸ These advantages reduce overall operating costs by a significant margin.

In such a competitive industry these cost reductions can make a huge impact. Chapter 11 airlines can either take the cost savings to build up the bottom line, lower ticket prices in hope of attracting more passengers, or combine the two strategies.¹⁵⁹ In the airline business, airlines usually match their competitors' fare changes. Non-chapter 11 airlines argue they are forced to keep their ticket prices below profitable levels just to compete with Chapter 11 airlines.¹⁶⁰

B. ARGUMENTS OF AIRLINES IN CHAPTER 11

Conversely, Chapter 11 airlines argue they are the ones faced with disadvantages.¹⁶¹ After all, they are the ones in financial difficulty, having been forced to seek bankruptcy to stave off going out of business. These airlines argue that the healthy airlines try to exploit their vulnerability by attacking non-Chapter 11 airline markets.¹⁶² Continental even initiated a lawsuit against American Airlines, which was later joined by Northwest, alleging predatory pricing.¹⁶³ This lawsuit resulted in a victory for American,¹⁶⁴ but the fact that the suit was commenced in the first place and that millions of dollars were spent on legal fees

¹⁵³ *Id.*

¹⁵⁴ See *supra* notes 80-82 and accompanying text.

¹⁵⁵ 11 U.S.C. § 365 (1994).

¹⁵⁶ See *supra* note 81-83 and accompanying text.

¹⁵⁷ *Id.*

¹⁵⁸ See *supra* notes 110-16 and accompanying text.

¹⁵⁹ HOUSE REPORT, *supra* note 3, at 4, 1993 U.S.S.C.A.N. 86. The market pressures on Chapter 11 airlines suggest lowering ticket prices to generate more ticket purchases, thereby providing the necessary cash flow bankrupt entities so desperately need. *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Jury Acquits American in Air Price War*, L.A. TIMES, Aug. 11, 1993, at 1D.

¹⁶⁴ *Id.*

between the two sides points to the seriousness of the allegations.¹⁶⁵

Airlines in bankruptcy argue they are hurt by resorting to Chapter 11.¹⁶⁶ They point out that they must cancel flights, tickets, and in some cases stop operating for a few days.¹⁶⁷ Consequently, they lose customer confidence and passengers to the healthy airlines.¹⁶⁸ The negative publicity also hurts. They are also placed under the additional scrutiny and control of the bankruptcy courts. The future of Chapter 11 airlines is in the hands of their creditors since the airlines cannot be released from Chapter 11 until all of their creditors agree on a reorganization plan.¹⁶⁹

C. WHAT IS THE TRUTH?

Amidst the rhetoric offered by both sides, the truth is hard to decipher. A conclusive study which quantified the effects of Chapter 11 on the remaining airlines has yet to be done.¹⁷⁰ Certainly the provisions of Chapter 11 make it easier for an airline to operate under its protection. Indeed, that is part of the purpose behind its enactment.¹⁷¹ It is generally conceded that Chapter 11 has contributed to the financial problems of the industry,¹⁷² but there are other significant causes as well. As mentioned earlier, factors such as deregulation, recession, terrorist bombings, and fluctuating fuel prices have all done their share to make it difficult to run an airline.¹⁷³ While no one has determined to what extent Chapter 11 airlines have contributed to

¹⁶⁵ American spent more than \$20 million and employed three law firms to defend itself. *Id.*

¹⁶⁶ See Nomani & O'Brian, *supra* note 12, at B4.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ 11 U.S.C. 1126 (1994).

¹⁷⁰ The witnesses from George Washington University to the Aviation Subcommittee of the Committee on Public Works and Transportation testified that they have done a mathematical study of the effects of bankrupt carriers on the industry, but the study has not been published. See HOUSE REPORT, *supra* note 3, at 5, 1993 U.S.S.C.A.N. 87.

¹⁷¹ The purpose of Chapter 11 is to help businesses regain their health by restructuring debt, reforming burdensome contracts, consolidating finances—in short, temporarily easing business pressures. See *supra* notes 62-65 and accompanying text.

¹⁷² COMMISSION REPORT, *supra* note 3, at 15.

¹⁷³ See *supra* notes 39-52 and accompanying text.

the financial woes of the airline industry, bankrupt air carriers are definitely a factor.¹⁷⁴

V. TO CHANGE OR NOT TO CHANGE: A SAMPLING OF RECOMMENDATIONS

Due to the high profile of airline bankruptcies, potential Chapter 11 reforms are invariably included in discussions regarding the state of the American airline industry. Consequently, various opinions and recommendations have surfaced over the last few years. A few of these are summarized below.

A. THE NATIONAL COMMISSION TO ENSURE A STRONG COMPETITIVE AIRLINE INDUSTRY

The National Commission to Ensure a Strong Competitive Airline Industry (National Commission) was established at the end of the 102d Congress. The National Commission gave "the President and Congress expert, objective advice on the financial crisis now facing the airline industry and the recent decline in industry competition."¹⁷⁵ The National Commission's mandate was to "investigate, study and make policy recommendations about the financial health and future competitiveness of the United States airline and aerospace industries," and to report its findings ninety days after appointment of the commissioners.¹⁷⁶ The report was released in August 1993 under the title, "Change, Challenge and Competition" (Commission Report).¹⁷⁷

While the National Commission's analysis and recommendations covered a broad spectrum of issues facing the airline industry, the issue of bankruptcy received more attention than

¹⁷⁴ See COMMISSION REPORT, *supra* note 3, at 15.

¹⁷⁵ HOUSE REPORT, *supra* note 3, at 1, 1993 U.S.C.A.N. 83.

¹⁷⁶ COMMISSION REPORT, *supra* note 3, at ii. The National Commission's membership consists of 15 voting and 11 non-voting members. Five voting members were appointed by the President, five by the Senate leadership, and five by the House leadership. The National Commission is bipartisan, with members appointed from "among individuals who are experts in aviation economics, finance, international trade and related disciplines and who can represent airlines, passengers, shippers, airline employees, aircraft manufacturers, general aviation and the financial community." *Id.*

¹⁷⁷ The commissioners were appointed by Congress and President Clinton on May 24, 1993. The National Commission submitted its recommendations to the President and Congress on August 19, 1993, two days before the deadline. *Id.* at 4.

almost all others.¹⁷⁸ The National Commission recognized that the operation of bankrupt carriers is one of many factors behind the airline industry's financial problems.¹⁷⁹ Although the National Commission never chose sides as to the fairness of airline bankruptcies, it acknowledged both sides of the bankruptcy argument stating, "[W]hile Chapter 11 protection does provide some cost advantages, such as suspension of debt payments, it can also lead to reduced consumer (especially business flyer) confidence, marked loss of traffic and reduced revenues."¹⁸⁰ The National Commission sympathized with Chapter 11 airlines by acknowledging the substantial costs for professional fees, the time and attention diverted from top management, as well as the cost of doing business with suppliers on a cash-up-front basis.¹⁸¹

The fact that airline bankruptcies take too long, however, was also clear to the National Commission.¹⁸² It blamed much of the heated debate regarding airline bankruptcies on the Bankruptcy Code noting that "[t]here is little question that comprehensive [B]ankruptcy [C]ode reform is overdue, and the Commission urges the Congress to begin such a review promptly."¹⁸³

Recognizing that bankrupt airlines face difficult financial hurdles that affect not only the airlines but also the general public and the industry as a whole, the National Commission made a number of specific recommendations which include the following:

1. Subject to judicial review, bankruptcy judges should make findings in individual cases on whether to grant an extension of the 120-day reorganization limit.¹⁸⁴ A one-year absolute limit should be imposed on a bankrupt airline's exclusive right to file its reorganization plan.¹⁸⁵

¹⁷⁸ The Commission Report discusses the need for efficiency and technology superiority, the need for financial strength (including bankruptcy, tax policies, new entrants, and work forces), and the need for international operations in a global economy. *Id.* at 6-27.

¹⁷⁹ *Id.* at 15.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.* The National Commission also acknowledged that the same can be said for bankruptcies in other industries.

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

2. The time period for bankrupt airlines to assume or reject their leases for scarce airport gates should be limited.¹⁸⁶ These public assets should not be tied up and under utilized for extensive periods of time to the detriment of surrounding communities and the traveling public.¹⁸⁷

3. Government bodies, such as the Pension Benefit Guaranty Corporation and airports, should be allowed to sit on the creditors' committee.¹⁸⁸

4. Provisions in the Bankruptcy Code with respect to aircraft leases should be clarified,¹⁸⁹ making it easier for the lessor to lease to other airlines. Concern by lessors about potential impacts of bankruptcy should be allayed, allowing other airlines to obtain better lease terms for aircraft.¹⁹⁰

5. The Secretary of Transportation should have statutory permission to participate directly in bankruptcy proceedings.¹⁹¹

B. CONGRESSIONAL COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

Prior to the establishment of the National Commission to Ensure a Strong Competitive Airline Industry, the House Committee on Public Works and Transportation explored the same problems addressed by the National Commission.¹⁹² The Committee's Aviation Subcommittee held hearings during the 102d Congress to gather information from more than thirty expert witnesses.¹⁹³ The hearings covered the airline industry's problems and the advantages and disadvantages of various governmental actions to aid the industry.¹⁹⁴ A "major area of disagreement among the expert witnesses concern[ed] the extent to which airlines in Chapter 11 bankruptcy are responsible for the industry's financial problems."¹⁹⁵

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² HOUSE REPORT, *supra* note 3, at 1, 1993 U.S.S.C.A.N. 83.

¹⁹³ Three days of supplemental hearings were also held on February 16, 17, and 24, 1993. Expert witnesses "included the Department of Transportation, airlines of all sizes, employee representatives, passenger representatives, airports, aircraft manufacturing companies, persons adversely affected by aircraft noise, and financial experts." *Id.* at 1-2, 1993 U.S.S.C.A.N. 83-84.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* at 4, 1993 U.S.S.C.A.N. 86.

One theory advanced by some of the largest airlines and other experts is that carriers in Chapter 11 are the main culprits responsible for financial problems in the industry since bankrupt carriers are not required to make debt payments on debts and are able to renegotiate their union contracts.¹⁹⁶ Those in favor of this theory advocate dealing with the below-cost pricing of Chapter 11 carriers.¹⁹⁷ Proposed remedies include: "requiring [the Department of Transportation] to revoke the certification of Chapter 11 carriers on the grounds [of unfitness]; time limits on how long a carrier can stay in Chapter 11; and limits on the rights of Chapter 11 carriers to initiate fare reductions."¹⁹⁸ The large carriers also voiced opposition to additional foreign investment in United States carriers, especially when the foreign government involved does not grant satisfactory rights in return.¹⁹⁹

In the subcommittee hearings, the Chapter 11 airlines and other experts disputed these contentions and opposed the proposals. They argued that the need to make cash payments and consumer resistance would offset any cost savings.²⁰⁰ They also denied being initiators of fare reductions and argued that the main problem in the industry was overcapacity, which was created by the "Big 3"²⁰¹ carriers' addition of 445 aircraft to their fleets between 1988 and 1992 when demand growth was flat.²⁰²

As a result of the hearings, the Aviation Subcommittee identified certain questions which will need to be explored in the future. One question related to bankruptcy is how much does entering Chapter 11 reduce an airline's costs and to what extent are any reductions offset?²⁰³ The Aviation Subcommittee discovered that no party or expert witness had quantified the effects of Chapter 11 on the airline industry.²⁰⁴ So, the Subcommittee recommended further analyses and studies to measure in quantifiable, economic terms how bankruptcy affects the industry as a whole and what effects bankruptcy has on individual carri-

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ United, American, and Delta comprise the "Big 3."

²⁰² HOUSE REPORT, *supra* note 3, at 4, 1993 U.S.S.C.A.N. 86.

²⁰³ *Id.*

²⁰⁴ *Id.*

ers.²⁰⁵ The Subcommittee also recommended analysis of setting fares and the motivation of airlines in setting fares.²⁰⁶

C. VOICES AGAINST CHANGE

While some experts are calling for reform of the Bankruptcy Code, at least as it pertains to airlines,²⁰⁷ others still argue that bankruptcy serves the airline industry well. Jeffrey Heuer and Musette Vogel are two authors who support this alternative view.²⁰⁸ Their argument, however, is placed in the context of bankruptcy as an alternative to governmental regulation of the airlines, the situation prior to the Airline Deregulation Act of 1978.²⁰⁹ The argument is that bankruptcy, rather than direct government regulation, more adequately serves the airline industry.²¹⁰ Three reasons are given for this opinion:

First, the bankruptcy courts are without power to affect those airlines which have succeeded in the deregulated era. Second, the courts have greater power and more flexibility to especially rehabilitate a failing airline. Third, bankruptcy courts, as courts of general equity, will more adequately balance the interests of the debtor-airline, creditors, employees, government, airline industry and the public.²¹¹

Despite standing against regulation, this argument concedes the need for some government intervention and help. Otherwise, the free market will "chew up and spit out the airlines daring enough to enter the market."²¹² Bankruptcy is offered as a better alternative to regulation due to the reasons stated above and the fact that bankruptcy courts are quick to respond and are considered more flexible and equitable than an administrative agency, while not as intrusive.²¹³ It is the "proper forum to han-

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ See, e.g., COMMISSION REPORT, *supra* note 3, at 15.

²⁰⁸ Heuer & Vogel, *supra* note 53, at 249.

²⁰⁹ Deregulation Act, *supra* note 20.

²¹⁰ Heuer & Vogel, *supra* note 53, at 249.

²¹¹ While a valid argument, the first reason stated ignores the indirect power bankruptcy courts do hold over successful airlines. By their decisions, bankruptcy courts decide if and how long an airline will be in bankruptcy. Airlines in bankruptcy have certain operating advantages over their healthier rivals. Thus, bankruptcy courts are able to wield some influence over airlines not under their direct jurisdiction.

²¹² *Id.* at 255.

²¹³ *Id.* at 260

dle rapid growth and an equally rapid attrition of the many new entrants into the airline industry."²¹⁴

Heuer and Vogel note that numerous parties receive the benefits of bankruptcy.²¹⁵ The public is benefitted by lower air fares and better service.²¹⁶ Due to competition, airline management must think aggressively and innovatively.²¹⁷ Labor, through an increase in efficiency and participation, can take a more active role in corporate matters; creditors are able to recover their debt through a single forum; and government resources are more properly directed at enforcing consumer protection and antitrust laws than running an administrative agency.²¹⁸

The authors also suggest the airline industry as a whole is better off under the bankruptcy forum.²¹⁹ The airline industry, just like individual airlines in bankruptcy, "goes through a painful, cathartic period," and in the end, airlines emerge leaner and profitable."²²⁰ These authors suggest that the bankruptcy forum facilitates the change of an airline's structure while allowing the industry to function.²²¹

The authors suggest that "[w]here deregulation has failed, bankruptcy has adequately filled the gap. It has kept some airlines flying and sold off the effective parts of airlines that could not stay afloat."²²² Through attrition, the most inefficient airlines have been lost.²²³ In the view of these authors, the worst times are behind the airline industry.²²⁴ They concede that per-

²¹⁴ *Id.* at 256. Unfortunately, the two airlines the authors cited as successful models of the bankruptcy forum, Midway and Continental, were chosen prematurely. Midway was cited as "an example of building an airline through bankruptcy liquidation or sale of assets pursuant to a reorganization plan" (much of Midway's growth was due to purchases from bankrupt airlines, namely, Air Florida). *Id.* at 279. As noted earlier, Midway went bankrupt in 1991 and never recovered. *See supra* note 6. Continental was cited as a bankruptcy success. Heuer & Vogel, *supra* note 53, at 282. This success, however, related to Continental's first bankruptcy and re-emergence. Continental had yet to file for bankruptcy a second time when this article was published. *See supra* text accompanying note 7.

²¹⁵ Heuer & Vogel, *supra* note 53, at 279.

²¹⁶ *Id.* at 260.

²¹⁷ *Id.*

²¹⁸ *Id.* The Civil Aeronautics Board (CAB) which had performed most of the agency functions during regulation was abolished as a result of the Airline Deregulation Act of 1978. *See supra* notes 23 and 38.

²¹⁹ Heuer & Vogel, *supra* note 53, at 278.

²²⁰ *Id.*

²²¹ *Id.*

²²² *Id.* at 286.

²²³ *Id.* at 285.

²²⁴ *Id.*

haps a few more airlines may be subjected to bankruptcy due to "mismanagement, . . . high costs, poor service, or inefficiency,"²²⁵ but "[t]he lion's share of reorganization, liquidation, merger and consolidation has taken place."²²⁶ In the view of Heuer and Vogel, bankruptcy has "balanced the interests of all concerned, including the government and the public . . . produc[ing] positive results on a larger scale."²²⁷ In contrast to the National Commission²²⁸ and the Aviation Subcommittee,²²⁹ Heuer and Vogel suggest leaving the bankruptcy forum as is.²³⁰ To them bankruptcy is an excellent forum in the era of deregulation and "does not and will not trample the ability of strong airlines to effectively run their business."²³¹

D. NEUTRAL OPINIONS

Some authors have chosen to take the middle ground regarding the use of the bankruptcy forum and recommending changes. In essence, they are not impressed with the current Bankruptcy Code, but do not advocate drastic changes either. For example, Robert K. Rasmussen, while conceding some problems with the current bankruptcy system, notes that it is "part and parcel" of the American economy.²³² The operation of a market-based economy such as that of the United States, with ownership of private property, "directly implicates bankruptcy law. The hallmark of such an economy is that some firms inevitably fail."²³³ "[A]bsent some form of nonmarket subsidization, [the result] is eventual bankruptcy."²³⁴ "Any economic system which often results in corporate insolvency needs a way to deal with these failures."²³⁵ "Bankruptcy law performs that function."²³⁶ Some firms may be both efficient in the long run, but "in the short run [may] be unprofitable and unable to receive interim financing."²³⁷ Bankruptcy provides an adequate forum.

²²⁵ *Id.*

²²⁶ *Id.*

²²⁷ *Id.* at 286.

²²⁸ See *supra* note 183 and accompanying text.

²²⁹ See *supra* notes 205-06 and accompanying text.

²³⁰ Heuer & Vogel, *supra* note 53, at 260.

²³¹ *Id.* at 286.

²³² Rasmussen, *supra* note 39, at 10.

²³³ *Id.* at 9.

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.* at 10.

²³⁷ *Id.*

It allows an otherwise strong company to survive short term cash shortages, outliving economic downturns.²³⁸ "[I]t determines the fate of the financially troubled firm and allocates who gets what when there are not enough assets to go around."²³⁹

VI. CONCLUSION

The evidence as to how badly the use or abuse of Chapter 11 has hurt the airline industry has not been quantified. It is conceded by most that Chapter 11 does have some effect on the overall state of the industry and does give airlines under its protection some unfair advantages, mainly the reduction of operating costs.

It is also conceded that the airline industry's problems are not caused by the proliferation of Chapter 11 litigation. Deregulation, recession, and international politics have played a major role in the success or failure of airlines. These problems will still exist and plague the industry regardless of Chapter 11. The use of Chapter 11 by a significant number of airlines during times of crisis, however, only adds to the struggle and has caused bad blood between the competitors.

The public interest pressures related to airline bankruptcies are enormous. Public policy plays an important role, both in the initial bankruptcy legislation and also in interpreting the Bankruptcy Code. When an airline struggles, thousands of employees are affected, which in turn affects the cities in which they live and work. Consequently, pressure is placed on congressional, judicial, and other governmental representatives to keep the airline operating. This public pressure is manifested in the Bankruptcy Code, the partial purpose of which is to keep businesses operating.²⁴⁰ One specific goal is to provide continuous employment to the debtor's workforce.²⁴¹

Congress has admitted that it does not want airlines to fail. The National Commission's report stated, "We want to do everything possible to preserve the jobs of the 73,000 employees of carriers now in Chapter 11. We need these carriers as competitors to preserve the benefits of deregulation."²⁴² The irony of this statement cannot be lost on those who consider deregula-

²³⁸ *Id.*

²³⁹ *Id.*

²⁴⁰ See 11 U.S.C. §§ 1101-1330 (1988 & Supp. 1994).

²⁴¹ See *supra* note 70 and accompanying text.

²⁴² HOUSE REPORT, *supra* note 3, at 3, 1993 U.S.S.C.A.N. 85.

tion to be at the heart of the airline industry's problems. As stated earlier, the overall goal of deregulation is to restore competitive capitalism to the airline industry.²⁴³ Minimal government involvement is one of the tenets of any capitalist structure where regulation is replaced by free market control.

In the wake of deregulation, the federal government (both courts and Congress) has remained deeply involved in the airline industry through the long reach of the Bankruptcy Code. Despite one's feelings whether Chapter 11 is good or bad for the airline industry, it is incontrovertible that Chapter 11 is an artificial device, used to prop up a business and keep it operating when it would have otherwise failed under market conditions. In effect, Congress has substituted one artificial control—regulation—for another, Chapter 11 protection. Instead of letting the market forces alone decide which airlines will survive or fail, the federal government has kept its hand in the air travel industry. Such action seems to be at odds with the stated purposes behind deregulation.

This Comment opened with the news that no major airlines are now in Chapter 11 bankruptcy protection. Perhaps now is the time to decide what reforms, if any, should be made to the Bankruptcy Code as it concerns airlines. With no major airlines in Chapter 11, discussions can proceed under less political scrutiny and prejudice caused by the differing industry opinions and agendas.

²⁴³ Gesell & Farris, *supra* note 18, at 108.

Current Literature

