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The Chapter 11 Shuttle - Coincidence or Competitive Strategy

Eva M. Dowdell
THE CHAPTER 11 "SHUTTLE"—COINCIDENCE OR COMPETITIVE STRATEGY?

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I. INTRODUCTION

"Capitalism without bankruptcy is like Christianity without hell."¹

SINCE INDUSTRY deregulation in 1978, more than 100 airlines, including large, or “legacy” carriers, and as small regional airlines, have filed for bankruptcy protection.² Several airlines, including Continental and US Airways, have filed for bankruptcy more than once.³ With the recent bankruptcy filings by Northwest Airlines and Delta, four of the six legacy carriers in the United States now operate under bankruptcy protection.⁴

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⁴ See Wessel & Carey, supra note 2.
The Northwest and Delta bankruptcies have spurred a familiar debate. Some airlines, it is said, abuse the bankruptcy process to the detriment of competitors, employees, retirees and others. Rather than cut costs by eliminating layers of management or streamlining operations, these carriers “hide out” in bankruptcy court.

Not surprisingly, those airlines in bankruptcy have a different view. They maintain that structural issues and unanticipated factors, such as markedly increased oil prices, preclude the adoption of necessary cost reductions outside of bankruptcy. These carriers also justify their bankruptcy filings because other airlines have already “used the bankruptcy process,” and the only way to effectively compete in such a volatile market is under Chapter 11 protection.

This Paper explores both sides of the bankruptcy debate. It begins with an overview of the airline industry before and after deregulation. It also includes a discussion of relevant sections of the Bankruptcy Code, and other government supports to the airline industry. Following that are the arguments advanced by proponents of the airlines’ use of the Chapter 11 process. Then the case against repeated airline filings is presented. After considering both positions, this Paper argues that allowing airlines to continually seek refuge in Chapter 11, especially in light of other support the industry already receives from the govern-

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5 See John Helyar, Time to Clear the Air: The Airline Mess Has Gone From Unstable to Untenable. But This Fall the Market May Finish What It Started, FORTUNE, Sept. 20, 2004, at 39 (“The torrent of ink spilled about airline ineptitude has been flowing for . . . years.”).

6 Robert Crandall, Coffee, Tea . . . or Bankruptcy?, WALL ST. J., Sept. 16, 2005, at A14. Mr. Crandall is a former CEO of American Airlines and writes frequently about the harms caused by the airline industry’s Chapter 11 practices.

7 See Jerry Knight, Airlines Hide Out in Bankruptcy Court, WASH. POST, Sept. 19, 2005, at D1.

8 In a news release announcing the Northwest bankruptcy, the airline’s president and chief executive officer, Doug Steenland, explained that the carrier was attempting to restructure outside of Chapter 11, but the “efforts were overtaken by skyrocketing fuel costs.” See Northwest Airlines, Northwest Airlines Files for Chapter 11 Reorganization to Facilitate Restructuring (Sept. 14, 2005), http://www.nwa.com/corpinfo/newsc/2005/pr091420051625.html (last visited Oct. 13, 2006) [hereinafter News Release]; see also U.S. GEN. ACCOUNTABILITY OFFICE, COMMERCIAL AVIATION: BANKRUPTCY AND PENSION PROBLEMS ARE SYMPTOMS OF UNDERLYING STRUCTURAL ISSUES 12 (2005) [hereinafter “GAO REPORT”].

9 See News Release, supra note 8.
ment, makes for unsound bankruptcy policy. This Paper concludes with a discussion of possible alternatives to the airlines' current Chapter 11 scheme.

II. BACKGROUND

"Bankruptcy is endemic to the airline industry. . . ."11

A. INDUSTRY OVERVIEW

Prior to deregulation, the government largely controlled fares, routes, and other aspects of the airline industry.12 During that time, if operating costs increased—due to higher fuel costs, or more expensive labor contracts—prices, in most instances, were correspondingly raised.13 Routes were not added without a demonstrated need for new services.14 With competition effectively in check, the pre-deregulation era was described as a "fairly comfortable operating environment."15 Airline bankruptcies prior to 1978 were "extremely rare."16

Despite the relative certainty of the status quo, airline deregulation was enacted with an eye toward restoring competition in the industry.17 Lowering the barriers to entry would mean more airlines in the marketplace to challenge existing carriers.18 Service would be brought to smaller, previously underserved areas.19 Carriers could set their own rates, with more efficient operators gaining ground on lesser competitors.20 Consumers would also enjoy lower prices.21 Deregulation, it was argued, would restore industry profits to the benefit of all.22

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10 Airline industry experts also maintain that this practice makes for unstable aviation policy as well. See Knight, supra note 7 (quoting Robert Crandall's congressional testimony).
11 See GAO REPORT, supra note 8, at 2 (emphasis added).
13 Id. at 1022. Fares were government-regulated, but "approvals" were based on cost projections provided by the airlines. Id.
14 Id.
15 Id.
17 See Mathiesen, supra note 12, at 1021.
18 Id. at 1022.
19 See id. at 1021 n.24.
20 See id. at 1022-23.
21 Id. at 1023.
Detractors, however, worried that given the industry's fundamental structure—capital intensives, with high fixed costs and virtually no marginal costs—carriers would not strive for efficiency, but rather compete on price alone. Deregulation would be a disincentive to capital investment; employees would also suffer, as management could no longer routinely pass off higher costs to consumers. Profits in the industry would all but disappear.

Both proponents and detractors of airline deregulation were correct. New carriers did enter, and remain in the market. Fares decreased. But as the roster of airlines expanded, so too did the number of bankruptcy filings. Profits sharply declined. The industry seemingly floundered outside of the regulatory comfort zone.

Numerous explanations have been offered for the airline industry's financial woes that immediately followed deregulation and continue today. The list includes: deregulation itself (which is cited by some as a public policy failure); fuel costs; expensive pre-deregulation labor contracts; changes in the travel patterns of business and leisure passengers; marked increases in security costs related to world events; surplus capac-

24 See Heuer & Vogel, supra note 22, at 253-54.
25 See Crandall Interview, supra note 23.
26 See Heuer & Vogel, supra note 22, at 254-55.
27 Id. at 254. The price benefits of deregulation are ongoing. Consumers today are flying more, but paying less; fares are up only four percent over a decade ago, while the prices of other goods have increased more than twenty-seven percent. See Wessel & Carey, supra note 2.
28 See Heuer and Vogel, supra note 22, at 255.
29 One statistic estimated industry losses from 1979–1983 at approximately $2 billion. Id. at 255.
30 See generally Paul Stephen Dempsey, The Disintegration of the U.S. Airline Industry, 20 Transp. L.J. 9, 12-13 (1991) (describing a number of deregulation "mistakes," including the initiation of the hub and spoke system, which created new markets but increased fuel consumption; thus, when fuel prices increased, the airlines were caught somewhat unaware and were hit particularly hard). For a thorough discussion of the shortcomings of deregulation, see Melvin A. Brenner, Airline Deregulation – A Case Study in Public Policy Failure, 16 Transp. L.J. 179 (1988).
31 See Air Transp. Ass’n, 2005 Economic Report 5, 15-16, 30, available at http://www.airlines.org/economics/review_and_outlook/annual_reports.htm (follow "2005" hyperlink). "[T]he infrastructure taxes are justified, but security is a national, not an airline, problem and we see no reason why the industry should
ity; price transparencies (with the advent of the Internet); and excessive taxation, among other causes. The debut of low-cost carriers ("LCCs"), for example, Southwest Airlines and JetBlue, is also blamed. Before analyzing the validity of these accounts, a review of government supports, including general sections of the Bankruptcy Code (applicable to all businesses), provisions of the Code specific to airlines, and other direct benefits or concessions granted to the industry, is helpful.

B. LEGISLATIVE AND PROGRAM SUPPORT


Although the government no longer regulates airlines—at least not economically—it still provides direct and indirect support to the industry. General provisions of the Bankruptcy Code provide that the airline industry pays the highest federal tax rate of any industry as it continues to lose massive amounts of money through user and security taxes that amount to an estimated 10% of revenues.).

Southwest and JetBlue have consistently reported profits, where legacy carriers have lost value. See, e.g., Eric Torbenson and Terry Maxon, Forced to Reroute: American Rivals Grop for a New Business Plan: 'Ultimately, Everybody's Going to Have to Change', DALLAS MORNING NEWS, Apr. 27, 2003, at 1D; see also James Mason, No-frills Fortunes: U.S. and European Low-Cost Carriers Have Gained Significant Market Share at the Expense of Legacy Carriers over the Last Five Years and Expect Growth to Accelerate in the Next Five, AIRLINE Bus., Mar. 1, 2005, at 4 (quoting Michael O'Leary, a European LCC executive, about Rynair's plans to expand onto the turf of European and American legacy carriers, as saying, "We're going to kick the [stuff] out of every other airline."); Jeremy Peters, JetBlue Sets a Shuttle to Boston, N.Y. TIMES, Oct. 12, 2005, at C1 (explaining how JetBlue's intrusion onto the turf of Delta and US Airways, two legacy carriers, is "one of the most frustrating industry dynamics the major carriers are now facing"); Andy Serwer & Kat Bonamici, Southwest Airlines: The Hottest Thing in the Sky: Through Change at the Top, Through 9/11, in a Lousy Industry, It Keeps Winning Most Admired Kudos How?, FORTUNE, Mar. 8, 2004, at 86 (discussing how even with the financial consequences of 9/11, not a single Southwest employee was furloughed); Hawn Tully, Airlines: Why the Big Boys Won't Come Back, FORTUNE, June 14, 2004, at 101 ("Domestically, the majors are on a permanent path to decline.").

Government assistance to the airlines has not come with similar strings attached. See generally AIR TRANSP. ASS'N, supra note 31. References to "direct" support indicate either provisions in generally applicable laws that pertain specifically to the airline industry; other direct benefits include loans, bailouts, or other assistance. The term "indirect benefits" refers to the use of generally applicable laws by the airlines. For example, it is argued that bankruptcy court judges approve Chapter 11 plans filed by airlines that stretch the notion of feasibility. This too can be an indirect benefit, as the standards applied to other companies in reorganization may vary. Further, it is suggested that some government assistance sets airlines apart from other struggling businesses, which do not receive...
Code invoked by airlines filing for Chapter 11 include § 362 (Automatic Stay); § 365 (Executory Contracts); and § 1113 (Labor Agreements). Section 1110 specifically protects aircraft equipment financiers.

The automatic stay provision of the Bankruptcy Code enables airlines, just like other businesses undergoing reorganization, to forgo the payment of most current expenses, including debt-service payments and other obligations. This provision is invoked much to the consternation of airline partners, suppliers, and other carriers not in bankruptcy. For example, Northwest reneged on a $19 million obligation to Mesaba Airlines, a regional carrier/partner, when it recently filed for Chapter 11 protection. In addition, because immediate costs for airlines in Chapter 11 are lower, these carriers are able to, and often do, reduce fares and expand routes in the short run, presumably to raise capital.

The executory contract provision, § 365 of the Bankruptcy Code, allows airlines to reject contracts on unexpired leases. This too has ramifications for airline suppliers, financiers and, of course, competitors. Northwest, for example, reportedly plans to renege on some of its aircraft leases, in an attempt to update an aging and inefficient fleet.

similar concessions. See, e.g., Eduardo Porter, Reinventing the Mill, N.Y. TIMES, Oct. 22, 2005, at C1, C5; see also Joel J. Smith, Airlines Fear Bankruptcy; Feds to Meet, Discuss Bailout Package for Industry Hit By Slowdown, DETROIT NEWS, Sept. 18, 2001, at 113 (mentioning how the government bailed out Chrysler Corp. in 1980, but that financial package required the car maker to raise matching funds, adopt stringent cost-cutting measures, and repay the government with interest).

36 See Knight, supra note 7.
37 Id. (quoting a Continental Airlines representative, who, commenting on the Northwest and Delta filings, said, "[W]hen competitors enter Chapter 11 and default on their financial obligations, including their employees' hard-earned pensions, it puts us at a cost disadvantage."). Expanding routes while in bankruptcy strikes this author as a rather curious "cost-cutting" measure. See, e.g., Micheline Maynard, The Trans-Atlantic Solution, N.Y. TIMES, Oct. 18, 2005, at C6 (describing how Delta Airlines, in an effort to "eclipse" domestic and international rivals, added new flights to several European destinations). Ironically, a news item entitled Federal Court Allows Delta to Skip Payment for Pilots (concerning bankruptcy court permission to forego a pension payment obligation) appeared on the same page as Delta's route expansion announcement. Federal Court Allows Delta to Skip Payment for Pilots, N.Y. TIMES, Oct. 18, 2005, at C6.
39 See Mathiesen, supra note 12, at 1028.
40 See, e.g., Chris Serres, Bankruptcy: A Good Deal for NWA?, STAR TRIBUNE, Sept. 18, 2005, at 1A; see also Liz Fedor, Spotlight Turns To Airline's Lawyer: In the First
bankruptcy process both to reject these cumbersome lease obligations and to renegotiate purchase agreements for eighteen additional planes, priced at approximately $120 million each.\footnote{See Serres, supra note 40, at 1A; see also James E. Ellis, \textit{The Law of Gravity Doesn’t Apply: Inefficiency, Overcapacity and Huge Debt... What Keeps U.S. Carriers up in the Air?}, \textit{Bus. Wk.}, Sept. 26, 2005, at 49 (describing how a “complex web” of business relationships in and around the airline industry helps keep it aloft, despite financial troubles). For example, GE Commerical Finance, General Electric Corp.’s finance arm, has bankrolled reorganizations of several airlines, in addition to selling these carriers costly aircraft engines. \textit{Id.} Thus, what seems like unwise exposure to the vagaries of a floundering industry actually has a limited downside for the financing giant. \textit{See generally} Diane Brady et al., \textit{Why GE is Keeping Loser Airlines Aloft}, \textit{Bus. Wk.}, Feb. 7, 2005, at 35.}

Companies in Chapter 11 are no longer able to use § 365 of the Bankruptcy Code to reject labor agreements outright as they had in the past.\footnote{This development also links back to the airline industry. In 1983, Continental Chairman Frank Lorenzo invoked § 365 to abrogate labor contracts, terminating roughly 60% of all unionized employees after the airline filed for bankruptcy the first time. \textit{See Mathiesan, supra note 12, at 1029. The unions filed challenges, arguing that the Chapter 11 filing was in bad faith, but they did not prevail. \textit{See id.} at 1029. The Supreme Court also held that a collective-bargaining agreement was subject to rejection under § 365. \textit{See NLRB v. Bildisco}, 465 U.S. 513, 525-26 (1984). Section 1113 was enacted to impose some restraints on employers (and some protection for employees) with respect to repudiating labor agreements in bankruptcy. \textit{See Mathiesen, supra note 12, at 1030-31.}} Rather, § 1113 requires that a business negotiate with the union before changing collective-bargaining agreements.\footnote{\textit{Id.}} With labor as one of the more significant costs for airlines,\footnote{\textit{Id.}} this requisite wrangling begins soon after a carrier files for Chapter 11 protection.\footnote{\textit{Id.} Shortly after filing for Chapter 11, Northwest “signaled” that it would ask the bankruptcy court to annul current labor agreements to impose new terms on its workers. \textit{See Susan Carey, Northwest Outlines Financial Plan—Airline Presents Creditors With Profit Improvements After Bankruptcy Filings}, \textit{Wall St. J.}, Oct. 1, 2005, at B6. That signal eventually proved true. \textit{See Airline Seeks Permission to Void Labor Pacts}, \textit{N.Y. Times}, Oct. 13, 2005, at C5. Airline unions seem accustomed to these motions as part of the Chapter 11 process. \textit{Id.} (quoting a spokesman from the Airline Pilot’s Association as saying, “We viewed it as a matter of when, not if.”).} While airlines need bankruptcy court approval before modifying collective-bargaining agreements, they only have to show that such change is necessary to keep the airline from going out of business.\footnote{\textit{See Mathiesen, supra note 12, at 1030-31.} Unions may challenge this need, but with the subtle preferences af-
forded to airlines by bankruptcy judges, most of these changes are subsequently approved.\textsuperscript{47} Even after the protection afforded to labor agreements under §1113, airlines in Chapter 11 have continued to seek concessions from unions in a take-it-or-leave-it fashion.\textsuperscript{48}

Section 1110 of the Bankruptcy Code is an example of a direct benefit to the airline industry, as it provides special protections to aircraft financiers.\textsuperscript{49} This Code provision requires that within sixty days of filing for Chapter 11 protection, an airline must decide whether to assume or reject any lease or purchase obligations for its aircraft.\textsuperscript{50} If the carrier retains the aircraft, it must cure all defaults and agree to honor all future payment requirements.\textsuperscript{51} Failure to do so enables owners or financiers to immediately assert their interests and take possession of the equipment—the automatic stay does not apply in these instances and the aircraft are not considered property of the bankruptcy estate.\textsuperscript{52} This provision was enacted to enable airlines to secure the requisite financing for their fleets, and also to give aircraft financiers the extra protection they needed in order make such loans to a financially precarious industry.\textsuperscript{53} Accommodations for other capital-intensive industries, such as automotive or steel manufacturers, are not found within the Bankruptcy Code.

2. Other Benefits

The airline industry is the subject of much study by the government, perhaps because it also receives considerable support. For example, in 1992,\textsuperscript{54} Congress authorized the establishment of the National Commission to Ensure a Strong Competitive Airline Industry.\textsuperscript{55} The goals of the Commission were to “investigate, study, and make policy recommendations about the

\textsuperscript{47} Id.
\textsuperscript{48} See Carey, supra note 45, at B6.
\textsuperscript{49} See Gregory P. Ripple, Special Protection in the Airline Industry: The Historical Development of Section 1110 of the Bankruptcy Code, 78 Notre Dame L. Rev. 281, 282 (2002). Given the high costs of aircraft equipment, very few carriers actually own their fleets. Id.
\textsuperscript{51} Id.
\textsuperscript{52} Id.; see also Ripple, supra note 49, at 290.
\textsuperscript{53} See id. at 281–82.
\textsuperscript{54} Government support of the industry clearly predates 1992, but a longer historical discussion is beyond the scope of this Paper.
\textsuperscript{55} See Mathiesen, supra note 12, at 1037.
financial health and future competitiveness of the United States airline and aerospace industry. At the same time, the House Public Works and Transportation Committee held similar hearings. The industry's use of Chapter 11 was a hot topic in both venues, but little was resolved.

More recently, the United States General Accountability Office ("GAO") conducted a study of bankruptcy and pension problems in the airline industry. Prompted by sharp criticisms of the airline pension funding legislation and ongoing financial decline in the industry, the report was narrowly drafted: rather than explore the larger implications of airline bankruptcies, the GAO focused, for the most part, on the alleged harm to the industry only. The GAO found no evidence that airlines in bankruptcy contribute to overcapacity in the industry or harm their competitors through underpricing. While the GAO studies other industries at the behest of Congress, this particular report, published only weeks after the Delta and Northwest bankruptcy filings, was curiously timed, given the flurry of headlines critical of airlines around that date.

In addition to being studied, airlines also receive direct support from the government. In 2004, Congress enacted legislation that eased pension funding requirements for major airlines. This enabled carriers to legitimately underfund pension obligations by approximately 80% in the first year, and 60% in the second year. The theory was to provide temporary relief

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56 Id. at 1037 (internal citation omitted).
57 Id. at 1039-40.
58 Mathiesen notes that the National Commission, while slightly concerned about airline bankruptcies, was careful not to take sides in the debate. Id. at 1038. The Transportation Committee merely identified issues for further exploration. Id. at 1040-41.
59 See GAO REPORT, supra note 8.
60 Id. at 2. (indicating three areas of study: the role of bankruptcies in the industry; whether bankruptcies are harming the industry; and the effect of pension underfunding on employees, airlines and the Pension Benefit Guaranty Corporation). The last part, focusing on pension issues, is the only signal that the GAO considered the ramifications of airline bankruptcies beyond the effects on carriers themselves. See id.
61 Id. at 3.
62 See generally Carriers Face New Pension Burdens When Stopgap Law Expires in 2006, AIRLINE BUS. REP., Oct. 11, 2004. This temporary relief also applied to the steel industry. Id.
63 Id.
so that cash-strapped carriers could recover from financial losses in the aftermath of 9/11.\textsuperscript{64}

In April, 2005, the Senate introduced the Employee Pension Preservation Act of 2005,\textsuperscript{65} which was designed specifically for airlines. The bill amends the Internal Revenue Code and the Employee Retirement Income Security Act ("ERISA") to permit passenger airlines to restructure their unfunded plan liabilities over a 25-year period; carriers that elect this option are precluded from accruing future unfunded pension liabilities.\textsuperscript{66} Not surprisingly, this bill was sharply criticized by those who believe that government assistance to the airline industry has gone too far.\textsuperscript{67} Most support the government bailout of the airlines after 9/11.\textsuperscript{68} But this additional help, especially when some companies, like General Motors, have borrowed billions of dollars to fully fund their pension obligations, is described as a "slap in the face" to other industries.\textsuperscript{69}

Airline pensions made headlines again in May 2005 when United Airlines, currently under Chapter 11 protection, off-loaded four of its pension plans.\textsuperscript{70} The United pension "dump" saddled the already-underfunded Pension Benefit Guaranty Corporation ("PBGC") with $6.6 billion of additional pension obligations.\textsuperscript{71} The move cost United employees and retirees approximately $3.2 billion in lost benefits.\textsuperscript{72}

\begin{itemize}
\item \textsuperscript{64} \textit{Id.} This temporary relief was unique to airlines. However, there is a pension overhaul legislation pending in Congress that will make similar—yet far less generous—concessions to the airline.
\item \textsuperscript{65} S. 861, 109th Cong. (2005).
\item \textsuperscript{66} Id.
\item \textsuperscript{67} \textit{See Pensions: It's Not Time for a Bailout: The Airlines Need to Address Older, Structural Problems,} Bus. Wk., June 6, 2005, at 138 (suggesting that additional special treatment for the airlines, especially after the 2004 pension relief and the 9/11 bailout, was "overkill").
\item \textsuperscript{69} \textit{See Pensions: It's Not Time for a Bailout, supra note 67.}
\item \textsuperscript{70} \textit{See David Carpenter, United Gets OK to Dump Four Pension Plans,} Associated Press, May 11, 2005, \textit{available at} http://articles.news.aol.com/business/-a/united-gets-ok-to-dump-four-pension/2005010903209990005?.
\item \textsuperscript{71} \textit{Id.}
\item \textsuperscript{72} \textit{See Tim McLaughlin, Airlines Seldom Have Much Lift After Bankruptcy: A New Federal Report Shows a Low Survival Rate for Airlines that Declared Bankruptcy Between 1978 and 2004,} St. Louis Post-Dispatch, Oct. 4, 2005, at C1.
\end{itemize}
Other direct support of airlines includes the recent federalization of airport security systems. Earlier attempts by the airlines to change the security scheme had failed. Soon after September 11th, however, Congress enacted the Aviation and Transportation Security Act ("ATSA"), creating the new Transportation Security Administration ("TSA"), which shifted the burden of airport security to the federal government. Some suggest that this was a shrewd move on the part of the airlines, who supported the ATSA under the guise of wanting a strengthened security system. The airlines, it is said, actually used this national crisis to off-load security cost burdens.

III. POINT: AIRLINES "CAN'T HELP" BUT FILE FOR BANKRUPTCY PROTECTION

“We should stop worrying and learn to love bankruptcy . . . .”

Many scholars and industry experts question the flack raised about airline bankruptcy patterns. Bankruptcy, they say, fills the gap left by the failure of deregulation. So what if the carriers use the Chapter 11 process to cut costs and extract concessions from labor unions? Professor Baird suggests that debt relief (for the airlines) and protection (for creditors) is not an undue competitive advantage. Rather, he insists that carriers in bankruptcy—just like other airlines—must develop plans that ensure cash flow for survival. Others, noting that consumers are benefiting from lower prices, suggest that the bankruptcy process is nothing more than a mechanism to facilitate the transfer of assets from the equity holders to the debt holders.

Airlines in bankruptcy are also painted as disadvantaged. One scholar cited the Eastern Airlines and Pan Am examples to remind us that bankrupt airlines rarely survive reorganization.

73 See Branum & Dokupil, supra note 68, at 434-35.
74 Id.
76 See Branum & Dokupil, supra note 68, at 456-57.
77 See id.
78 See Wessel & Carey, supra note 2 (quoting Severin Borenstein, an economist from the University of California at Berkeley.)
79 See Heuer & Vogel, supra note 22, at 286.
81 Id.
82 See Wessel & Carey, supra note 2 (quoting Professor Borenstein).
83 See Scott McCartney, Surviving Chapter 11: More Bad News for Delta and Northwest: The History of Airline Bankruptcies Isn't Pretty, WALL ST. J. ONLINE, Sept. 14,
The recent GAO report said that bankruptcy is not a “panacea” for airlines and that those in bankruptcy have a staggering failure rate. The actual costs of bankruptcy to the airlines, in legal and consulting fees, is also noted, with United’s bankruptcy costs mounting to $260 million and counting as of June 2005.

The airlines themselves maintain that they have little choice but to file for bankruptcy. Oil prices spike, and the airlines warn—almost reflexively—of financial doom. Rising oil prices strip carriers of cash, leaving them unable to purchase valuable hedging contracts to insulate them from future increases. Oil prices are a quagmire from which the legacy carriers cannot emerge; an Air Transportation Stabilization Board representative described the fuel-cost problems faced by the airlines as “uncontrollable.” A United representative claimed that rising fuel costs kept the airline from exiting bankruptcy in the summer of 2005. That fall, after another oil-price hike caused by Hurricane Katrina, the airline industry immediately lobbied Congress for a temporary suspension of the jet fuel tax.

In addition to fuel costs, airlines and industry experts argue that the underlying business structure of the industry causes its financial woes. For example, the GAO report noted that legacy carriers retained the same cost structures even after deregula-

84 See GAO REPORT, supra, note 8 at 3.
85 See id. at 35.
86 See Knight, supra note 7.
87 Days after Hurricane Katrina hit the Gulf Coast, a journalist claimed that a Delta spokesperson said (of the storm’s impact on the airline) that “Delta is already bleeding cash and at the near-term risk of insolvency.” Russell Grantham, Katrina: The Aftermath on Airlines, ATLANTA J.-CONST., Sept. 4, 2005, at 1C. The airline filed for Chapter 11 protection only ten days later.
89 See Maynard, supra note 88. Interestingly, another airline industry expert said, “If you take fuel costs out, this industry is not a sick industry.” See Kelly Yamanouchi, Airlines’ Profits and the State of the Industry are Sinking as Fuel Prices Go . . . Up, Up, and Away, DEnver POST, Oct. 18, 2005, at Cl.
90 See Marilyn Adams, Oil Worries Airlines More Than Terrorism, USA TODAY, July 8, 2005, at 1B.
91 See Alexandra Marks, Airline Industry is Poised for a Shakeout, CHRISTIAN SCI. MONITOR, Sept. 16, 2005, at 3.
This included the considerable expense of a highly trained and unionized workforce. Alternatively, because LCCs have a younger, less expensive workforce, and because underlying pension and benefit packages are different, these carriers have the advantage of a lower basic costs structure.

The "plight" of legacy carriers has also been compared with the steel industry, which also was plagued by volatile demand, high capital costs, expensive union contracts, and other seemingly intractable problems. The steel industry, however, unlike the legacy airlines, has undergone drastic changes with mergers, acquisitions, and liquidations, a phenomenon less common among airlines.

Other external pressures on airlines include changing travel demand, due to either the overall economy or security concerns, war or political unrest, and even health epidemics, such as SARS. Technological changes in the industry, such as increased use of the Internet to shop for fares and book travel, have also impacted legacy carriers. Because the Internet leaves the industry vulnerable to price transparencies, it is argued that airlines cannot increase prices, even when costs do demand. Last year, a representative from British Airways remarked that the carrier would add a temporary fuel surcharge to passenger fares to compensate for the spike in oil prices. United States carriers do not believe they have this option.

Competitive pressures and the basic industry structure also lead, some argue, to over-scheduling. For example, allure in the airline industry is, at least partially, tied to output-more flights scheduled to more places—is both obvious, and appealing to passengers. This same dynamic does not exist, however, in

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92 See GAO Report, supra note 8, at 4.
93 Id.
94 Id. at 5.
96 See Porter, supra note 34, at Cl.
97 See GAO Report, supra note 8, at 14.
99 Id.
100 Kevin Done, The Airline Industry’s Problems Are on Walsh’s Shoulders, FIN. TIMES, Oct. 1, 2005, at 11.
101 See Brenner, supra note 30, at 201–02.
102 Id.
the market for consumer goods, where manufacturers can adjust production volumes based on projected sales. Airlines add flights regardless of whether there is a change in the demand for seats on a particular route. There is some attempt to market a particular carrier based on perceived consumer preferences, as American Airlines attempted a few years ago with adding more legroom in coach, but that campaign was unsuccessful. Such experiments tend to strengthen the argument that winning consumers in the airline industry is almost exclusively accomplished by price and that such competition leads to over-capacity. Airlines further contend that their inability to raise prices, or at least to maintain price increases for long, creates a mechanism whereby the industry is subsidizing other travel-related business, such as hotels and restaurants.

Airlines in bankruptcy offer all of these external reasons, rather than any internal explanations, as justifications for their difficulties. Some also deny that the industry receives any extraordinary treatment from the government. In response to criticisms about repeated bankruptcies, one airline manager remarked that the Chapter 11 provisions “apply across all industries.” Curiously, airlines use a similar argument to rationalize their bankruptcy filings; Northwest’s President Steenland recently said that one reason the airline was compelled to file for Chapter 11 was because its competitors had done so in the past.

IV. COUNTERPOINT AND CONCLUSION: THE CASE AGAINST THE CHAPTER 11 “SHUTTLE”

“The airline industry is not for the faint of heart.”

While the airline industry is an integral component to a strong national economy, many scholars and industry experts re-
ject the notion that airlines require repeated trips through bankruptcy court in order to stay aloft. Rather, airlines can cut costs and retool their businesses outside of Chapter 11 protection. Instead, some carriers continually seek refuge from creditors and gain leverage on employees under the guise of bankruptcy protection. This over-reliance on the process frustrates market mechanisms on a macro level and hurts employees, retirees, taxpayers and others on a smaller scale. Bankruptcy protection is premised on the notion that a troubled business can be reorganized and rehabilitated under Chapter 11 protection, returning thereafter as a viable economic unit. Airlines repeatedly land back in bankruptcy court; this practice is contrary to the intent of Chapter 11 protection.

Bankruptcy is rooted in the notion that airlines, like other businesses, are presumed more valuable as going concerns than they would be if liquidated. Further, allowing airlines to take full advantage of the bankruptcy process and other government assistance is important to preserve jobs and protect related industries from the ripple effects of an airline failure. This argument does not ring true, however, when one considers the extent to which airline employees lose jobs, take pay-cuts and endure benefit reductions while the carrier is supposedly in the safety zone of Chapter 11 protection. Arguably then, the Chapter 11 “Shuttle” does not spare much beyond, perhaps, the jobs of incumbent management and the interests of large creditors.

Professor Frost offers us something to consider along those lines. He posits that some businesses are obsolete, suffer from over-capacity, management failures, excessive debt, or unworkable cost structures. The airlines, perhaps, suffer from more than one, if not all, of those issues. If, as Frost argues, the pur-

112 American Airlines has recently adopted cost-cutting measures, as well as creative revenue-generating plans, such as taking on third-party mechanical repairs to maximize the utility of its premier maintenance facilities. See Simpkins, supra note 108. Continental reportedly has created better working relationships with several of its unions, so management and labor can work together on cost reductions rather than proceeding in terms of forced concessions. See Melanie Trottman, Airline Bankruptcy Filings Put Continental, American, At Risk, WALL ST. J., Sept. 22, 2005, at B4.


114 Id.

115 See Branum & Dokupil, supra note 68, at 473-74.

pose of Chapter 11 is to serve the interest of investors, then liquidation for inefficient carriers is the answer.\footnote{117}{Id. at 80.}

While the prospect of liquidation seems harsh, what would happen if one or more inefficient legacy carriers exited the market?\footnote{118}{When TWA was liquidated, American Airlines absorbed its most efficient equipment and routes. See Knight, supra note 7. The same thing happened when Eastern was liquidated. See id.} In all likelihood, save for the immediate impact on employees (who might be absorbed by other carriers) and perhaps frequent flyers with significant mileage balances in their accounts, the liquidation would largely go unnoticed. Even the airlines themselves think that over-capacity is an issue; the prospect of losing one or more legacy carriers is actually welcomed and not feared.\footnote{119}{See Shawn Tully, Terminal Illness: The Major Airlines Were Praying United Would Go Under. But With a Pension Bailout in the Works, the Turbulence is Just Beginning, FORTUNE, May 30, 2005, at 25.} Before United dumped its pensions earlier this year, and the carrier’s liquidation seemed imminent, one airline insider described United’s potential demise as “the best thing that could happen to this industry.”\footnote{120}{Id.} This was not necessarily a competitor’s joust, but rather a reference to over-capacity in the industry. With a “single watershed event,”\footnote{121}{Id.} like the liquidation of a major carrier, other airlines would then be able to raise prices (given the capacity reduction), which would presumably ease some financial problems.\footnote{122}{Id.}

The tension between airlines in and out of bankruptcy is not surprising and, in fact, is quite common in capital-intensive industries. As one scholar notes, interest payments are a substantial proportion of operating expenses in such businesses.\footnote{123}{See Ian Dattner, Chapter 11 Protection: Whom Are We Protecting?, 38 COLUM. J.L. & SOC. PROBS. 287, 293 (2005).} Airlines in bankruptcy, then, have a free ride on expensive assets,\footnote{124}{For airlines that have leased equipment, which most do, this argument does not exactly hold when § 1110 of the Bankruptcy Code is considered. See supra notes 49–52 and accompanying text. However, the point about the cost inequities is well taken, as it is common for airlines in Chapter 11 to cut prices in the short run to raise cash; lower fares have the added benefit of luring away passengers from rivals that do not have the “free pass” from many operating costs. See Knight, supra note 7; Maynard, supra note 37.} while competitors continue to grapple with rising ex-
penses (such as fuel) and on-going interest payment obligations.\footnote{125}{See Dattner, supra note 123, at 293.}

Cost "disparities" are especially pronounced when an airline that seeks Chapter 11 protection is financially capable of paying its obligations at the time of filing. Northwest, for example, was "flush" with cash when it filed in September.\footnote{126}{See Knight, supra note 7.} One report indicated that the carrier had $1 billion in available cash and credit at the time of filing.\footnote{127}{Id.} Northwest's filing was so surprising that its stock was recommended as a "buy" by prominent Wall Street firms like Merrill Lynch, Morgan Stanley, Prudential, JP Morgan, and Fulcrum Securities on the morning the airline sought Chapter 11 protection.\footnote{128}{Id.}

Insolvency is not a prerequisite to filing for Chapter 11 protection. That said, however, the Northwest picture does not exactly square with the notion of offering a helping hand to businesses that have fallen on hard times. Rather, it appears as if Northwest is inappropriately using Chapter 11 as a sanctuary or safe zone from creditors to quickly reduce expenses and gain ground on its competitors. It seems, as one observer mused, that bankruptcy has become "irresistible" to the airlines.\footnote{129}{Id.}

Why do we allow this? One Congressman recently said that he would not worry if a debt-ridden lipstick company failed, but that allowing an airline to go under would "send shock waves through the economy."\footnote{130}{The author overheard this "sound bite" early in the fall of 2005 on an NPR broadcast story about the recent airline bankruptcies. She does not recall the name of the representative.} This comment explains the added government support to the airlines. It is also consistent with Professor Warren's view, which suggests that bankruptcy is best viewed as akin to contract law, with greater consideration given to social concerns.\footnote{131}{See Elizabeth Warren, Bankruptcy Policy, 54 U. CHI. L. REV. 775, 780 (1987).} This author agrees that, in general, bankruptcy policy should not return to the historical debtor's prison concept. The extraordinary measures afforded to airlines, however, including bailouts, favorable pension legislation, and "flexible" or perhaps even absurd stamps of feasibility given to reorganization plans,\footnote{132}{United's reorganization plan is reportedly based on average oil prices of $50 per barrel. See Micheline Maynard, Just When Airlines Thought Things Couldn't}{is beyond reasonable.}
So what? With airline over-capacity, consumers win because fares remain artificially low. By keeping legacy carriers aloft, noted bankruptcy law professors and others with scores of frequent flyer miles are happy. Fair enough, but allowing airlines to muddle through without forcing them to behave more like other businesses, which rise and fall on their ability to manage expenses and strive for efficiencies, is costly. When bankruptcy is used for such unfair advantage, pressure is put on healthier carriers, who, in turn, may need to file for reorganization as well, or risk liquidation. Airline employees are hurt, with nearly 135,000 jobs lost since 2000. Abandoned pension promises affect not only retirees, but taxpayers as well, especially since the ground was broken in May 2005 when United’s pension obligations were dumped onto the already-stressed PBGC.

What can be done about this? With the continued success of LCCs like Southwest and JetBlue one may hardly argue that the legacy carriers are helpless. Southwest, for example, constantly examines costs and eliminates inefficiencies—it closed three call centers earlier this year when it became apparent that the bulk of its bookings were made on the Internet. Fiscal conservatism is nearly ingrained: the company’s president is not shy about saying, “It’s like the Marine Corps . . . [W]e run this company to prepare ourselves for the bad times, which always come in the business.”

It is hard to imagine legacy carriers transforming overnight to adopt the LCC mantra, but clearly more attention must be paid to costs for the larger carriers to survive. This is especially important if rumors about Congressional “relief fatigue” are true. Apparently, when the airlines lobbied for suspension of

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Get Worse, N.Y. TIMES, Sept. 23, 2005, at C1. Clearly, with recent market prices above $60 per barrel, this is not realistic, and in the absence of other severe cost cutting measures, or extraordinary revenue production assumptions, the airline is poised for another trip through bankruptcy court before it even gets out.

133 See Wessel & Carey, supra note 2.
134 Id.
135 See Tully, supra note 119.
136 See Serwer & Bonamici, supra note 33.
137 Id.
138 Id.
139 Even when legacy carriers have spun-off LCC-like subsidiaries, like United’s “Ted,” those initiatives too have failed. Id.
140 See Marilyn Geewax, No Rush to Aid Delta, “Relief Fatigue”: With Four Big Airlines in Bankruptcy, Congress May Wait for the Market to Shake Out. ATLANTA J.-CONST., Sept. 17, 2005, at 1A.
the fuel tax in the fall of 2005, almost directly on the heels of the pension legislation debates, some lawmakers remarked that if they helped the airlines (with the tax suspension), they would have to answer to the trucking industry, the railroads, and other businesses as well.\footnote{Id.}

Beyond forcing more stringent cost-cutting measures on the airlines, there are a number of additional suggestions for grounding repeated flights through bankruptcy court, including some that appear "doable" and those that "will never happen." An example of the latter might be a "means test," similar to the one included in the new Bankruptcy Code amendments, which could be developed for the airlines. This is not to suggest that an insolvency requirement be added, but rather some additional showing that the airline was indeed seeking Chapter 11 protection as a last resort. In the Northwest example, with its $1 billion in available cash, the airline would be called upon to demonstrate that these considerable assets were otherwise spoken for or that its immediate obligations were such that they wiped out more than the amount of these reserves. Limiting a carrier to a set number of voluntary Chapter 11 filings, absent overriding circumstances or demonstrable need, would also provide a check on the industry. Clearly, however, this is likely a politically unpopular solution and, therefore, a remote possibility.

Another potential solution, perhaps to address the over-capacity problem, is to ease legislative constraints on airline industry mergers. In 2005, a bankruptcy court approved the merger of America West and US Airways\footnote{See In re US Airways, Inc., 329 B.R. 793 (Bankr. E.D. Va. 2005).}; these two carriers will now use a ticker symbol of "LCC" to connote their new identity as a price and cost-conscious carrier.\footnote{See Yamanouchi, supra note 89.} Previous efforts, such as the attempted merger a few years back between United and US Airways, met with resistance from antitrust officials.\footnote{See Editorial, Oh, Those Unfriendly Skies, BOSTON HERALD, Sept. 25, 2005, at A28.} If regulators are assured that mergers will not result in undue price increases, then morphing larger carriers into leaner LCCs may be of some help to this troubled industry.

Additional constraints can and should be enacted with respect to airline pensions. The proposed pension reform legislation supposedly forbids a carrier from underfunding its liabilities
once the deferred payment option offered under the act is chosen. This does not, however, address the problem of a carrier who does not choose the deferred payment option. Further, the legislation has not yet passed, perhaps because other financially stressed industries are lobbying Congress to do the same for them. Regardless of whether it is enacted or not, the legislation is not a cure-all for the PBGC. Airlines still have the option of dumping their pensions on the PBGC, which will eventually be at great cost to taxpayers. In order to insulate this important entity from unanticipated moves by airlines, one solution would be to allow the PBGC a seat on the creditors' committee. This recommendation was originally made by the National Commission to Ensure a Competitive Airline Industry in 1992 and is still bandied about today.

Finally, the definition of "feasibility" with respect to the reorganization plans submitted by airlines should be more narrowly defined. Under § 1129 of the Bankruptcy Code, courts supposedly confirm plans only if it is "not likely to be followed by the liquidation or the need for further financial reorganization . . . ." Such requirements, however, have typically been low. By tightening the terms of feasibility, say, starting with important cost projections such as oil prices, bankruptcy courts may indeed preclude a carrier from returning to Chapter 11, at least in the short term.

Regardless of what the GAO says, allowing repeated airline bankruptcies does harm the industry because it fuels instability. Further, measuring the impact of airline bankruptcies solely in terms of the effect on other carriers leaves out a host of important constituents. Airline bankruptcies burden employees, retirees, shareholders, and others. Although the necessary changes may be politically difficult, amending bankruptcy laws and practices to award success and penalize failure will restore financial stability to this important industry. Moreover, these adjustments will (hopefully) prevent future harms caused by repeated bankruptcy filings, for as Senator Hatch cautioned: "At the end of the day, it is law-abiding, bill-paying citizens who pay for the bankruptcy of others, regardless of whether the debts

145 See Mathiesen, supra note 12, at 1038-39.
147 For a more detailed discussion of plan feasibility, see Rollman, supra note 95, at 409.
148 See Mathiesen, supra note 12, at 1019.
involved were taken on by con men or those whose situations simply got out of hand."149
