

Airline Bankruptcy: The Post-Deregulation Epidemic

By

Paul Stephen Dempsey

McGill University

Institute of Air & Space Law

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- *“Airline deregulation is a bankrupt policy.”*

Hobart Rowen

Washington Post columnist



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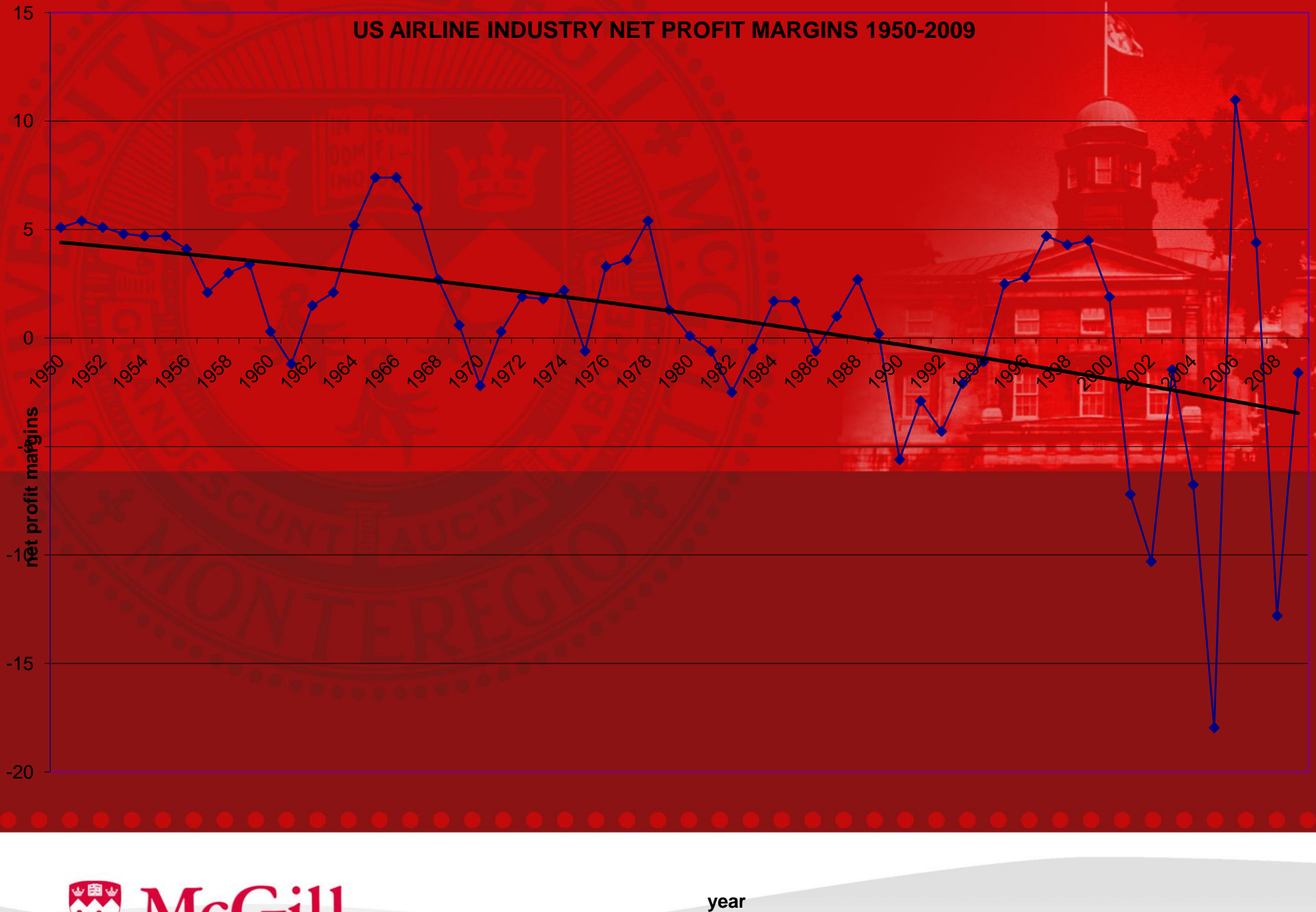


Every major US interstate airline at the time of deregulation in 1978 has since visited bankruptcy court, several more than once.



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US AIRLINE INDUSTRY NET PROFIT MARGINS 1950-2009



- 2000 – U.S. profit \$2.5 billion
- 2001 - U.S. loses \$8.3 billion
- 2002 - U.S. loses \$11.4 billion
- 2003 - U.S. loses \$1.7 billion
- 2004 - U.S. loses \$9.1 billion
- 2005 - U.S. loses \$27.2 billion
- 2006 - U.S. profit \$18.2 billion
- 2007 - U.S. profit \$7.7 billion
- 2008 - U.S. loses \$23.8 billion
- 2009 - U.S. loses \$2.5 billion
- 2010 – U.S. profit \$3.6 billion

US Carriers cumulatively lost \$52 billion in this decade.



U.S. General Accountability Office

- *“Structurally, the airline industry is characterized by high fixed costs, cyclical demand for its services, intense competition, and vulnerability to external shocks. As a result, airlines have been more prone to failure than many other businesses, and the sector’s financial performance has continually been very weak”*
- *“Since the 1978 economic deregulation of the U.S. airline industry, airline bankruptcy filings have become prevalent in the United States, and airlines fail at a higher rate than companies in most other industries.”*
- U.S. Government Accountability Office, *Commercial Aviation: Bankruptcy and Pension Problems are Symptoms of Underlying Structural Issues* (Sep. 2005).



Liquidation or Reorganization?

- The purpose of bankruptcy is to give honest debtors a “fresh start” by relieving them of most debt, and to repay creditors in an orderly manner to the extent the assets of the debtor are adequate.
- Because the “going concern value” of an airline is typically greater than the liquidation of the carrier, most airlines opt for Chapter 11 reorganization bankruptcy.
- Many, however, are dismembered in Chapter 7 liquidations.

Voluntary or Involuntary?



- Bankruptcy proceedings may be classified as either voluntary or involuntary.
- A *voluntary* bankruptcy is filed by the debtor, whereas an *involuntary* bankruptcy is filed by the creditors.

New York Airways
Aeroamerica
Florida Airlines
Indiana Airways
Air Bahia
Tejas Airlines
Mountain West
LANICA
Coral Air
Pacific Coast
Swift Aire Line
Golden Gate
Pinehurst Airlines
Silver State
Air Pennsylvania
Cochise Airlines
Braniff International
Astec Air East
Will's Air
Aero Sun Int'l
Aero Virgin Islands
Altair
North American
Island Empire
State Airlines
Golden West
Continental Airlines
National Florida
Air Vermont
Pacific Express
Dolphin
Combs Airways
New York Helicopter
Air Florida
Excellair
American Int'l
Emerald
Hammonds Commuter
Air North
Wright Air Lines
Oceanaire Lines
Atlantic Gulf
Connectaire
Air One
Capital Air

Exec Express
Caribbean Express
Pocono Airlines, Inc.
Virginia Island Seaplane
Princeton Air Link
Qwest Air
Southern Jersey Airways
Eastern Air Lines
Big Sky Airlines
Air Kentucky
Braniff, Inc.
Presidential
Resort Commuter
Pocono Airlines
SMB Stage Lines
CC Air
Britt Airways
Rocky Mountain Airways
Continental Airlines
Pan Am World Airways
Pan Am Express
L'Express
Eastern Air Lines
Bar Harbor Airlines
Northcoast Executive
Midway Airlines
Grand Airways
Metro Airlines
Mohawk Airlines
Jet Express
Metro Airlines
Northeast

America West
Midway Airlines
Flagship Express
Virgin Island Seaplane
Trans World Airlines
L'Express
MarkAir
Hermans/Markair Express
States West Airlines
Hawaiian Airlines
Florida West
USAfrica Airways
MarkAir
Trans World Airlines
Grand Airways
The Krystal Company
GP Express
Business Express
Jet Aspen
Kiwi International
Conquest
Air 21
Sun Jet International
Mahalo
Air South
Western Pacific Airlines
Mountain Air Express
Pan American World
Euram Flight Center
Sunjet International
Eastwind Airlines
Access Air

Lower Air
Kitty Hawk
Pro Air
Fine Air Services
Legend Airlines
National Airlines
Trans World Airlines
Midway Airlines
Sun Country Airlines
Vanguard Airlines
US Airways
United Airlines
Hawaiian Airlines
Midway Airlines
Great Plains Airlines
Atlas Air/Polar Air Cargo
US Airways
ATA Airlines
Southeast Airlines
Aloha Airlines
Delta Air Lines
Comair
Northwest Airlines
TransMeridian
Mesaba Airlines
Era Aviation
Independence Air
Florida Coastal
Kitty Hawk Aircargo
MAXjet Airways
Aloha Airlines
ATA Airlines
Skybus Airlines
Frontier Airlines
Eos Airlines
Sun Country
Primaris Airlines
Arrow Air

US AIRLINE BANKRUPTCIES

Defunct European Airlines

- **Aeris**
- France
- Bankrupt 2004.
- **Aero Flight**
- Oberursel
- Germany
- Operating licence not renewed.
- **Air Adriatic**
- Rijeka
- Croatia
- Ceased operations in March 2007
- **Air Anatolia**
- Turkey
- Ceased Operations.
- **Air Europe**
- Italy
- Operations Suspended.
- **Air Holland**
- Netherlands
- Closed.
- **Air Italica**
- Pescara
- Italy
- Ceased Operations.
- **Air Lithuania**
- Kaunas
- Lithuania
- Bankrupt November 2005.
- **Air Littoral**
- Montpellier
- France
- Ceased Operations Feb 2004.
- **Air Livonia**
- Tallinn
- Estonia
- Ceased operations
- **Air Luxor**
- Lisbon
- Portugal
- Ceased operations October 2006
- **Air Madrid**
- Madrid
- Spain
- Ceased Operations Dec 2006.
- **Air Polonia**
- Warsaw
- Poland
- Flights Suspended 2004.
- **Air Scandic**
- Ceased Operations Sep 2005.
- **Air Scotland**
- Glasgow
- United Kingdom
- Operations Suspended December 2006.
- [Air Scotland](#)
- **Air Turquoise**
- Béthany
- France
- Ceased operations August 2006.
- **Air Wales**
- Swansea
- United Kingdom
- Ceased Operations April 2006
- **ADA Air**
- Tirana
- Albania
- Closed January 2007.
- **ajet**
- Larnaca
- Cyprus
- (Formerly Helios Airways)
- Flights ceased November 2006.
- **Albatros Airways**
- Tirana
- Albania
- Grounded September 2006.
- **AlpaOne Airways**
- United Kingdom
- **Amber Air**
- Kaunas
- Lithuania
- Suspended operations October 2007.
- **Angel Airlines**
- Romania
- Bankrupt and closed in 2004.
- **Armenian International Airlines**
- Yerevan
- Armenia
- Bankrupt April 2003
- **Axis Airways**
- Marseille Provence Airport
- France
- Ceased operations December 2009
- **Azzurra Air**
- Italy
- Ceased Operations 2004.
- **BackpackersXpress**
- Startup Failed.
- **Basiq Air**
- Amsterdam
- Netherlands
- Merged with Transavia.
- **Berlin Jet**
- Berlin
- Germany
- Ceased Operations.
- **Bexx Air**
- Sofia
- Bulgaria
- Operations Suspended.
- [Bexx Air](#)
- **Britannia**
- United Kingdom
- Rebranded as Thomsonfly in 2005.
- [Britannia Airways](#)
- **BritishJet.com**
- Malta International Airport
- Malta
- Ceased operations 2008.
- **British NorthWest Airlines**
- Blackpool
- United Kingdom
- Ceased operations December 2006
- **Centavia**
- Belgrade
- Serbia
- Declared Bankrupt November 2006.
- **Centralwings**
- Warsaw
- Poland
- Merged with LOT 2008/2009.
- [Centralwings](#)
- **Channel Express**
- Bournemouth
- United Kingdom
- Rebranded to become Jet2.com in January 2006.
- **Clickair**
- Barcelona
- Spain
- Merged with [Vueling](#), July 2009.
- **Club Air**
- Milan
- Italy
- Grounded 2008.
- **Dalavia Airlines**
- Khabarovsk
- Russia
- Operations suspended October 2008.
- **dba**
- Munich
- Germany
- Bought by Air Berlin.
- [dba](#)
- **Direct Fly**



Warsaw Poland Suspended operations May 2007.	•	Flyjet London Luton United Kingdom Ceased operations October 2007.	Hapagfly Hanover Germany Merged with HLX in January 2007 to form TUfly.com .	LTU Düsseldorf Germany Merged with Air Berlin 2009.
Domodedovo Airlines Moscow Russia Suspended operations September 2008 due to the AiRUnion collapse.	•	flyLAL - Lithuanian Airlines Vilnius Lithuania Suspended operations January 2009.	TUfly.com Hapagfly Hapag-Lloyd Express Hanover Germany Merged with Hapagfly in January 2007 to form TUfly.com .	TUfly.com Maersk Air Copenhagen Denmark Merged with Sterling, September 2005.
duo Birmingham United Kingdom Closed.	•	FlyMe Göteborg Sweden Bankrupt March 2007.	TUfly.com HLX Helios Airways Larnaca Cyprus Rebranded as ajet March 2006.	Malev Hungarian Airlines Budapest Hungary Bankrupt Feb 2012.
DutchBird Netherlands Suspended all operations.	•	FlyNordic Stockholm Sweden Merged with Norwegian Air Shuttle April 2008.	Hellas Jet Athens Greece Closed 2005.	Malev MyAir Italy Suspended operations July 2009.
EUjet Shannon Ireland Closed.	•	Flying Finn Helsinki Finland Bankrupt 2004.	Hemus Air Sofia Bulgaria Merged with Bulgaria Air.	Nordic Airways Stockholm Sweden Licence cancelled January 2009.
EuroManx Isle of Man United Kingdom Ceased operations May 2008.	•	Fly West Brest France Website Not Found 2005.	JetOnly Brussels Belgium Now Jetairfly.com	Nordic Regional Stockholm Sweden All operations were cancelled in 2008.
European Air Express Cologne/Bonn Germany Closed September 2007.	•	FreshAer Dublin Ireland Closed.	Jetmagic Cork Ireland Closed.	Now London Luton United Kingdom Startup Deferred.
Fairline Graz Austria Closed.	•	Futura Palma de Mallorca Spain Ceased trading September 2008.	Karat Airlines Moscow Russia Closed	Odette Airways Zurich Switzerland Closed 2004.
Falcon Air Malmö Sweden Ceased operations in 2006	•	Gandalf Airlines Italy Bankrupt Feb 2004.	LowFare Jet Hannover Germany Closed.	
Fare 4U Malta International Airport Malta Air Malta low cost airline closed.	•	Globespan Glasgow Prestwick United Kingdom Closed December 2009.	LTE International Airways Palma de Mallorca Spain Suspended operations November 2008.	
Fly Eco France Closed.	•			
Fly Gibraltar Gibraltar Airport Gibraltar Startup never started.	•			



- **Olympic Airlines**
Athens
Greece
- Ceased operations 29 September 2009,
successor Olympic Air.
- **Omskavia Airlines**
Omsk
Russia
- Suspended October 2008.
- **Pulkovo Airlines**
St.Petersburg
Russia
- Merged with Russia State Transport
Company to form Rossiya, Oct 2006.
www.rossiya-airlines.ru
- **Rockhopper**
Alderney, Guernsey
Channel Islands
- Now known as Blue Islands.
www.blueislands.com
- **Samara Airlines**
Samara
Russia
- Suspended operations September 2008
due to the AiRUnion collapse.
- **Sibaviatrans Airlines**
- Suspended operations September 2008
due to the AiRUnion collapse.
- **Silverjet**
London Luton
United Kingdom
- Suspended operations May 2008.
Silverjet
- **Sky Europe**
Bratislava
Slovakia
- Bankrupt September 2009.

[SkyEurope](#)
Skynet Airlines

Shannon
Ireland
Bankrupt 2004.
Slovak Airlines
Bratislava
Slovakia
Ceased operations in February 2007.

SN Brussels Airlines
Brussels International
Belgium
Merged with Virgin Express to form Brussels Airlines

Spanair
Spain
Bankrupt Jan 2012.

[Spanair](#)
Spirit of Balkan
Never Started

Star Airlines
Paris CDG
France
Now owned by the XL Leisure Group and rebranded as XL
Airways France.
www.xlairways.fr

Sterling
Copenhagen
Denmark
Bankrupt October 2008.

[Sterling](#)
Styrian Spirit
Graz
Austria
Bankrupt 2006.

Swedline
Sweden
Closed August 2006

Tempelhof Express
Germany
Closed 2001.

UK International Airlines

Sheffield
United Kingdom
Suspended operations December
2007.

V BIRD
Düsseldorf Niederrhein
Germany
Bankrupt 2004.

Viking Airlines
Stockholm
Sweden
Ceased operations on 18 October
2010.

Virgin Express
Brussels
Belgium
Merged with SN Brussels Airlines to
form Brussels Airlines.

[Virgin Express](#)

XL Airways
London Gatwick
United Kingdom
Went into administration September
2008.

[XL Airways](#)



The Largest Airline Bankruptcies

Airline	Year	Asset Value
American	2012	\$24.7 billion
United	2002	\$22.8 billion
Delta	2005	\$21.6 billion
Northwest	2005	\$14.4 billion
US Airways	2004	\$8.6 billion
US Airways	2002	\$8.0 billion
Continental	1990	\$7.7 billion
Eastern	1989	\$4.0 billion
TWA	1992	\$2.9 billion



Notable Liquidations

- Braniff was liquidated in 1982.
- Pan Am entered bankruptcy in 1989 and was liquidated.
- Eastern entered bankruptcy in 1991 and was liquidated.
- TWA was folded into American on the verge of liquidation.
- In Europe, British Caledonian, Laker Skytrain, Sabena, Swissair, Olympic, Malev and Spanair were liquidated. In America, Mexicana ceased operations.



Trans World Airlines

- TWA owned by Howard Hughes from 1941-1961.
- In 1967, TWA became the first all-jet airline.
- In the 1980s, Trans World Airlines operated more transatlantic flights than any other airline.
- In 1985, TWA was acquired in an LBO by Carl Icahn.
- TWA was collapsed into Chapter 11 bankruptcy three times:
 - 1992
 - 1995, and
 - 2001
- On the verge of liquidation, TWA was sold to American Airlines.





US Airways

- US Airways entered bankruptcy in August 2002, after a failed merger with United Airlines that stretched through 2000-2001.
- US Airways emerged from bankruptcy in March 2003.
- But it fell into bankruptcy again in September 2004.
- US Airways emerged in September 2005, when it was acquired by American West.
- America West also had filed for bankruptcy more than a decade earlier, in June of 1991.
- Although America West was the acquiring company, it named the combined airline US Airways.



United Airlines



- United filed for bankruptcy protection in December 2001.
- In so doing, United became the largest airline and sixth-largest U.S. company (by assets) in history to file under Chapter 11.
- UAL listed assets of \$22.8 billion and liabilities of \$21.5 billion.
- United was facing \$920 million of past due debt repayments looming within a week of the filing.
- After more than three years of restructuring, United emerged in February 2006.

Continental Airlines

- After a LBO by Frank Lorenzo, Continental Airlines declared bankruptcy in 1983.
- It filed for bankruptcy a second time in 1990.
- Continental emerged in 1993 after an investment by Air Canada and the Texas Pacific Group.
- Continental was acquired by United Airlines in 2011.



American Airlines



- In 2011, AMR had a net loss of \$471 million. Delta had net earnings of \$593 million; United earned \$854 million. AMR has lost nearly \$5 billion since 2007.
- As of November 1, 2011, American Airlines had a fleet of over 600 jet aircraft and provided approximately 1,800 scheduled daily departures to approximately 160 destinations. As of September 30, 2011, AMR had consolidated reported assets and liabilities of approximately \$24.72 billion and \$29.55 billion, respectively. AMR employed more than 88,000 people.
- American Airlines entered bankruptcy in November 2011.
- In January 2012, US Airways hired investment bankers Barclays Capital and Millstein & Co., and law firm Latham & Watkins LLP to help it assess a possible bid for AMR.
- Delta Air Lines Inc. and private equity firm TPG Capital also expressed interest in purchasing or investing in AMR.



Foreign Airline Bankruptcies

- Laker Skytrain liquidated.
- British Caledonian liquidated.
- Sabena liquidated.
- Swissair liquidated.
- Olympic Airlines ceased ops 2009.
- Air Canada entered bankruptcy in April 2003, emerging in September 2004.
- Japan Airlines entered bankruptcy in January 2010, emerging in March 2011, after raising \$3 billion in new capital, cutting one-third of its staff, grounding more than 100 aircraft, and abandoning 49 routes.
- Mexicana entered bankruptcy in August 2010 and suspended operations.
- Spanair and Malev ceased operations in 2012.



Too Big to Die?

- Given the 20- to 30-year life of airline capital assets (aircraft), and the high cash flows generated from ticket sales, an airline can go through a very long period of chronic illness before rigor mortis sets in. Moreover, the “going concern value” often is larger than the liquidation value of an airline.
- Large airlines have an interesting advantage over small airlines in bankruptcy. Because large airlines typically have large inventories of leased aircraft and large amounts of debt owed to various creditors, those lenders have the biggest stake in the success of the bankruptcy reorganization, and are most likely to provide the DIP financing and concessions necessary for reorganization. The threat of a large airline to return aircraft to lessors in a soft market can instill financial generosity in the cold heart of a lessor. Because large communities will also be adversely affected should the carrier be liquidated, large airlines also have considerable political power at their disposal to assist them should the regulators or pension agencies become difficult.



US Bankruptcy Laws



- *Chapter 7* is liquidation. It is a complete termination of the business. The trustee collects the debtor's assets, reduces them to cash, and distributes the proceeds to creditors on a pro-rata basis, though secured creditors receive preferential treatment vis-à-vis unsecured creditors and stockholders.
- *Chapter 11* is reorganization. The debtor is given protection from creditors while it reorganizes itself. It may reject any outstanding contract (except a labor agreement), subject only to the "business judgment" or "benefit to the estate" test. It may also seek to reschedule or reduce payment of its debts. The company is allowed to defer existing obligations, except for aircraft payments. A company that fails to reorganize successfully may find itself in Chapter 7 liquidation proceedings.
- *Chapter 15* involves cross-border issues. It codifies the UNCITRAL Model Law on Cross-Border Insolvency. Usually, it is ancillary to a bankruptcy proceeding brought in the debtor's home country. Generally, it applies only to the foreign debtor's assets in the United States. For example, Mexicana filed for Chapter 15 bankruptcy protection in the U.S. Bankruptcy Court for the Southern District of New York on August 2, 2010.

US Bankruptcy Laws

- Section 1110 addresses the return of aircraft to lenders or lessors having a security interest in them. Once an airline falls into bankruptcy, it enjoys an automatic stay from making lease payments on that asset for only 60 days after the filing of bankruptcy, after which the lessor or lender free to repossess the aircraft unless, it enters into an agreement to defer payments with the lessor. Failure enables the aircraft to be repossessed. The Bankruptcy Reform Act of 1994 clarified the law to give equal protection to lease financing agreements of aircraft equipment and all debt financing that involves a security interest, irrespective of whether the interest is obtained at the time the equipment was acquired.
- Section 1113 allows the Bankruptcy Court to amend the Collective Bargaining Agreement between the airline and its unions unions if: (1) the debtor has submitted a modification proposal that satisfies certain procedural requirements; (2) the union refuses to accept the proposal without “good cause”; and (3) the balance of the equities clearly favors rejection of the CBA.



Debtor in Possession



- Management is given the exclusive right to file a reorganization plan for 120 days, though the deadline may be, and often is, extended by the bankruptcy judge for cause. Usually, management remains in control of the airline while in Chapter 11, as the “Debtor in Possession,” [DIP].
- Subject to the supervision of the Bankruptcy Judge, the DIP carries on the operation the business under an automatic stay, protecting the debtor from creditors’ demands for payment. Significant decisions, however, must be approved by the Judge. The objective of Chapter 11 is to restructure the business and financial obligations of the debtor so that the company becomes viable. The stay enables the debtor to bring the creditors together for discussion, explanation and negotiation. If negotiations are successful, the DIP will file a plan for reorganization containing proposals for repayment of the debt and reorganization of the company. The Bankruptcy Judge may confirm the plan. The debtor may then attempt to implement it. Success or failure will depend upon several variables, such as: (1) the adequacy of capital; (2) the earnings of the company; (3) economic conditions; and (4) the quality of management. If the plan succeeds, the debtor emerges from Chapter 11 discharged of its prepetition debt.



Trustee in Bankruptcy

- There are some 90 bankruptcy courts in the United States, one in each judicial district. The Bankruptcy Judge appoints a trustee to oversee the estate. The trustee's role is to take charge of the estate, investigate irregularities such as fraudulent transfer or preferential transfer, see that creditors are treated fairly, receive claims, liquidate property and/or distribute available funds. Irregularities such as fraudulent and/or preferential transfer are common transgressions where bankruptcy is imminent. These irregularities result from attempts by debtors to retain assets at the expense of creditors. *Fraudulent transfer* is the transfer of money or property to “defraud” creditors. A common example of fraudulent transfer might be the transfer of company funds to immediate relatives just prior to filing for bankruptcy protection. Conversely, *preferential transfer* occurs when certain, “preferred” creditors are paid in full while leaving others partially or totally unpaid. Under “avoiding powers”, transfers of money or property concluded within the 90 days preceding bankruptcy can be voided by the trustee, and the assets forcibly returned to the bankrupt estate. Transactions by insiders may be voided up to a year prior to filing.
- 11 U.S.C. §§ 101(31), 101(54), 547, and 548.



Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

- Congress also amended the Bankruptcy Code with the which tightened rules on debtors. It extended pre-petition liability of the estate on claims for unpaid wages to \$10,000 and increased the reach back period from the prior 90 days, to 180 days. It also limited the time period during which management has the exclusive right to file a reorganization plan to 18 months. Post-petition wages are administrative expenses, given first priority for payment without any dollar limitation.
- Pub. L. 109-8 (2005).



Plan of Reorganization – American Airlines



- **American Airlines to slash 13,000 jobs, demands deep concessions**
- By Shannon Jones 3 February 2012
- American Airlines . . . plans to eliminate 13,000 jobs, make draconian changes to work rules and cut wages, pensions and healthcare benefits. The measures are expected to slash labor costs by some 20 percent.
- American Airlines . . . estimates that its proposals will save some \$2 billion a year. Sixty percent of the savings will come off the backs of its workers.
- Management says it will seek the approval from the bankruptcy court to terminate its traditional pension plan and substitute an inferior 401(k) plan. According to the federal Pension Benefit Guarantee Corporation (PBGC), American has a \$10 billion shortfall in its employee pension account. This week the PBGC put liens on \$91 million in AMR property after the company paid only \$6.5 million of a required \$100 million into its pensions. American workers stand to lose \$1 billion if their pensions are terminated
- American and its regional carrier American Eagle employ a combined 88,000 full and part time employees. The company wants to cut the jobs of 4,600 mechanics, 4,200 ground service workers, 2,300 flight attendants, 400 pilots and 1,400 management and support workers. The company is planning to close its maintenance base at Fort Worth's Alliance Airport and outsource maintenance operations. The airline is also planning an unspecified number of job cuts for gate agents, service representatives and airline planners.



Plan of Reorganization – Delta



- Delta and Northwest Airlines filed bankruptcy in 2005 before the newly-imposed 18-month limit went into effect.
- Delta's plan of reorganization sought to achieve \$970 million through bankruptcy restructuring. It hoped to reduce costs by retiring four of its 11 aircraft types, and shrinking its overall fleet by 80 planes, of which half would be lease rejections, resulting in \$607 million in savings. It sought to close its Dallas and Cincinnati hubs, and increase the efficiency of its Atlanta hub. Delta sought \$325 million in reduced labor and benefit costs, including a 20% pay cut. Finally, it sought reorganization of its defined benefit pension plans, which were underfunded by \$5 billion.



Plan of Reorganization - Northwest

- Northwest sought permission to void its collective bargaining agreements after its unions refused pay cuts of approximately \$950 million. It hoped to out-source all maintenance work, cut wages, base many of its flight attendants in foreign venues, create a new low-cost subsidiary airline flying 77-100 seat aircraft, and return 13 aircraft to lessors. Northwest hoped that bankruptcy reorganization would result in a profit improvement of between \$2.2-\$2.5 billion. Ultimately, both Delta and Northwest emerged from bankruptcy, and merged together.



Northwest in CHAOS



Northwest Airlines successfully abrogated its CBA with its flight attendants' union in its 2005 bankruptcy filing. The union responded by notifying Northwest that it intended to disrupt the carrier's operations with a tactic it dubbed "CHAOS" ("Create Havoc Around Our System"). Northwest sought an injunction. The court granted the injunction, finding:

1. Northwest abrogated (but did not breach) the CBA by successfully securing bankruptcy court approval under section 1113,
2. abrogation terminated the status quo created by that agreement, and
3. the union's strike would violate its duty under the Railway Labor Act [RLA] to use every effort to conclude a new agreement.

Instead of striking, the RLA compelled the union to use "every reasonable effort" to conclude a new contract that would establish a new status quo.

Plan of Reorganization – Air Canada

- Debtor-in-Possession Financing;
- Aircraft Lease Restructuring;
- Cost Restructuring;
- New Aircraft Orders;
- Corporate Reorganization;
- Reduction of Pension Liabilities;
- Bondholder Negotiations;
- Exit Debt Financing;
- Exit Equity Financing;
- Rights Offering to Creditors;
- Claims Process; and/or
- Emergence Plan

AIR CANADA 



- Air Canada's Calin Rovinescu observed, navigating an airline bankruptcy is “like playing full-contact multi-dimensional chess in a fish bowl.”



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Duration

- Airline bankruptcy overall duration averages 714 days (fifth among U.S. industries, and significantly higher than the average of all industries of 518 days).
- U.S. Government Accountability Office, *Commercial Aviation: Bankruptcy and Pension Problems are Symptoms of Underlying Structural Issues* 23 (Sep. 2005).
- At 1,150 days, the longest and most expensive bankruptcy in aviation history was that of United Airlines, which emerged in 2006. The company spent \$400 million in consulting and legal fees on the transaction. Upon exiting bankruptcy, United management announced it was giving itself and other salaried employees about \$100 million in stock and other equity—that after taking some \$3 billion from employees in wage and benefit concessions, as well as their pension plans.
- Marilyn Adams, *United Leaves Bankruptcy Behind*, USA Today, Feb. 6, 2006, at 3B.
- *Lavish Payout for Management*, Rocky Mountain News, Dec. 17, 2005, at 14C.
- Congress in 2005 amended the Bankruptcy Code to limit the exclusive right of the debtor-in-possession to file a reorganization plan to 18 months.



Criteria for Extension of Exclusivity Period

- (i) the size and complexity of the debtor's case;
- (ii) the necessity for sufficient time to permit the debtor to negotiate a chapter 11 plan and prepare adequate information;
- (iii) the existence of good faith progress towards reorganization;
- (iv) the fact that the debtor is paying its bills as they become due;
- (v) whether the debtor has demonstrated reasonable prospects for filing a viable plan;
- (vi) whether the debtor has made progress in negotiations with its creditors;
- (vii) the amount of time which has elapsed in the case;
- (viii) whether the debtor is seeking an extension of exclusivity in order to pressure creditors to submit to the debtor's reorganization demands; and
- (ix) whether an unresolved contingency exists.



Amending Collective Bargaining Agreements in Bankruptcy Court

THE PROCEDURES:

- *The debtor must make a proposal to the union providing for modification of the CBA;*
- *The debtor must provide the union with relevant information to evaluate the proposal;*
- *The debtor must meet with the union and confer in good faith in an attempt to reach mutually satisfactory modifications to the CBA;*
- *After an application has been filed, the bankruptcy judge must schedule a hearing within 14 days (which can be extended by 7 days, or longer if all parties agree); and*
- *The court must make a ruling within 30 days of the beginning of the hearing unless all parties agree to an extension.*
- Upon completion of these hurdles, the Bankruptcy Judge can reject the CBA if: (1) the debtor has made the modification proposal that satisfies the procedures described above; (2) the union refuses to accept the proposal without “good cause”; and (3) the balance of the equities clearly favors rejection of the CBA.

1 U.S.C. § 1113(b),(d). John Gallagher, Jon Geier & Margaret Spurlin, *An Unhappy Crossroads: The Interplay of Bankruptcy and Airline Labor Law*, address before the ABA Forum on Air & Space Law, Washington, D.C. (Feb. 2, 2006).

Allegheny-Mohawk LPPs

From 1950-1978, the CAB imposed Labor Protective Provisions [LPPs] in each of the 43 mergers and acquisition applications it approved.

Typically, they had these characteristics (known as *Allegheny-Mohawk Provisions*):

- Displacement allowances for those having to move domiciles due to merger-related restructuring;
- Dismissal allowances for those furloughed as a result of mergers;
- The right to continued health benefits for furloughees;
- Reimbursement for personal losses resulting from mergers, such as forced home sales; and
- Guarantees that seniority lists would be combined in a fair and equitable manner.

LPPs Incorporated into CBAs

- The post-deregulation CAB and the USDOT refused to impose LPPs in any airline merger, advising unions to negotiate their own merger protections through collective bargaining.
- Typically, provisions addressing seniority integration have been incorporated into the airline/union CBAs. Many CBAs of the legacy airlines included provisions mirroring the *Allegheny-Mohawk* seniority integration rules. They ordinarily provide for employee seniority integration in a “fair and equitable manner”, and mandatory arbitration to resolve LPP disputes. Often, employees in merged airlines were integrated on a date-of-hire seniority basis or according to a formula established by a neutral arbitrator (e.g., three from the acquiring airline, one from the acquired airline, based on date of hire).



Labor Betrayal in the Airline Deregulation Act

To soften the impact of deregulation upon displaced workers, and temper political resistance to deregulation, the Airline Deregulation Act included Employee Protection Provisions [EPPs], including:

- the right of first hire at another airline; and
- monthly assistance payments to furloughed or terminated eligible “protected employees” suffering economic injury as a result of a “qualifying dislocation”, defined as an airline bankruptcy or major contraction “the major cause of which is the change in regulatory structure provided by the Airline Deregulation Act.”

BUT NEITHER THE CAB NOR THE DOT EVER FOUND AN AIRLINE BANKRUPTCY WAS CAUSED BY DEREGULATION, AND CONGRESS NEVER FUNDED THE PROGRAM





American-TWA: Tail-Ending

- The 1998 CBA between the Airline Pilots Association [ALPA] and TWA required “the fair and equitable seniority integration of employees in the event of a merger or acquisition of TWA”, or essentially *Allegheny-Mohawk* standards. But the CBA between the Allied Pilots Association [APA] and American Airlines required any newly hired pilots be “stapled” to the tail end of the American pilots’ seniority list.
- When ALPA refused to agree to American’s insistence that the LPPs be removed from TWA’s CBA, TWA petitioned the Bankruptcy Court for rejection of the entire CBA under section 1113(c) of the Bankruptcy Code. ALPA and its local Master Executive Council [MEC] then agreed to eliminate the LPPs. As a result, the American Airlines acquisition of TWA went forward, and closed on April 10, 2001. American imposed a default seniority integration formula on the TWA pilots, whereby they were placed on the seniority ladder behind the American pilots hired prior to April 10, 2001.
- TWA’s flight attendants also were stapled to the end of the seniority list, with the result that all 4,200 former TWA flight attendants were furloughed after the 9/11 recession. More than 90% of them would have kept their jobs had the TWA attendants received date-of-hire seniority when the companies merged.
- *Bensel v. Allied Pilots Assn.*, 675 F. Supp. 2nd 493, 495-96 (D.N.J. 2009).



McCaskill-Bond Seniority Protection Act of 2007

- Provided for the “integration of seniority lists in a fair and equitable manner, including, where applicable, agreement through collective bargaining between the carriers and representatives of the employees affected. In the event of failure to agree, the dispute may be submitted . . .” to binding arbitration.
- The National Mediation Board [NMB] provides a list of seven names, and the parties alternatively strike names until one remains.
- The salary and expenses of the arbitrator are shared by the airline and the employee group or individual employees.
- The parties are free to agree to a different method or procedure of dispute resolution.
- If the employee groups are represented by a common union, that union’s internal policies regarding integration will be applied.
- 49 U.S.C. § 42112. See *Committee of Concerned Midwest Flight Attendants v. Int’l Brotherhood of Teamsters*, 2010 U.S. Dist. Lexis 104199 (E.D. Wis. 2010). Pub. L. 110-161. See *Assn of Flight Attendants-CWA v. Delta Air Lines*, 2010 U.S. Dist. Lexis 134715 (D.D.C. 2010).



Bankruptcy Extinguishes All Claims

- Many rights conferred in CBAs, including the seniority rights of integration upon merger with another airline, have been deemed rights of payment dischargeable in bankruptcy. The Bankruptcy Court's approval of a reorganization plan discharges and releases all pre-existing debts and claims. Bankruptcy can also extinguish pending workers' claims against the carrier for example, in areas of employment discrimination or sex discrimination, where the Bankruptcy Court approves the sale "free and clear" of successor liability.

- *In re Continental Airlines*, 484 F.3rd 173 (3rd Cir. 2006); *In re Continental Airlines*, 279 F.3rd 226 (3rd Cir. 2002).
- 11 U.S.C. § 1141(d)(1)(A). *Holmes v. Air Line Pilots Assn.*, 2010 U.S. Dist. Lexis. 108572 (E.D.N.Y. 2010).



Duty of Fair Representation

- In airline mergers, sometimes disgruntled worker groups sue their union for breach of the “duty of fair representation.” Allegations of bad faith usually arise as the two groups of pilots (from the acquiring, and acquired airline) are consolidated under the same union. Inevitably, there are winners and losers on issues such as seniority integration and salary. The union usually is not responsible for actions that favor the larger number of workers in the class or craft over the smaller number, so long as its actions are rational and non-discriminatory.
- See e.g., *Rakestraw v. United States*, 981 F.2nd 1524, 1533 (7th Cir. 1992); *Bensel v. Allied Pilots Assn.*, 675 F. Supp. 2nd 493, 501 (D.N.J. 2009); *Vaughn v. Air Line Pilots Assoc.*, 604 F.3rd 703 (2nd Cir. 2010); *Addington v. US Airline Pilots Assn.*, 606 F.3rd 1174 (9th Cir. 2010).



Republic-Frontier: Representation Dispute



- After Republic Airlines acquired Frontier in bankruptcy, it transferred maintenance work from its unionized Frontier Airlines subsidiary in Denver to its non-union Midwest Airlines subsidiary in Milwaukee. The Frontier Teamster's union objected on grounds that it violated its CBA. Republic responded that once it purchased Frontier and began integrating its operations with other subsidiaries, the combined operations became a "single transportation system" within Railway Labor Act parlance, and because most of the combined system's employees were not unionized, the CBA was not binding upon it.
- The Railway Labor Act requires that an airline recognize and bargain with a union certified by the NMB. The Teamsters Union had been so certified, and had not been decertified. According to the court, "The carrier's view on matters such as whether the merger resulted in the creation of a single transportation system and whether the union represents a majority of the relevant workers is simply irrelevant."
- Certifications survive mergers. Further, the airline cannot ask the NMB to investigate whether a single transportation system exists, or whether the Teamsters union represents the majority of its employees; only the employees may do that.
- *Committee of Concerned Midwest Flight Attendants v. Int'l Brotherhood of Teamsters*, 2010 U.S. Dist. Lexis 104199 (E.D. Wis. 2010).
- *Int'l Brotherhood of Teamsters v. Frontier Airlines*, 708 F. Supp. 2nd 750, 756 (E.D. Wis. 2010).

Republic-Frontier: On Appeal



- The US Court of Appeals noted that so long as the “preliminary” injunction remained in effect, only the Teamsters Union could ask the NMB to resolve the representation dispute, but had no motive to do so.
- The Court also noted that an injunction is an equitable action.
- It therefore amended the injunction “to condition its continuance on the union’s prompt application to the Board for a ruling on the representation of Frontier’s mechanics: are they represented by the union or no one? If the union complies with the condition in good faith (no foot dragging), as it can easily do, the injunction will preserve the status quo, and thus the union’s representative status, until the Board resolves the dispute.”



Underfunded Pension Plans

- After the stock market bubble burst in the late 1990s and early 2000s, many U.S. airlines found their balance sheets saddled with seriously underfunded pension plans. Historically, the legacy carriers had negotiated employee pension “*defined benefit*” plans [DB] with their unions. When the stock market was rising, company pension investments were growing at a corresponding pace; but as the stock market fell, so too did pension investment yields, thereby increasing company liability exposure.
- By 2005, U.S. legacy airlines had defined pension benefit plans underfunded by \$14 billion (\$35 billion in defined benefit obligations minus \$21 billion in assets) In contrast, the new entrant airlines had negotiated “*defined contribution*” plans [DC], leaving the gains and losses of invested pension contributions to the employee.
- Bear Sterns, *Airlines: Fear and Loathing on the Pension Front* (Mar. 2005).



The Pension Benefit Guaranty Corporation



- The PBGC is a federal agency created by the Employee Retirement Income Security Act of 1974 [ERISA] to help protect employee pensions.



U·S AIRWAYS

US Airways & ERISA

- Though the Employment Retirement Income Security Act required that pension plans have sufficient funding to cover 80% of pension obligations at all times, by 2002, US Airways plan was funded at only 64%. Management approached ALPA to request concessions on wages and benefits, insisting that they were necessary to stave off bankruptcy.
- Despite the concessions, USAirways filed for bankruptcy reorganization under Chapter 11 in August of 2002. While in bankruptcy, management approached ALPA about modification of the defined benefit plan. ALPA agreed, in addition to another round of wage and benefit reductions. Still, the deficit in the DB plan was projected to exceed \$1.7 billion over seven years.
- In 2003, the company petitioned the Bankruptcy Court to “distress terminate” the DB plan. The court agreed, and ALPA agreed to replacement of the DB plan with a new DC plan.
- USAirways emerged from bankruptcy, but then sought bankruptcy protection a second time under Chapter 11 in September 2004. While in bankruptcy a second time, ALPA agreed to further concessions, including amendments to the DC plan further reducing company contributions.
- *Vaughn v. Air Line Pilots Assoc.*, 604 F.3rd 703 (2nd Cir. 2010).



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United Airlines & ERISA



- United Airlines declared bankruptcy in 2002, at which time it stopped contributing to the pilots' DB plan. It entered negotiations to eliminate the DB pension plan, giving the pilots in exchange convertible notes valued at \$550 million and a DC plan.
- United then turned the DB plan over to the PBGC (which agreed to accept \$1.5 billion in stock in the post-reorganized UAL), thereby extinguishing any claims the employees may have had against United under the DB plan, replacing them with insurance claims against the PBGC.
- In 2004, the PBGC moved for involuntary termination of the plan, fearing it would go into default, leaving the PBGC with staggering liability. United's \$7.5 billion liability was the largest amount the agency had ever assumed at that time. The court granted the PBGC's petition. As the U.S. Court of Appeals for the Seventh Circuit observed, "The deal between United and the unions exemplifies the moral hazard to which insurance gives rise."
- United Airlines' retired pilots were not given any compensation, and their supplemental and medical benefits were transformed into unsecured claims in the bankruptcy proceeding, and placed in a separate class from other United Airlines creditors. The reorganization plan left the retired pilots with between 4 and 8 cents on the dollar. The court noted, "A union's duty to bargain collectively on behalf of the members of the bargaining unit that the union represents does not extend to retired workers, because they are not members of the unit."
- *In the Matter of UAL Corp. (Pilots' Pension Plan Termination)*, 468 F.3rd 444, 452 (7th Cir 2006).
- *In re UAL Corporation*, 468 F.3rd 456, 459 (7th Cir. 2006).



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Delta Air Lines & ERISA



- In financial extremis, Delta Air Lines negotiated a one-third reduction of salaries with its pilots in 2004, and in 2005, entered bankruptcy.
- It then sought, and received, further concessions from its pilots, including an additional 14% decrease in hourly wages. In exchange, Delta gave ALPA an unsecured \$2.1 billion bankruptcy claim. Delta then turned its DB plan over to the PBGC in exchange for an unsecured \$2.2 billion bankruptcy claim and \$225 million in cash. With permission of the Bankruptcy Court, Delta terminated the pension plan in 2006. The PBGC took over Delta Air Lines' pension plan which had \$1.7 billion in assets to cover \$4.7 billion in liabilities.
- *Holmes v. Air Line Pilots Assn.*, 2010 U.S. Dist. Lexis. 108572 (E.D.N.Y. 2010).

PBGC Liability



Pension Benefit Guaranty Corporation
A U.S. Government Agency

- Congress responded to the financial crisis with the Pension Equity Funding Act of 2004, which authorized airlines to enjoy an 80% pension contribution reprieve for 2004, a 60% reprieve for 2005, and a lowered benchmark for contributions.
- But that was still inadequate relief, so two years later Congress passed the Pension Protection Act of 2006 exempting commercial airlines and airline catering services from PBGC funding rules. The law allows air carriers to amortize unfunded liabilities over a period of ten years (as opposed to seven years under the prior funding requirements), or to elect to follow special rules allowing plan sponsors to amortize unfunded liabilities over 17 years.
- By 2009, with the addition of pension plans of the auto industry, the PBGC had liabilities of more than \$30 billion exceeding its assets. In FY 2010, 147 pension plans failed.
- <http://unfundedliabilitiesandclasswar.blogspot.com/2009/09/pension-benefits-guarantee-corporation.html> (visited Mar. 6, 2011).



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The Age 60 Rule

- Between 1959 and 2007, U.S. airline pilots were required to retire at age 60; in that year the mandatory retirement age was increased to 65, but not made retroactive to recently retired pilots. Unfortunately, the PBCG penalizes pension recipients who retire before age 65 by cutting their monthly pension benefits in half, despite the fact that federal law required their retirement at age 60.

- 49 U.S.C. § 44729.
- See *Avera v. Airline Pilots Assn.* 2010 U.S. Dist. Lexis 102813 (N.D. Fla. 2010).

REMARKS OF ROBERT L. CRANDALL

THE WINGS CLUB

JUNE 10, 2008

- OUR AIRLINES, ONCE WORLD LEADERS, ARE NOW LAGGARDS IN EVERY CATEGORY, INCLUDING FLEET AGE, SERVICE QUALITY AND INTERNATIONAL REPUTATION.
- THE FINANCIAL HEALTH OF THE INDUSTRY, AND OF THE INDIVIDUAL CARRIERS, HAS BECOME EVER MORE PRECARIOUS. MOST HAVE BEEN THROUGH THE BANKRUPTCY PROCESS AT LEAST ONCE, AND SOME HAVE PASSED THROUGH ON MULTIPLE OCCASIONS.
- I FEEL LITTLE NEED TO ARGUE THAT DEREGULATION HAS WORKED POORLY IN THE AIRLINE INDUSTRY. THREE DECADES OF DEREGULATION HAVE DEMONSTRATED THAT AIRLINES HAVE SPECIAL CHARACTERISTICS INCOMPATIBLE WITH A COMPLETELY UNREGULATED ENVIRONMENT. TO PUT THINGS BLUNTLY, EXPERIENCE HAS ESTABLISHED THAT MARKET FORCES ALONE CANNOT AND WILL NOT PRODUCE A SATISFACTORY AIRLINE INDUSTRY, WHICH CLEARLY NEEDS SOME HELP TO SOLVE ITS PRICING, COST AND OPERATING PROBLEMS.



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