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Soaring Labor Costs Clip American's Wings

By Ian Thoms

Law360, New York (November 29, 2011, 9:55 AM ET) -- After allowing its labor costs to balloon over the past decade while its competitors streamlined in Chapter 11, American Airlines Inc. now faces the thankless task of tearing down those expensive employment agreements in hopes of emerging a more competitive carrier, attorneys say.

Before filing Chapter 11 along with parent company AMR Corp. on Tuesday, American Airlines had put off restructuring by negotiating with labor unions and winning enough concessions to remain afloat, according to attorneys.

But the airline's competitors — US Airways, United Airlines, Delta Air Lines Inc. and others — all took advantage of the bankruptcy process in recent years, pounding out new labor agreements and ridding themselves of unprofitable leases before exiting as leaner companies. Couple that with a surge in fuel costs, and American Airlines found itself unable to compete with its restructured rivals.

"What they've done has been, in a way, noble in that they have not sought protection under the bankruptcy process. But their competitors did," said Lloyd Palans, a partner at Bryan Cave LLP. "And now, by trying to do the right thing, they've put themselves at a competitive disadvantage."

Once the world's largest airline, American Airlines has fallen to third place in the U.S. after shunning the industry's march toward restructuring and consolidation.

Now that the airline has given in and filed for Chapter 11, it will try to reduce wages, increase hours, cut benefits and alter pension plans to bring its work force more in line with others in the industry, according to attorneys.

"The labor issues will be the No. 1 battle in the case," said attorney Max J. Newman of Butzel Long PC. "I think that it's steps A through about E or F, at least."

Labor unions have already expressed disappointment with American Airlines' decision to file for Chapter 11. The Transport Workers Union said the move "could have and should have been avoided," and the Allied Pilots Association called the bankruptcy a "truly somber occasion for the 8,000 pilots of American Airlines."

"While today's news was not entirely unexpected, it is nevertheless disappointing that we find ourselves working for an airline that has lost its way," the union said.

While most predict an impassioned fight between the unions and American Airlines, what little leverage the employees had before the bankruptcy was significantly diminished by Tuesday's filing, according to attorneys.

"That's the bitter pill in all this because the workers out there have already taken some serious cuts, but they flat-out haven't been enough, so there's going to be more pain," said Southern Methodist University economics professor Michael Davis.

While trimming employee contracts ranks paramount among American Airlines' Chapter 11 priorities, the carrier will also look to save dollars by dropping some routes and rejecting unprofitable leases, according to attorneys.

The airline is also trying to remake its fleet with newer, more efficient jets. Earlier this year, American Airlines announced that it had placed a \$38 billion order with Boeing for 460 new single-aisle planes, which are more fuel-efficient than their older, wider-body brethren.

American Airlines had not hidden efforts to streamline its business and its at-times bitter fights with labor leaders, prompting some to wonder why the company had waited as long as it did to file. Several attorneys said they expected the airline saw an advantage in remaining untainted by the bankruptcy stigma and mistakenly believed it could lower costs outside court.

"I'd say around 2009, American probably realized they were heading this way, but they tried to drag themselves along a little further," said Ken Yager, a principal in charge of media at consulting firm MorrisAnderson & Associates Ltd.

The prospect of restructuring immediately after the 2008 financial crisis was probably a deterrent as well, Yager said.

"I can't say there's a whole lot of capital lying around dying to get into airlines now, but in 2009, it would have been far worse," he said.

The company said Tuesday that it had \$4.1 billion in cash and short-term investments in order to continue business operations, making debtor-in-possession financing unnecessary at the moment.

"Our very substantial cost disadvantage compared to our larger competitors, all of which restructured their costs and debt through Chapter 11, has become increasingly untenable," AMR CEO Thomas W. Horton said.

On Tuesday, Horton took over for retired AMR chairman and CEO Gerard Arpey.

With its cash on hand and the fact that numerous other airlines have already gone through Chapter 11, most predicted a relatively quick case for American Airlines. They also expect American Airlines to attract some takeover interest when it emerges as a lighter company. US Airways has long been rumored as a potential merger partner for the airline.

"This one's cleaner and quicker. It's going to be a modern bankruptcy," Yager said. "I think they'll draw some looks, but if they do their homework, they'll come out of this strategically lean and go out and snap someone up. Get themselves down to fighting weight and go find some smaller carrier to buy."

AMR is represented by Weil Gotshal & Manges LLP.

The case is In re: AMR Corp., case number 1:11-bk-15463, in the U.S. Bankruptcy Court for the Southern District of New York.

--Additional reporting by Max Stendahl. Editing by Lindsay Naylor.

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