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**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

-----X	
In re	: Chapter 11 Case No.
	: :
AMR CORPORATION, et al.,	: 11-15463 (SHL)
	: :
Debtors.	: (Jointly Administered)
	: :
-----X	

**REPLY MEMORANDUM IN SUPPORT OF DEBTORS’
MOTION TO REJECT COLLECTIVE BARGAINING AGREEMENTS
PURSUANT TO 11 U.S.C. § 1113**

* admitted *pro hac vice*

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I. INTRODUCTION

The Opposition briefs filed by the three Unions in this Section 1113 proceeding contest every inch of ground covered in hundreds of existing pages of declarations and briefs and during weeks of testimony. American Airlines does not intend to respond in kind in this Reply Brief. Section 1113's requirements and their application to this case are discussed at length in American's opening brief and, particularly in light of the Court's request that the parties submit proposed Findings of Fact and Conclusions of Law, no purpose would be served in retracing that ground now.

Rather, American limits this brief to a previously unaddressed theme that runs throughout the Union Oppositions. The three Unions amass a number of interrelated arguments all tethered to the notion that the speculative possibility of a merger renders this proceeding premature.

First, they argue that this Court cannot grant American's Motion (or at least cannot grant one now) because the possibility of a merger just over the horizon means that a better deal for labor is possible; the proposals American has made to fix its profound labor agreement disadvantage are thus not "necessary" according to the Unions. Second, they claim that the merger to which they have been devoting so much energy — energy that would have been better spent at the bargaining table with American — could lead to less dramatic changes to their contracts, and thus that they had "good cause" to reject the Company's proposals. Finally, American's "failure" to pursue potential merger partners pre-filing, they say, necessarily means that the Company's Section 1113 proposals were not based on the most reliable information then available.

In another, loosely associated argument over the timing of the Section 1113 Motion, APFA and TWU argue that because American had not already extracted concessions from all of its non-union employees (and, by parity of reasoning, has not completed its non-employee cost

saving measures) before filing its Motion, they did not have all of the information necessary to evaluate American's proposals. TWU argues that without full information about precisely *how* the non-Union share of cost reductions would be accomplished, there was no way for them to be certain that the pain would be fairly allocated.

All of these arguments stem from a common, fundamental misunderstanding of the Section 1113 statutory standards and the process the statute mandates. They rest on the proposition that before the debtor can file its motion to reject collective bargaining agreements under Section 1113, all of the other moving pieces in a Chapter 11 case must come to rest. Indeed, APFA goes so far as to claim that, as a matter of law, a Section 1113 Motion will always be premature unless the "proposed economic modifications [made to the union are] derived from a fully developed and viable business plan for reorganization." APFA Br. at 37.

The arguments are all baseless as explained below. All are premised on rhetoric rather than precedent or statutory language, and all suppose a sequence of events under Section 1113 that would render the statute useless at accomplishing the aim for which it was enacted.

II. SPECULATION ABOUT A POSSIBLE STRATEGIC TRANSACTION AT SOME POINT IN THE FUTURE IS NOT RELEVANT TO THE TIMING OR CONTENT OF A MOTION TO REJECT UNDER SECTION 1113

The central thrust of the Unions' argument is that Section 1113 prescribes a specific order of events — that a debtor cannot file its Section 1113 Motion until it has completed an investigation into every possible strategic transaction that could impact the labor "ask." Unless it has done so, they argue, the debtor's proposals are not necessary, they are not based on complete and reliable information, and the union has good cause to reject.

The arguments are presented in inflammatory prose, but they come without meaningful citation to authority. There is good reason; none exists.

First, as the Eighth Circuit has held, “there is nothing in the language of §1113 that dictates when an application to reject must be made.” *In re Family Snacks, Inc.*, 257 B.R. 884, 896 (B.A.P. 8th Cir. 2001); *In re Century Brass Prods., Inc.*, 55 B.R. 712, 716 (D. Conn. 1983), *rev’d on other grounds*, 795 F.2d 265 (2d Cir. 1986) (rejecting union’s argument that the debtor filed its § 1113 motion too early and recognizing that “Section 1113 has no time restraint relative to when the debtor, following the submission of a proposal, may file its rejection application”).¹ Indeed, the *only* reference to the timing of a motion in the text of Section 1113 indicates that the motion may be filed *at any time* “subsequent to filing a petition” so long as there has been adequate time for the parties to negotiate about the employer’s pre-filing proposal. The Unions do not claim that they have had inadequate time to negotiate and thus they can find no support for their position in the text of the statute.

Second, although the Unions have asked the Court to weigh American’s proposals against the supposedly better (albeit contingent) deals they have negotiated elsewhere, courts in the Second Circuit have emphasized that the *debtor’s* proposals are at issue in a Section 1113 proceeding, and not the proposals of others. In *In re Delta Airlines, Inc.*, 359 B.R. 468, 487 (Bankr. S.D.N.Y. 2006), for example, the pilots’ union argued that “a union has good cause to reject a debtor’s proposal where the union’s own proposal satisfies the Section 1113 test.” The court categorically rejected that contention:

[I]t bears repeating that Section 1113 focuses on the debtor-employer’s proposal, not the union’s. It is Comair’s proposal which must pass muster under the several requirements of the statute, and Congress has not authorized the Court to decide a

¹ In *Family Snacks*, the Eighth Circuit held that the timing of rejection under Section 1113 was governed by 11 U.S.C. §365(d)(2), and under that provision, “the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan.”

Section 1113 motion by acting as a sort of super-arbiter choosing between competing proposals. The Court is required to focus on the debtor's proposal and grant or deny the motion based upon its conclusions as to whether the debtor's proposal meets the statutory criteria.

Id. at 488; *see also In re Delta Airlines, Inc.*, 342 B.R. 685, 699 (Bankr. S.D.N.Y. 2006) (“Note that the question is not whether the Union made a reasonable proposal or negotiated in good faith — it is solely whether it had good cause to reject [*the airline's*] offer.”).²

Section 1113, then, is inwardly-focused; it trains the court's attention on the *debtor's* needs, on *the debtor's* proposals and its sharing of information, and on *the parties'* conduct at the table. There is no basis in the text or structure of the statute or in the Section 1113 case law to hold this self-contained statutory process hostage to the prospect of possible transactions that might or might not materialize between the debtor and third parties. Incorporating such an amorphous, open-ended inquiry into the Section 1113 process would arm unions, or any hostile third party, with a convenient mechanism for derailing the statutory process Congress created.

This Court's decision in *In re Horsehead Indus., Inc.*, 300 B.R. 573 (Bankr. S.D.N.Y. 2003), is instructive. There, the debtor, a zinc manufacturer, made Section 1113 proposals to its unions designed to reduce its labor costs as to each of its local unions by 18-20%, expressly for the purpose of making the company more attractive to an already-identified potential purchaser, Sun Capital. PACE, one of the unions on the property, refused to negotiate directly with the debtor over its proposals, insisting instead that it had the right to bring Sun Capital, the potential purchaser, into the negotiations. This court found the unions' rejection to be without “good cause”:

² *Cf. In re Delta Airlines, Inc.*, 359 B.R. 468, 488 (Bankr. S.D.N.Y. 2006) (union did not have good cause to reject based on the airline's refusal to provide a commitment to maintain or expand its fleet capacity or agree to a no-furlough clause).

PACE's insistence that Sun participate in the negotiations may have been understandable, but the refusal to negotiate unless Sun participated led to a rejection without good cause. The Debtors, not Sun, were parties to the collective bargaining agreements. They made it clear to PACE that they had to reduce the *Debtors'* costs under the *Debtors'* labor contracts in order for the *Debtors* to survive. Sun was not even a party to an acquisition agreement approved by the Court. Sun could walk from the deal, as it eventually did, after agreeing with PACE to less stringent concessions that set a ceiling on what the union would be prepared to give up. Consequently, the Debtors' motions to reject the collective bargaining agreements with PACE, and terminate the PACE retiree health benefits is granted

300 B.R. at 589; *see also In re Bowen Enters., Inc.*, 196 B.R. 734, 747 (Bankr. W.D. Penn. 1996) (union did not have good cause to reject; at the final negotiating session, the union's lead negotiator stated the union wanted the debtor to fail so that the union could "cut a deal" with a subsequent buyer of the debtor's business).

Here, the Unions claim that their "term sheets" — qualified, contingent, and amorphous as they are — point towards the possibility of a transaction that must precede a Section 1113 motion. They also insist that those term sheets evidence their willingness to negotiate "concessions" (unvalued and in many instances unspecified) with any "reasonable" third party. By casting the Court's decision on American's motion to reject as a comparison between the Company's proposals and those offered by a potential merger partner, the Unions are asking this Court to do precisely what the *Delta Air Lines* court declared impermissible: to "act[] as a sort of super-arbiter choosing between competing proposals." *In re Delta Air Lines, Inc.*, 359 B.R. at 488.

Indeed, the Unions can present an even *less* compelling case for an outward focus than the union in *Horsehead Industries*. There, the union's desire to bring third party transactions into the Section 1113 process may well have been understandable — there was an identified potential buyer, a purchase had already being discussed, and the parties to the Section 1113

motion all understood that in the event of a sale, the expected, ultimate beneficiary of the proposed CBA changes was an entity not at the bargaining table. Nonetheless, the court rejected the union's effort to introduce that transaction into the Section 1113 process.³

None of those facts exists here. Here, the hurdles that would have to be surmounted to accomplish any merger are almost too numerous to mention. At present, American has made no determination as to whether any such a transaction, much less a particular transaction, would be feasible, and has made no judgment as to whether such a transaction would be in the best interests of the company or its creditors. To be perfectly clear, American has not entered into merger discussions of any kind with US Airways. The Unions oppose the Section 1113 motion on the rankest sort of speculation. *See In re Delta Air Lines, Inc.*, 359 B.R. at 488 (union had no good cause to reject based on fact that employer refused to base proposals on possibility of speculative contractual arrangement to be negotiated with third party; “[i]t is an eminently reasonable exercise of business judgment to refuse to [base proposals on] contractual commitments which subsequent events beyond the airline’s control may render impossible to fulfill”).

Finally, holding that a debtor has a pre-rejection obligation to chase down every possible transactional rabbit trail in order to ensure that its labor “ask” is as small as possible would do

³ Unlike the union in *Horsehead Industries*, the three unions at American have already negotiated with the one potential purchaser whose future acquisition of American they now suggest is “inevitable.” Because the American Unions have already negotiated what they view as appropriate terms and sufficient protections to apply in the event of a merger, they are “protected” in the event that such a transaction actually occurs. That does not, however, relieve them of their ongoing duty to bargain in good faith with American Airlines. *Barthelemy v. ALPA*, 897 F.2d 999 (9th Cir. 1990) (under Railway Labor Act, union was “under an obligation to negotiate in good faith with [the existing employer even] while it negotiated with the ‘new,’” potential employer). American’s unions cannot be allowed to bootstrap their negotiations with a third party into a barrier to American’s motion under Section 1113.

violence to Congress's obvious legislative aim for Section 1113 — speed. By creating a unique statutory scheme in which the entire process — from initial application to a decision by the court — must conclude within 51 calendar days (absent consent by the parties), Congress made unmistakably clear that expedition is a primary attribute of the process. That central feature of Congress's design is incompatible with the Unions' view of the statute, which would mandate nearly endless rounds of investigation and possibly negotiations with third parties as a precondition to a Section 1113 application. Indeed, adopting the Unions' view of the statute would create an obvious incentive for a union facing a Section 1113 motion (or another company seeking to derail a competitor) to conjure as many speculative transactions as possible to delay the debtor's attempt to lower its labor costs.

The only citation provided by the Unions for this remarkable contention — that the debtor has a virtually unbounded obligation to pursue strategic transactions before filing a Section 1113 motion — is *In re Karykeion*, 435 B.R. 663, 677 (Bankr. C.D. Cal. 2010). The case supports no such proposition. In that case, the debtor — the owner of a hospital — was simultaneously working towards two goals: to reorganize in Chapter 11 and to find a buyer. The unions complained that the employer had provided too little information about the prospect of a sale “despite questions they asked” of the employer on that subject. 435 B.R. at 681. *Rejecting* that argument as a basis for denying the Section 1113 motion, the court noted that while the debtor simultaneously “hoped for a buyer [and] hoped to reorganize. . . neither plan was a reality yet.” *Id.* The debtor's failure to provide detailed information about a transaction that was still a hope, and not “a reality,” was not a basis for denying the motion to reject. Thus, in *Karykeion*, even where the debtor was actively pursuing a specific transaction with an identified potential purchaser that, if consummated, would have directly impacted the labor ask, the court held that

the Section 1113 focus had to remain on the debtor and its proposals and not speculation about a transaction with a “white knight with greater riches” that might ultimately make a proposal that would better suit its unions. *Id.*

Here, where there is no such transaction being negotiated, the connection to Section 1113 is even more attenuated. The Unions’ negotiations with third parties, and the prospect of a transaction at some point in the future, are simply irrelevant.

III. THE DEBTOR’S OBLIGATION TO BASE PROPOSALS ON THE MOST CURRENT AND RELIABLE INFORMATION AVAILABLE DOES NOT REQUIRE THE DEBTOR TO CONSIDER MERGERS OR ACQUISITIONS BEFORE FILING A SECTION 1113 MOTION

The Unions try to tie the same theme to a different portion of the Section 1113 analysis, the requirement that American “make a proposal [for necessary changes] based on the most complete and reliable information available at the time of such proposal.” They claim that this requirement too is implicated by speculation about a strategic transaction at some point in the future. The Unions read this statutory language as creating a mandatory requirement that the debtor pursue potential merger partners before filing such a motion.

The argument is fanciful. The language of Section 1113 creating the “reliable information” obligation has nothing whatever to do with the potential for a merger, nor does it impose a duty on the debtor to go hunting for merger opportunities. Like the rest of the statute, the “reliable information” language is focused on the debtor’s financial condition, its restructuring, and the relationship between the debtor and its unions; it requires only that the debtor base its proposals on the best information it has at the time of the proposal. Nothing in that language even hints that it might create an obligation to go *looking* for additional information in the hands of unrelated third parties related to the possibility of a potential merger or *creating* new information by pursuing any type of transaction.

No court has interpreted this portion of Section 1113(b)(1)(A) as the Unions now propose. As the court explained in *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 722-24 (Bankr. D. Minn.), *rev'd on other grounds*, 350 B.R. 435 (D. Minn. 2006):

By the essence of the modifiers “complete and reliable,” the [information] requirement goes to the comprehensiveness of the underlying factual support for a debtor's projections under § 1113(a)—its breadth, depth, and objective credibility. Clearly, the statute's idea is that a debtor-employer must make a proposal firmly grounded in the historical reality of [its own] operational economics, an unvarnished evaluation of its [own] current straits, and a thorough analysis of all of the incidents of [its own] income and expense that would bear on its ability to maintain a going concern in the future, whether subject to the financial obligations of its collective bargaining.

Thus, the “debtor is simply required to gather the most complete information available at the time and to base its proposal on the information it considers reliable. *This requirement by definition excludes hopeful wishes, mere possibilities and speculation*” — speculation like the prospect of a corporate transaction that may materialize, if at all, at some point many, many months down the road. *In re Karykeion*, 435 B.R. at 677 (emphasis added). A debtor is not required to base its proposals on speculative ventures or share information on the premise that some “speculative white knight with greater riches” might some day make a proposal that the unions would find preferable. *Id.*

In this case, American has made herculean efforts to provide each of its Unions with information at an extraordinary level of detail on its “operational economics, an unvarnished evaluation of its current straits, and a thorough analysis of all of the incidents of [its] income and expense that would bear on its ability to maintain a going concern in the future.” Teams of professionals have worked for months to ensure each of the Unions — and each of the Unions’

professional advisors — has been given everything needed to understand American’s plight and the nature of its proposals. That is all the statute requires.⁴

IV. A UNION DOES NOT LACK THE INFORMATION NECESSARY TO EVALUATE A PROPOSAL SIMPLY BECAUSE THE EMPLOYER HAS NOT COMPLETED COST REDUCTIONS FOR ALL OTHER GROUPS PRIOR TO THE SECTION 1113 FILING

On the same day that the Unions were told that they would each be asked to reduce their contribution to American’s overall labor costs by 20%, they were told that the same sacrifice would be made by the Company’s non-union and management employees. As the Unions bargained (to varying degrees) with American regarding the way in which the cost reductions would be accomplished, the Company worked to determine the preferences of its non-union employees for accomplishing the same goals. Although it took American considerable time to perform this due diligence with its non-union employees (who deserve a say in this process no less than the unionized employees), from the outset the Company made clear to all of its employees that (a) changes to employee benefits would account for approximately 50% of the total cost reductions and would be common across all employee groups (including management and non-union employees); and (b) that the remainder would come from head count reductions

⁴ At trial, American has adduced, and will continue to adduce, evidence that the Unions’ isolated complaints with respect to information sharing are unfounded; these facts will be addressed in American’s proposed findings of fact and conclusions of law. As the evidence has and will show, the Company did far more than make the “honest effort to compile all relevant data” as the statute requires; it went to enormous lengths to ensure true understanding. *In re U.S. Truck Co. Holdings, Inc.*, No. 99-59972, 2000 Bankr. LEXIS 1376, at *39 (Bankr. E.D. Mich. Sept. 29, 2000) (employer made “honest effort to compile all relevant data” relating to its “assets and liabilities, including its potential withdrawal liability arising out of its withdrawal from” its multiemployer pension plan”); *In re Indiana Grocery Co. Inc.*, 138 B.R. 40, 47 (Bankr. S.D. Ind. 1990) (failure to take into account over-accruals of vacation and medical expenses was “inadvertent and not deliberately concealed from the union, and [] they were not of a sufficient magnitude to significantly change the figures on which [the debtor] made its proposals” and debtor “based its proposals on the best historical data and projections it could produce at the time”).

and workrule changes to increase productivity. American announced that it would reduce the number of American management positions by 15% as part of the restructuring process.

TWU now claims that it could not properly evaluate American's proposals because it did not know at the time *precisely* how cost reductions among management and non-union employees would be accomplished. The claim is frivolous.

TWU's complaint suggests that Section 1113 requires the debtor to complete changes to the terms of *non-union* employment (and, presumably, to complete its non-employee cost reduction efforts) *before* a Section 1113 motion can be filed. TWU cites no cases for this remarkable proposition and, of course, points to no relevant statutory language. In the *Northwest Airlines* 1113 proceeding, the court rejected the assertion that Section 1113 relief could be denied because cost reductions from other stakeholders had yet to be accomplished:

Although it is too early in this case to determine the level of concessions or loss that will be required of the other constituencies in a plan of reorganization, the [d]ebtors' business plan targets an aggregate of \$2.2 billion in annual cost reductions, including the \$1.361 billion in labor cost savings and \$700 million of additional cost savings in the non-labor area. Based on the business plan and the [d]ebtors' need for a comprehensive financial restructuring, there is no reason to believe that the unsecured creditors will not be asked for huge concessions and that the position of the [d]ebtors' current stockholders is uncertain at best.

In re Northwest Airlines Corp., 346 B.R. 307, 326 (Bankr. S.D.N.Y. 2006).

TWU does not deny that it knew *how much* the non-union employees would be asked to give; it claims that it was entitled to know the *precise manner* in which those concessions would be taken before being asked to make its own cost reductions. But American made clear to all of its Unions that the Company was largely agnostic as to the way in which its cost reduction needs were met. TWU could not possibly claim that it had good cause to reject American's proposals to the mechanics group, for example, because some *other* group chose to achieve its cost

reductions by pay cuts instead of head count reductions. Although the *quantum* of sacrifice made by other groups is relevant to the “fair and equitable” inquiry, the precise *manner* in which non-TWU represented employees make that sacrifice is not.

V. **CONCLUSION**

For the foregoing reasons and those given in American’s opening brief, and based on the evidence adduced at the trial of this matter, the Court should grant American’s Motion to Reject the Company’s agreements with the Allied Pilots Association and the Association of Professional Flight Attendants as well as the Transport Workers Union agreements that remain at issue.

Dated: May 19, 2012

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