

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:)	Chapter 11
)	
UAL CORPORATION, <i>et al.</i> ,)	Case No. 02-B-48191
)	(Jointly Administered)
Debtors.)	
)	Honorable Eugene R. Wedoff

REPORT OF EXAMINER ROSS O. SILVERMAN

By order dated February 20, 2004 (the "Order"), the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division (the "Court"), granted the Motion of the Association of Flight Attendants ("AFA") for Appointment of an Examiner ("Motion")^{1/} and directed the United States Trustee to appoint an examiner "for the limited purpose of examining whether the above-captioned Debtors decided to seek Section 1114 relief prior to July 1, 2003." The Order directed the examiner to submit a report to the Court by March 19, 2004.^{2/} By order dated February 26, 2004, the Court approved, without objection, the United States Trustee's appointment of Ross O. Silverman as the examiner (the "Examiner").

I. SCOPE OF INVESTIGATION

Following my appointment as Examiner, I retained my law firm, Katten Muchin Zavis Rosenman ("KMZR") to serve as counsel in this matter. My retention of KMZR was approved, without objection, effective February 26, 2004, by order dated March 2, 2004.

^{1/} The International Association of Machinists (IAM) and the Aircraft Mechanics Fraternal Association (AMFA) also joined in the Motion.

^{2/} On March 15, 2004, the Court issued an opinion explaining its decision to appoint an examiner and the scope of the investigation.

My investigation of the matters surrounding the decision of the above-captioned debtors and debtors in possession (collectively, the "Debtors" or "United") to seek relief pursuant to 11 U.S.C. § 1114 ("§ 1114") has included interviews with: (1) employees, officers and directors of United; (2) members and officers of the AFA and other unions; (3) representatives from various advisors to United, including Towers Perrin (a human resources consulting firm that has consulted with United regarding employee and retiree medical benefit plan design, costs and savings), RLM Public Relations (a public relations firm that has consulted with United regarding public relations issues), Rothschild (an investment banking firm that has consulted with United regarding restructuring, bankruptcy and financing strategies), as well as Bank One, JP Morgan and CitiGroup (financial institutions that have provided debtor-in-possession ("DIP") financing and exit lending commitments to United); (4) attorneys for the Official Committee of Unsecured Creditors (the "Creditors' Committee"); and (5) KPMG, which has acted as an advisor to the Creditors' Committee.

Every witness was represented by counsel of his or her choice at these interviews. Accordingly, attorneys from Kirkland & Ellis LLP ("Kirkland") represented all of the employees and officers of United except the members and officers of the AFA and other unions, who were represented by the law firm of Guerrieri, Edmond & Clayman, P.C., and other counsel of their choice. Kirkland attorneys also represented all the advisors to United that were interviewed. The United directors interviewed were represented by their own counsel, as were the bank witnesses whom we interviewed. At the request of the bank witnesses, we permitted Kirkland attorneys to attend their interviews. Other than occasionally asserting appropriate attorney-client and work product privileges, the attorneys did not object or in any way attempt to interfere with or impede any of the questioning that occurred in any of the interviews.

In addition to these interviews, we reviewed more than 50,000 pages of paper and voluminous documents in electronic format produced in response to my requests. These documents consisted primarily of: (1) all the exhibits referenced in the parties' legal memoranda regarding the appointment of an examiner; (2) all the fee petitions and billing records submitted to the Court by United's counsel, including Kirkland and other law firms; (3) agendas for and presentations made over the course of United's bankruptcy to the Creditors' Committee, as well as to United's Board of Directors and Executive Council (a group consisting of various officers of United who report directly to and meet weekly with Glenn Tilton, United's Chairman, President and Chief Executive Officer); (4) agendas and documents created for and used at internal meetings at United to discuss § 1114 and/or issues relating to retiree medical benefits and other issues; (5) electronic calendars of United officers and employees whom we interviewed, which reflect the dates and times of various meetings relating to § 1114 and/or issues relating to retiree medical benefits; (6) documents reflecting communications between United and Towers Perrin regarding plan designs for retiree medical benefits; (7) financial forecasting models and other documents created and used by United for purposes of its actual and prospective DIP and exit lenders, including Bank One, JP Morgan, CitiGroup and the Air Transportation Stabilization Board ("the ATSB"), as well as for other business purposes throughout the bankruptcy; and (8) e-mails, workpapers, internal memoranda, press releases and other documents relating to various matters occurring prior to and during the bankruptcy.

At the outset of the examination, I asked United to waive its attorney-client and work-product privileges for all documents and discussions referenced in their attorneys' fee petitions regarding § 1114 and/or retiree medical benefits. The AFA's Motion relied heavily on these fee petition references in questioning the timing of and motives behind United's decision to seek § 1114 relief.

Specifically, the fee petitions from two of United's law firms, Kirkland and Piper Rudnick LLP ("Piper"), establish that eighteen attorneys recorded more than 333 hours during 2003 researching, discussing and preparing documents relating to § 1114 and/or retiree medical benefit matters. These time entries refer to § 1114 "research," "strategy," "timeline," "motions" etc., and more than half of the time allotted to these matters occurred before July 1, 2003.

United declined to waive its privileges regarding the above-described matters primarily on four grounds. First, United was concerned that disclosure to the Examiner would be treated as a waiver of any privilege, and that such a waiver would be deemed a general waiver.^{2/} Second, United expressed concern that any waiver would be considered precedent in the event that other examiners are appointed in this case. Third, United voiced concerns about revealing its legal analyses and strategies to interested parties in this case. Finally, United expressed its opinion that the information and documents that it would produce in my investigation would sufficiently demonstrate the relevant facts so that it would not be necessary for it to also have to disclose its privileged matters. On the last point, United indicated that it would be willing to revisit a possible waiver of privilege if later in the investigation I felt that such a waiver would be necessary to complete effectively my investigation.

I analyzed Kirkland's and Piper's fee petitions for descriptions of legal work performed, the dates on which it was performed and the amount of time billed. Having interviewed virtually all the individuals for whom these legal services were rendered, and having reviewed United documents

^{2/} At the February 20, 2004, omnibus hearing, the Court expressed its opinion that disclosures of privileged materials to the Examiner would likely constitute a waiver. Specifically, the Court stated: "The attorney/client privilege and work product documents don't change depending on the identity of the person seeking to pierce them. . . . The examiner is still a third party. . . . If the examiner is allowed to examine these things in camera, the attorney/client privilege is pierced." (2/20/04 Tr. at 42.)

that were prepared at the time of those legal services as well as other contemporaneous internal documents, I have no reason to believe that disclosure of the privileged documents and information would change the conclusions I reach in this Report.⁴

I was given twenty-three days to conduct an investigation and submit this Report. While further investigation could disclose additional evidence, I have found there to be few, if any, disagreements among the witnesses regarding the material facts surrounding United's decision to seek § 1114 relief. Based on the interviews we have conducted and the documents and other information that we have reviewed, I am very confident that those material facts surrounding United's decision to seek § 1114 relief are substantially as set forth herein.

The remainder of this Report sets forth: (1) the facts relevant to United's analysis of planning for and decision to seek § 1114 relief; and (2) my conclusion that the decision to seek § 1114 relief was made either on December 15, 2003, or January 6, 2004.

II. RELEVANT FACTS

The following is a brief statement of facts relevant to my assessment of the events leading up to and surrounding United's decision to seek § 1114 relief. In sum, these facts establish that:

- (a) United began analyzing § 1114, as well as many other bankruptcy provisions, shortly before the bankruptcy began;
- (b) very early in the bankruptcy, a team led by Virginia Grady, United's Director of Benefits, and Marian Durkin, Vice-President, Deputy General Counsel & Assistant Corporate Secretary, was assigned to assemble an appropriate team of United employees as well as its legal and other advisors to develop a contingency plan for

⁴ Indeed, the specific references in Kirkland's and Piper's bills to § 1114 matters enabled me to confirm the nature and timing of these legal services through other documents and interviews of United personnel.

the implementation of the § 1114 process if the decision to seek such relief were ever made;

- (c) different people among United's management and officers had different feelings about the likelihood that the company would decide to seek § 1114 relief, including Frederick F. (Jake) Brace, United's Chief Financial Officer, who, well before July 1, 2003, believed that it was likely that United would eventually decide to do so;
- (d) in late July 2003, Brace first made the decision to incorporate estimated savings from § 1114 relief into United's financial forecasting model; in late November or early December 2003, he decided to eliminate any such estimated savings from the model; and then again on December 15, 2003, with Tilton's approval, he caused estimated savings from § 1114 relief to be reincorporated into the model that was provided, within a few days thereafter, to exit lenders and the ATSB; and
- (e) although there are differing perspectives among the individuals who were part of the decision-making process at United as to whether the decision to seek § 1114 relief was made on December 15, 2003, or January 6, 2004, there is no doubt that the decision was made on one of those dates.

A. Relevant Events Prior To United's Bankruptcy

Throughout 2002, United took several measures to try to avoid bankruptcy, including negotiating concessions from its employees' labor unions and attempting to secure a loan guarantee from the ATSB. Simultaneously, United began working with a variety of financial, legal and restructuring advisors to prepare for a possible bankruptcy filing.

In approximately the summer or fall of 2002, various management personnel at United were directed to learn about and report to the Executive Council on the options that would be available

if United filed for bankruptcy protections. These options were many, including the possibility of renegotiating collective bargaining agreements (“CBAs”) pursuant to 11 U.S.C. § 1113 (“§1113”), seeking to modify retiree medical benefits pursuant to § 1114 and seeking to modify or reject aircraft leases within the limitations of 11 U.S.C. § 1110 (“§1110”).

On December 4, 2002, the ATSB advised United that it was rejecting its application for a loan guarantee. In that notification, the ATSB questioned the basis of some of United’s financial assumptions underlying the application. On December 9, 2002, United commenced this bankruptcy proceeding.

B. The Urgent Matters Of December 2002 and January 2003

1. The Need For Union Concessions To Avoid Defaults On DIP Loans

While many issues arose for United as a result of the bankruptcy filing, one of the most urgent concerns for the company was to secure immediate concessions from its labor unions pursuant to §1113, which governs modifications to CBAs. These concessions were necessary for United to avoid violating DIP loan covenants under which it was required to meet monthly EBITDAR (earnings before interest, taxes, depreciation, amortization and aircraft rent) commitments. A failure to meet the monthly EBITDAR commitments would constitute an event of default under the DIP loans. Accordingly, United and its attorneys committed significant time and resources in December 2002 and January 2003 to negotiations with its employees’ union representatives for immediate wage concessions that would enable the company to meet its EBITDAR commitments in the first few months of 2003. In fact, fee petitions from Kirkland reflect that Kirkland attorneys alone spent almost 2,000 hours on § 1113 matters during this two-month period. In January 2003, four of the unions representing United’s employees agreed to interim wage relief, and the Court imposed the same relief upon the IAM.

2. **Contingency Planning For Other Bankruptcy Options, Including § 1114 Relief**

Simultaneous with United's efforts to obtain interim wage relief in December 2002 and January 2003, certain United management level groups and attorneys were assigned to prepare presentations for the Executive Council regarding various options within a bankruptcy proceeding, including § 1114. In that connection, presentations regarding § 1114 were made to the Executive Council on December 17, 2002, and January 28, 2003.

The December 17, 2002 § 1114 presentation to the Executive Council was purely informational, discussing the procedure, timetables, standards and relief set forth in § 1114. In this presentation, the Executive Council was informed that no decision on § 1114 was required at that point and that the need for any such strategy should be revisited later. Following this presentation, Grady and Durkin were asked to prepare a more detailed report with any further recommendations for the Executive Council. They did so, and made their presentation on January 28, 2003.

In their January 28, 2003, presentation to the Executive Council regarding § 1114, Grady and Durkin provided much of the same information that had been presented on December 17, 2002. In addition, among other things, they presented the Executive Council with three options regarding the timing and substance of any decision to seek § 1114 relief, if the statutory standards were met. The first option was to decide immediately to seek modifications to retiree medical benefits that were necessary, fair and equitable pursuant to § 1114. The second option was to defer any decision as to whether to seek § 1114 relief until after the § 1113 process was completed and/or consensual agreements were reached with the unions to restructure the CBAs. The third option was to defer any decision regarding whether to seek § 1114 relief until United was close to exiting bankruptcy so that a determination could be made as to whether such savings were necessary to emerge successfully from bankruptcy.

Grady recommended the second option. At that time, her rationale supporting this option was that no determination regarding the necessity for § 1114 savings could be made until the savings achieved through the union negotiations and § 1113 process were determined. If a determination were made at such time that § 1114 savings were necessary, United could seek modifications to retiree benefits that would be substantially consistent with those applicable to current employees and future retirees through the union negotiations and § 1113 process. This approach would address the § 1114 requirement that any modifications to retiree medical benefits be “fair” and “equitable” by providing current retirees the same medical benefits plan design as current employees and future retirees. Finally, Grady believed that it could be very confusing to seek relief under §§ 1113 and 1114 simultaneously because all the unions, except one, would likely be in the dual role of negotiating on behalf of two different constituencies – their current employees as well as their current retirees.

The Executive Council agreed with the above recommendation, and directed the assembly of a team of United employees as well as outside advisors to further study potential § 1114 strategies so that the company would be in a position to seek such relief if the decision were made to do so. Following the January 28, 2003, Executive Council meeting, however, Durkin and Grady both became relatively consumed with the union negotiations and the § 1113 process. Therefore, as discussed below, little effort was made by Grady, Durkin or anyone else at United regarding § 1114 until the § 1113 process approached finality in April 2003.

Kirkland’s fee petition for January 2003 services reflects approximately 120 hours of time devoted to § 1114 matters. About half of that time was recorded by non-attorneys. The attorney time in January 2003 refers, in large part, to time spent before January 28, 2003, in conferences with Grady and Durkin regarding § 1114 issues and “preparation for Policy Committee re: Section

1114.”^{2/} These entries seem consistent with the events that were occurring in anticipation of the January 28, 2003 Executive Council presentation made by Grady and Durkin. Other entries in the Kirkland fee petition for conferences regarding “Section 1114 filing” and “Section 1114 motion” are consistent with the witness descriptions of the contingency planning that United was undertaking in the event a decision was made in the future to seek § 1114 relief.

C. Substantial Resources Are Committed To The § 1113 Negotiations In February and March 2003

According to Grady, Durkin and all other witnesses with knowledge whom we interviewed, no meaningful efforts were made during February and March 2003 to study or plan further for the possibility that United would decide to seek § 1114 relief. Most of United’s resources were committed to the union negotiations and the § 1113 process, as well as to other urgent matters. Consistent with the interview information, few, if any, documents regarding § 1114 were created during this period. Furthermore, Kirkland’s fee petitions show minimal time on § 1114 matters for these months, and the time that was spent appears to have involved researching relevant precedents.

D. The Contingency Planning For § 1114 Between April And June 2003

1. The Conclusion Of The Union Negotiations And Ratification Process

By early April 2003, United and its employees’ union representatives had completed their negotiations and agreed on restructuring the CBAs to achieve average annual labor cost savings of approximately \$2.5 billion between 2003 and 2008. Throughout the month of April 2003, the union negotiating teams conducted road shows for, and sought ratification from, their members for the restructured CBAs.

^{2/} The Executive Council used to be known as the Policy Committee. For purposes of convenience, this Report refers to this body as the Executive Council regardless of the label under which it may have been operating at any particular time.

Throughout the union negotiations and the road shows, various union representatives had conversations with a variety of United's management and officers regarding whether United intended to seek further concessions or relief from the employees through § 1113, § 1114 or any other means if United obtained the average annual labor cost savings of \$2.5 billion to which the employees were being asked to agree through the restructured CBAs.

There are disagreements about who said what to whom in these conversations. Essentially, several union representatives, as well as one union representative who is a member of United's Board of Directors, claim that they were told by United or its counsel that United did not intend to seek § 1114 relief unless circumstances grew substantially worse or another catastrophic event like "9/11" or the Iraq war occurred. The United representatives flatly deny making these representations, contending that their standard response to all such inquiries was that they could not guarantee that the company would not seek any additional relief under § 1113, § 1114 or any other means during the bankruptcy. Given the limited question that I have been asked to examine, it is not necessary to resolve the conflicting accounts of these conversations as I have concluded that they have no bearing on my decision as to when United decided to seek § 1114 relief.

2. The April 30 Agreed Order Approving Restructured CBAs

By the end of April 2003, United's employees had ratified the restructured CBAs that had been negotiated pursuant to the § 1113 proceedings. On April 30, 2003, the Court entered an Agreed Order, the language of which had been negotiated and approved by the unions, United and counsel. The restructured CBAs included substantial changes to wages, benefits and work rules. The changes in the medical benefits increased the contributions and reduced the benefits for current employees and future retirees. These changes did not apply to current retirees (i.e., former union employees who had already retired and met United's eligibility standards for retiree medical benefits).

United recognized that a period of 60 days would be necessary to make the administrative changes necessary to implement the restructured medical benefits plan for current employees and future retirees. Among other reasons, this 60-day period would permit United's third-party administrators to arrange for implementation of the new plan and for United to arrange for appropriate payroll deductions to be taken from employees' paychecks according to their new contribution requirements.

In this context, United and the unions agreed that anyone who retired between May 1, 2003, and June 30, 2003, would be considered a current retiree when the restructured medical benefits plan went into effect on July 1, 2003. Current retirees would be covered under the existing medical benefit plans for that population. The plans for current retirees offer substantially better benefits with much lower beneficiary contributions than the plans agreed to in the restructured CBAs for the current employees and future retirees. According to the AFA's memorandum filed in support of its Motion, the medical benefit contributions for some flight attendants rose as much as 1,200% as a result of the changes negotiated in the restructured CBAs.

The Agreed Order approved the restructured CBAs, and stated that: "Neither this Order nor the Debtors' motion [seeking entry of the Agreed Order] restricts or in any way limits the Debtors' rights or their ability to seek further relief under Sections 1113, 1114 or any other Section of the Bankruptcy Code. . . ." According to United and its counsel, this provision in the Agreed Order is consistent with the representations made to union representatives during the negotiations to restructure the CBAs, and was merely a confirmation that United may need to seek further relief depending on how circumstances evolved during the bankruptcy proceeding. According to the union representatives and their counsel, they understood, based upon representations made by United's management and counsel, that United would not exercise its right to seek any further such relief

unless circumstances grew drastically worse. Once again, I do not believe that it is necessary to resolve this dispute in order to answer the limited question I have been asked to examine.

3. More Than 2,100 Flight Attendants Retire Between May 1 and July 1, 2003

According to the AFA, more than 2,100 flight attendants retired between May 1 and July 1, 2003. This was in addition to the more than 600 flight attendants who retired between January and April 2003. To put this number of retirements into perspective, the AFA explains that only approximately 1,600 flight attendants had retired from United between 1945 and January 1, 2003. Although there may have been many factors that motivated so many flight attendants to retire between May 1 and July 1, 2003, such as the reduced wages and more demanding work rules in the restructured CBAs, it is not disputed that many employees may have retired to secure more favorable medical benefits available to current retirees.

On May 7, 2003, Grady sent a letter to all United flight attendants, notifying them in the first line that the restructured CBA "includes substantial changes to the benefits plans" that become effective July 1, 2003. Attached to the letter are nine pages of questions and answers regarding the changes. The last page of the attachment sets forth the following question and answer:

13. If I retire before July 1, 2003, am I guaranteed the retiree medical benefit plan provisions and rates that are currently in effect for retirees?

As the Company has previously stated, the Company must continue to pay retiree medical benefits unless the bankruptcy court modifies those benefits or an authorized retiree representative consents to modifications of those benefits. The Company has been seriously reviewing retiree medical costs, along with all other cost reduction proposals, to determine if any modifications should be made to the retiree medical program. Changes which could be proposed may include increasing the retiree's contributions for coverage. This could be a lengthy process, and affected individuals will be notified of any changes that take place.

Notwithstanding the above representations in Grady's May 7 letter, allegations have been made that a May 1, 2003 letter from Frank Colosi, United's Director of Labor Relations for On-Board Services, to Gregory Davidowitch, President of the AFA, offered some assurance that United did not intend to seek any such changes to current retiree medical benefits. In fact, Colosi's May 1 letter does not say anything about whether United was considering any change to retiree medical benefits. Based upon the circumstances surrounding its creation, I do not see any reason for it to have done so.

Colosi's May 1 letter was originally created at the request of the AFA as a side letter to accompany the AFA's restructured CBA in April 2003 and to inform its members of the existing CBA's language in § 33 of the Benefits Section. The AFA believed that a side letter would be an easy reference source for its members in assessing the benefits provisions available to those retiring before July 1, 2003. However, the parties continued drafting the May 1 side letter between April and October, 2003, and the first draft of the May 1 letter did not appear in written form until an e-mail dated June 13, 2003, from Frank Colosi to the AFA negotiators. The letter was not finalized until December 5, 2003, and was dated May 1, 2003, to coincide with the effective date of the Restructuring Agreement.⁴

⁴ To the extent that anyone may contend that any flight attendants who retired between May 1 and July 1, 2003, relied on Colosi's May 1 letter, this could not have happened because this letter did not exist in final form until December 2003.

4. **Grady And Durkin Form An 1114 Team To Continue Preparing For The Implementation Of The § 1114 Process If The Decision Is Made To Seek § 1114 Relief**

In early April 2003, Grady and Durkin were directed by Kathy Mikells, Vice President of Corporate Real Estate, who reported to Brace and was in charge of United's "Restructuring Office," to resume preparations for implementation of the § 1114 process should United decide to seek such relief. One of Mikells' general responsibilities during this period was to monitor various teams of United and advisor personnel who were involved in various "workstreams" of the bankruptcy process such as § 1110, § 1113, § 1114, executory contracts, etc. To assist this monitoring, Mikells created the "60-Day Calendar." The 60-Day Calendar was updated weekly and it tracked various bankruptcy "workstreams" to maintain awareness of particular issues and to keep the Executive Council informed.

The character and importance of items on the 60-Day Calendar were designated through the use of geometric shapes: (1) a box or square signified a hearing; (2) a triangle signified a due date; and (3) a long rectangular box containing writing signified an issue being considered at a "high level" that may or may not occur at some future date. From the first appearance of the 60-Day Calendar in March 2003, § 1114 is mentioned as one of the many "workstreams." On July 8, 2003, all mention of § 1114 is removed from the 60-Day Calendar, only to return on July 15, 2003, this time linked with pensions. Thereafter, § 1114 and pensions remained linked in the 60-Day Calendar. Notably, § 1114 – when it did appear on the 60-Day Calendar – was always shown in a long rectangular box that moved each week – that is, § 1114 was considered an important issue that may or may not come to fruition in the future.

In April and May, Grady, Durkin and Mikells communicated on a few occasions among themselves, as well as Kirkland attorneys, about how best to assemble a team to prepare for

implementation of the § 1114 process if the decision were made to seek such relief. The Kirkland fee petitions reflect approximately 80 hours spent researching, discussing and preparing documents regarding § 1114 issues during these two months. Consistent with our interviews and the documents we reviewed from this time period, these time entries include meetings and discussions among Kirkland attorneys, Grady and Durkin.

On June 12, 2003, Mikells scheduled a meeting of the "1114 Steering Committee" for June 13, 2003. The § 1114 Steering Committee included, at various times, Brace, Peter Kain, Vice President of Labor Relations, Sara Fields, Senior Vice President of People, Fran Maher, General Counsel and Rosemary Moore, Senior Vice President of Communications.⁷ The § 1114 Steering Committee was like several similar Steering Committees at United that also consisted exclusively of Executive Council members who were assigned by Tilton to oversee other bankruptcy "workstreams."

On June 13, 2003, the § 1114 Steering Committee members met with Grady, Durkin, Theresa Shea, Labor counsel at United, and David Seligman, a Kirkland attorney, to discuss the need to move forward with their implementation planning should the decision be made to seek § 1114 relief. An agenda for this meeting provides:

- Confirmation by Steering Committee that we are to proceed with 1114
- Review current status of work
- Steering Committee input on Retiree Committee members
- Discuss approach and timing of informal discussions with the unions

According to the people who attended the June 13 meeting, the above bullet points reflect that the Steering Committee confirmed, among other things, that contingency planning for § 1114 should proceed and that it should include a plan for how and when to proceed with informal

⁷ Shortly after the § 1114 Steering Committee was formed, Fran Maher left United.

discussions with the unions, which would be the first step of the § 1114 process if the decision were made to seek such relief. By the time of this meeting, Grady and Durkin also had prepared for discussion a “Section 1114 Timeline” and a list of United employees and advisors who would be part of the “1114 Company Team.”

The Section 1114 Timeline that existed as of the June 13 meeting identifies several tasks that would be involved if United decided to seek §1114 relief in time to accommodate a bankruptcy exit date in November or December 2003. Accordingly, it assumes that United would commence and have informal discussions with the unions and other appropriate retiree representatives between June 16, 2003, and July 15, 2003, and would attempt to negotiate with those groups between July 15, 2003, and August 15, 2003, for specific modifications to retiree medical benefits. If consensual agreements could not be reached during that time, a motion seeking § 1114 relief from the Court could be filed by August 15, 2003, in order to obtain a ruling from the Court by November 2003, which would be within the 90 days allowed for such a ruling under the statute.

According to the people who attended the June 13 meeting, the dates on the Section 1114 Timeline were merely “plugs” to let people know what the schedule would be if United decided to pursue § 1114 relief at that time. There does not appear to be any contemporaneous or other evidence to suggest that United had decided to seek § 1114 relief as of June 13. Therefore, I do not believe that the dates used in the Section 1114 Timeline were intended for any purpose other than to serve as informational “plugs.”^{8/}

^{8/} Furthermore, later iterations of the Section 1114 Timeline use different dates that would apply if the decision to seek § 1114 relief were made at the time of that particular iteration of the Timeline. These dates, like those in the Timeline that existed as of June 13, also appear to be informational “plugs.”

As a result of the June 13 meeting, Grady and Durkin held a "Section 1114 Kick-Off Meeting" on June 18, 2003. The following people, all of whom were identified as members of the Section 1114 Team, attended this meeting: Kain, Shea, Michael Dingboom, Director of Financial Planning, Candy Lewandowski, Senior Staff Representative of Corporate Communications, Jennifer Coyne, Senior Assistant General Counsel, and Gulsen Sanyer, Director of Financial Analysis, who attended on behalf of Mark Nelsen, Manager of Corporate Development. At this meeting, an overview of § 1114 was presented and the team discussed their respective roles and the importance of having a timeline in place if a decision were made to seek § 1114 relief. There is no indication that any further actions were taken regarding § 1114 through the end of June 2003.

Consistent with all of the above, the fee petitions from Kirkland and Piper show that several attorneys devoted approximately 80 hours to § 1114 matters during June 2003. This included several discussions with Grady and Durkin, as well as attendance at the June 18 Section 1114 Kick-Off Meeting.

E. The Decision To Incorporate Estimated Savings From § 1114 Relief In July and August 2003

1. The Decision To Tie § 1114 Planning To Decisions Regarding Pensions

Throughout the bankruptcy proceedings, United, its advisors and creditors were analyzing United's significant pension liabilities and the impact that they might have on United's ability to successfully emerge from bankruptcy and compete effectively in the commercial airline industry. In or around early July 2003, the Executive Council decided that all § 1114 planning should be deferred until United determined what, if any, actions would be taken with respect to its pensions for both its union as well as its salaried and management employees. Several options were under consideration with respect to pension liabilities, including plan terminations, legislative solutions

and/or waivers from the Internal Revenue Service. United's explanation is that, in the interests of acting fairly and equitably, the likelihood of seeking to modify retiree medical benefits for members of any particular union would depend on whether United also sought to terminate or modify the pension plan for members of that union. If pension plans for some unions were terminated or modified and others were not, and if § 1114 relief were still necessary, United probably would first seek to modify the retiree medical benefits for the union members whose pension plans had not been terminated or modified. Accordingly, no further actions appear to have been taken regarding § 1114 until unanticipated events occurred in late July 2003.

2. **The Discovery Of A \$300 Million Hole In United's Financial Model And Key Expense Assumption Changes Made To Fill The Hole, Including Estimated Savings From § 1114 Relief**

In July 2003, United discovered a \$300 million mistake in the projections produced by its financial forecasting model. This error is an important underpinning of my conclusions. Therefore, a detailed discussion is in order.

Before filing for bankruptcy protections, United and its advisors created a financial forecasting model for DIP and exit lenders as well as for other business purposes. This financial model eventually became known as the "Gershwin" model, and was based on many different assumptions regarding a number of different and very fluid variables. Based upon the constantly changing and unpredictable nature of the revenues, expenses and other aspects of the commercial airline industry, assumption changes were made in the Gershwin model on a relatively continual basis throughout the bankruptcy. The Financial Planning Group at United was ultimately responsible for managing the Gershwin model. The head of that group, Dingboom, reported directly to Amos Kazzaz, Vice President of Financial Planning and Analysis, who reported directly to Brace.

The first version of the Gershwin model ("Gershwin 1") was created in November and December 2002 to forecast United's anticipated financial performance over the next twenty-four months. The template for Gershwin 1 included § 1114 savings as one of many potential variables which could be activated or could lie dormant. The § 1114 savings variable was left dormant in Gershwin 1, which meant that this version assumed that United would not have any § 1114 savings in 2003 or 2004.

On approximately May 30, 2002, a new version of the Gershwin model ("Gershwin 2") was created by United's Financial Planning Group. Gershwin 2 was different from Gershwin 1 in at least three primary respects. First, the assumptions underlying Gershwin 2 were more sophisticated and complex than those underlying Gershwin 1. Second, Gershwin 2 was designed to forecast United's financial performance over a period of six years, rather than the two-year period covered by Gershwin 1. Third, several assumption changes were made regarding a number of variables in Gershwin 2. As in Gershwin 1, however, the § 1114 savings variable was left dormant in Gershwin 2, which meant that this version again assumed that United would not have any § 1114 savings in the years from 2003 through 2008.

In June 2003, a presentation was made to the Executive Council showing that Gershwin 2 was forecasting negative pre-tax income in the amount of \$300 million for 2004. In July 2003, however, the forecast from Gershwin 2 dramatically improved to a positive \$200 million in pre-tax income for 2004. This \$500 million swing in the pre-tax income forecast for 2004 was due primarily to an unexpected but welcome increase in revenues during April, May and June 2003. On July 22, 2003, this new forecast was presented to the Executive Council.

The good feelings regarding the new pre-tax income forecast for 2004 did not last long. On July 23 or 24, 2003, the Financial Planning Group at United discovered a significant problem with

certain Gershwin 2 assumptions regarding operating expenses for 2004. The context for this discovery was a process at United known as the “2003 Budget Re-Plan.” To understand the 2003 Budget Re-Plan requires reference to events in late December 2002.

Specifically, in late December 2002, United had begun to “roll-up” its budget for the year 2003. During this process, United realized that the budgeted operating expenses for 2003 needed to be reduced by approximately \$275 million to avoid violating monthly EBITDAR covenants in the DIP loans. In late December 2002 and early January 2003, Peter McDonald, Executive Vice-President of Operations, and others had meetings with various division heads, which led to commitments by the division heads to reduce budgeted operating expenses for 2003 by \$275 million. This commitment to reduce budgeted expenses became known as the “2003 CRAM savings.”

Based upon these events, the Financial Planning Group created an assumption in their financial model that United would have CRAM savings of \$275 million for 2003. This assumption should have applied only to 2003 because no one committed to CRAM savings for any year beyond 2003. However, for reasons that are not clear, the Financial Planning Group caused Gershwin 2 to assume that the same CRAM savings of \$275 million would be imposed every year over the forecast period (i.e., in 2004, 2005, 2006, 2007 and so on).

The mistaken assumption in Gershwin 2 regarding CRAM savings was not discovered until July 23 or 24, 2003, when Dingboom was reviewing the Budget Re-Plan process for the remainder of 2003. The Budget Re-Plan occurs in the spring or summer of each year, and involves a renewed analysis of projected revenues and expenses budgeted through the end of the year based upon actual experience in the previous months. In performing the Budget Re-Plan, Dingboom discovered that the projected operating expenses were approximately \$300 million more than the operating expenses assumed in Gershwin 2 for 2004. This meant that Gershwin 2’s assumptions regarding expenses that

United was likely to incur for 2004 were short by about \$300 million. At this point in time, Dingboom did not know the reason for the \$300 million discrepancy, but he knew that his discovery was a potentially major problem.

At one level, Dingboom's discovery was a problem because, on July 22, 2003, Brace had informed the Executive Council that Gershwin 2 was projecting pre-tax income of \$200 million for 2004. Unbeknownst to Brace, Dingboom or anyone else at United at that time, this forecast was based, in part, on an erroneous assumption that operating expenses for 2004 were likely to be \$300 million lower than it now appeared they actually would be. On July 24, 2003, Dingboom sent an e-mail to Brace stating that there were "potential changes to the fin model - \$300 m annual increase to labor." Dingboom said that this e-mail was intended to let Brace know that changes may need to be made to Gershwin 2 to make up for what appeared at the time to be a \$300 million underestimate of operating expenses for 2004. Brace apparently did not see and did not respond to Dingboom's e-mail.

On July 25, 2003, Dingboom met with Brace in Brace's conference room. Also present were Kazzaz and Sanyer. It was apparent when they arrived that Brace had not seen Dingboom's e-mail. When they told Brace about the \$300 million shortfall that they had discovered, Brace was, by everyone's account including his own, "stunned." Concerned about positive representations that he had made to the Executive Council and the press just days before, Brace told those at the meeting to "get out of model-land," find the problem and fix it.

From the conclusion of the meeting with Brace and through the entire weekend of July 26-27, Kazzaz, Dingboom and Sanyer worked with others in their department and discovered that the \$300 million gap in the expense forecast in Gershwin 2 for 2004 was mostly attributable to the mistaken

assumption that the 2003 CRAM savings would recur every year over the life of the Gershwin model, including 2004. They informed Brace, who told them to “fill the \$300 million hole.”

Kazzaz, Dingboom, Sanyer and others worked around the clock to explore ways to “fill the \$300 million hole.” Based upon discussions throughout the process among Brace, Kazzaz, Dingboom and Sanyer, Brace approved several key assumption changes to Gershwin 2. Those key assumption changes were made to Gershwin 2 at some point between July 27 and July 29, 2003, and included reducing capital expenditures, reducing fuel reserves, modifying the ATSB loan amortization and incorporating § 1114 savings. The assumption change regarding § 1114 savings was made simply by activating the § 1114 toggle (i.e., turning it from dormant to active) in the Gershwin model.

On July 29, 2003, Brace gave another presentation to the Executive Council that was nearly identical to the presentation that he had given to the same group one week earlier on July 22. The July 29 presentation showed a forecast of \$200 million in pre-tax income for 2004 based, in part, on labor cost savings of \$2.3 billion. This was slightly different from the July 22 presentation to the Executive Council, which had also shown a forecast of \$200 million in pre-tax income for 2004 but was based, in part, on labor cost savings of \$2.6 billion. In other words, the July 29 presentation assumed United’s pre-tax income in 2004 would not change even though its estimated labor cost savings for 2004 had dropped from \$2.6 billion to \$2.3 billion over the course of a week.^{2/}

At the July 29 presentation to the Executive Council, Brace apparently told the Executive Council that the \$300 million drop in estimated 2004 labor cost savings between the July 22 and July 29 presentations had resulted from a “modeling error.” Brace claims that he offered no further

^{2/} The \$275 million CRAM savings were considered to be “labor cost savings” in United’s Gershwin models. By removing them from the model, those labor cost savings were reduced accordingly.

explanation because the “modeling error” was allegedly too “complicated” and “technical,” and apparently no one asked for any further explanation. Based upon the \$300 million drop in estimated 2004 labor cost savings, Brace informed the Executive Council of several key assumption changes that had been made to Gershwin 2. One of these key assumption changes was to incorporate § 1114 savings.

3. Gershwin 3 Incorporates § 1114 Savings For The First Time

On August 4, 2003, a new version of Gershwin (“Gershwin 3”) with key assumption changes, including § 1114 savings, was sent to the unions, including the AFA, and the Creditors’ Committee. There does not appear to have been any effort to conceal the fact that § 1114 savings had been incorporated into Gershwin 3. In fact, on August 8, 2003, Brace made a presentation to the Creditors’ Committee in which one of the slides was captioned “Key Expense Assumption Changes” and identified five key assumption changes including “Incorporated estimated savings from § 1114 process.” Furthermore, Brace presented another slide captioned “Recommendation,” which included the following:

- Proceed with modification of retiree medical benefits
 - Attempt to negotiate modification that “marks” benefits of current retirees to those of future retirees

According to Brace, these slides and presentations were intended to inform the Creditors’ Committee that United was proceeding with plans to seek modification of retiree medical benefits if a subsequent decision were made that it was necessary, and that any such modification would be consistent with changes made to the benefits of future retirees through the restructured CBAs. Although several people who were present at the August 8 Creditors’ Committee vaguely recall the above slides regarding § 1114 and modification of retiree medical benefits, no one recalls any particular discussion or debate about them.

It does not appear that Brace informed anyone at the August 8 Creditors' Committee meeting about the discovery of any "modeling error," let alone a \$300 million modeling error. Nor does it appear that there was any discussion at the Creditors' Committee meeting regarding the reasons behind or meaning of any of the key expense assumption changes in Gershwin 3, including the decision to incorporate estimated savings from § 1114 relief.

Greg Davidowitch, the President of the AFA, and Robert Clayman, the AFA's counsel, were present at the August 8 Creditors' Committee meeting. Despite Brace's presentation, neither Davidowitch nor Clayman believed that the assumption change in Gershwin 3 regarding § 1114 meant that United had decided to seek § 1114 relief. They had this belief because the AFA and other unions had only recently finished making significant concessions to United through the restructured CBAs, and United's financial condition appeared to be improving, as opposed to getting worse.¹⁹ Nevertheless, within days following the meeting, Davidowitch had a discussion with Tilton, in which Davidowitch asked Tilton if United had decided to seek § 1114 relief. According to Davidowitch, Tilton told him that United had not decided to seek § 1114 relief but was continuing to consider it and other options should the need arise in the future. According to Tilton, this was true in that no decision had been made to seek § 1114 relief despite the fact that § 1114 savings were assumed for the time being in Gershwin 3.

On August 7, 2003, Brace had made a presentation to United's Board of Directors that was very similar to the one he made the next day at the August 8 Creditors' Committee meeting. The August 7 Board presentation included the same "Key Expense Assumption Changes" in Gershwin 3 and "Recommendation" slides that were presented at the August 8 Creditors' Committee meeting.

¹⁹ Based upon the alleged representations from United during the § 1113 process, Clayman and Davidowitch felt confident that United would not decide to seek § 1114 relief unless United's financial condition grew dramatically worse.

Once again, it does not appear that Brace informed anyone at the August 7 Board meeting about the discovery of any \$300 million modeling error. Nor does it appear that there was any discussion regarding the reasons behind or meaning of any of the key expense assumption changes in Gershwin 3, including the incorporation of estimated savings from § 1114 relief. Given the lack of any questions or negative reaction from the Board regarding the key assumption changes, Brace assumed that the Board members would not vigorously oppose a decision to seek § 1114 relief if it were determined to be necessary in the future.

E-mail traffic among several United employees following these August presentations to the Board and the Creditors' Committee reveals some initial confusion about the status of § 1114 during this period. An August 11, 2003, e-mail from Mikells (and copying Brace) stated that "the Board gave approval last week to move forward with our § 1114 and pension recommendations." However, on August 13, 2003, Brace attended a § 1114 Team meeting and clarified that no decision had been made to seek § 1114 relief. The § 1114 Team was simply supposed to continue preparing for implementation of the § 1114 procedures if the decision were made in the future to seek such relief.

By late August, however, United's attorneys, with approval from Brace, informed the Court that it was "likely" that the company would be seeking § 1114 relief. Specifically, at the August 29, 2003 Omnibus Hearing, United's counsel stated:

Additional and critically important matters which we're likely to bring before the Court at some point relates to our pension contributions and retiree medical benefits. Payment of those pre-petition liabilities in their current amounts will consume a significant portion of our free cash flow in the years following exit. Those liabilities affect our cash flows and, accordingly, complicate the exit financing process.

Brace contends that at this point in time he felt that there was a "distinct possibility" that United would need to seek relief from either one or some combination of its liabilities for pensions

and retiree medical benefits to secure exit lending and successfully emerge from bankruptcy. Once again, there was no reaction to the comments of United's counsel from anyone else present at the August 29 Omnibus Hearing regarding the likelihood that United would seek relief from its liabilities for pensions and retiree medical benefits.

Kirkland's fee petitions for July and August 2003 services reflect approximately 90 hours of time devoted to § 1114 matters, compared with approximately 90 hours of time devoted to § 1114 matters in June alone. The attorney time in July and August 2003 refers to continuing "1114 strategy," often mentioned in connection with pensions, and a few conferences with Grady, Mikells and "others." Again, these entries are not inconsistent with the documents and witness descriptions of the contingency planning that United was undertaking in case a decision were made in the future to seek § 1114 relief and the decision to tie consideration of § 1114 to pensions.

4. There Is Little Activity Regarding § 1114 In September And October 2003

In September and October 2003, there was little, if any, activity at United regarding § 1114. The focus in these months appears to have been on analyzing and working on various pension options, including potential legislative solutions and/or governmental waivers on funding requirements. Witness testimony and documents we reviewed reveal virtually no activity regarding § 1114 in these months. Again, Kirkland's fee petitions are consistent with the documents and interviews in that they reflect no time devoted to § 1114 matters.

5. Gershwin 3.5 Is Sent to United's Lenders In Late October And Early November 2003

In late October 2003, United sent its most recent iteration of the Gershwin model ("Gershwin 3.5") to its DIP and potential exit lenders, including Bank One, JP Morgan and CitiGroup. Gershwin 3.5 continued to incorporate estimated savings from § 1114 relief, although there does not appear

to have been any discussion or a deliberate decision to leave it in Gershwin 3.5. It appears to have stayed in Gershwin 3.5 more through inaction than any affirmative action.

Between November 4 and 7, 2003, Brace and Mikells were in New York with Noah Roy, a Rothschild advisor, to make their presentations to JP Morgan and CitiGroup regarding Gershwin 3.5 and their efforts to secure exit lending for United. In the midst of the initial presentations on November 4, Kathy Mikells and Noah Roy were reviewing a databook summarizing key assumptions in Gershwin 3.5 and saw that it still incorporated estimated savings from § 1114 relief. Mikells immediately reacted by sending an e-mail to Dingboom asking him not to circulate the databook externally because “one more assumption tweak will need to be made.” Dingboom responded by e-mail, asking Mikells what “assumption tweak” needed to be made and advising her that the databook had already been distributed to Bank One and other third parties. At that point, Noah Roy, who was sitting next to Mikells at the time, responded by e-mail that:

The model and the databook includes 1114 which seems less likely to be on the horizon currently. Discussed with Jake [Brace] and he agreed we don't want to be seen as putting in unrealistic assumptions—not consistent with our “conservative” theme. . . Therefore, we wanted to modify [Gershwin 3.5] and databook [by eliminating estimated savings from § 1114 relief] just once.

Dingboom's immediate e-mail response to Roy states:

Are you saying that we need to change the model and the databook to exclude § 1114? You realize that without the § 1114 savings that [one legislative bill regarding pensions] optimized get even tighter and our CASM goes up. . . No one in my . . . shop was aware that [whether to include § 1114] was an open issue. In our reviews of [Gershwin] 3.5 with Jake we had a long list of assumptions to Jake's buy-in and § 1114 was not on the list.

There is a consensus among the individuals involved in these e-mails regarding the circumstances and meaning of the exchanges. United anticipated filing its application for a loan guarantee with the ATSB before the end of 2003. Based upon United's last experience with the ATSB in December 2002, where several of its forecast assumptions were questioned by the ATSB,

United wanted to include in its Gershwin model only very “conservative” assumptions. Conservative assumptions, basically, were considered by those involved to be assumptions which would be under United’s control or which were relatively safe.

The desire to eliminate estimated savings from § 1114 relief in November 2003 stemmed from several concerns. First, United had not made the decision to seek § 1114 relief. Second, even if the decision were made to seek § 1114 relief, there was no guarantee that it would get such relief because it might run out of time based upon its exit date or the Court might refuse to grant it. These concerns triggered the e-mails from Mikells and Roy to Dingboom asking him to eliminate estimated savings from Gershwin 3.5.

As Dingboom’s e-mails of November 4, 2003, indicate, however, it was too late to eliminate § 1114 savings from Gershwin 3.5. Therefore, § 1114 savings remained in that version. There was no further mention or discussion of § 1114 savings at any of the meetings with exit lenders between November 4-7 in New York.

Also, in early November 2003, Tilton and others from United made a similar presentation regarding Gershwin 3.5 to representatives of Bank One in Chicago. At that presentation, an attorney with Bank One asked whether the time-consuming process of § 1114 would affect United’s exit date from bankruptcy. Tilton answered “no” and noted that United had not yet made a decision whether to seek § 1114 relief.

No further activity appears to have occurred regarding § 1114 until late November 2003.

6. Brace Decides To Remove § 1114 Savings From Gershwin 4 In Late November Or Early December 2003

On November 24, 2003, as the anticipated date for the filing of United’s ATSB application neared, Noah Roy sent another e-mail to Mike Dingboom. In this e-mail, Roy expressed to Dingboom several thoughts about key assumptions in the new version of Gershwin (“Gershwin 4”)

that would be shared with potential exit lenders and the ATSB. Among Roy's thoughts was this: "1114 probably needs to come out if we are not going to pursue. Undermines general credibility." According to Roy, this e-mail was consistent with the ones that he and Kathy Mikells had sent to Dingboom on November 4, 2003. Essentially, because United had not decided whether to seek § 1114 relief, it would undermine its credibility with the ATSB if Gershwin 4 included estimated savings from such relief.

Following up on Roy's November 24 e-mail, Dingboom met with Brace on December 3, 2003, to discuss several key assumption changes for Gershwin 4. In a document memorializing his meeting with Brace, Dingboom notes that they discussed the impact of eliminating § 1114 savings from Gershwin 4. Specifically, Dingboom notes in his memo that, even though United's "coverage ratio" (i.e. an important credit metric for lenders, measuring the borrower's ratio of cash balances to cash liabilities) would be negatively impacted if cash savings from § 1114 relief were not included in Gershwin 4, "Jake seemed comfortable [eliminating § 1114 cash savings] since cash balances are higher [than United expected] and offset the drop in coverage ratio." On that basis, and consistent with the "conservative" theme in the assumptions in United's anticipated ATSB submission, § 1114 savings were eliminated from Gershwin 4.

On December 11, 2003, Brace gave a presentation to United's Board of Directors in which he discussed Gershwin 4 and United's status with its exit lenders and its anticipated ATSB application. At this point, Gershwin 4 assumed no § 1114 savings and no mention was made of § 1114 at the December 11 Board meeting.

Also, on December 11, 2003, Brace had a telephone conversation with representatives of the Creditors' Committee regarding key assumption changes between Gershwin 3.5 and Gershwin 4. The Creditors' Committee still had not seen Gershwin 4. Therefore, one of its counsel asked Brace

if he could provide a summary of the key assumption changes. Brace agreed to do so, and provided a two-page summary of such assumption changes. One of those key assumption changes regarding Gershwin 4 provides:

- Revised Labor Expense forecast . . .
 - [Elimination of 1114 savings . . .]

Counsel from the Creditors' Committee assumed the above language – albeit in brackets – meant that United had decided to eliminate § 1114 savings from Gershwin 4. Brace states that the brackets were intended to convey that United had not made a final decision whether to include § 1114 savings in Gershwin 4 before sending it to the exit lenders and the ATSB. Regardless, no one from the Creditors' Committee appears to have thought any more about § 1114 until certain events occurred several days later.

7. **A New \$456 Million Hole Is Discovered in Gershwin 4 On December 13-14, 2003, Through The Budget Roll-Up For 2004, And The Decision Is Made To Include § 1114 Savings In Gershwin 4**

Over the weekend of December 13-14, 2003, the 2004 budget “roll-up” revealed approximately \$383 million more in operating expenses than were assumed in Gershwin 4 for 2004. Furthermore, the budget “roll-up” projected \$73 million less than the revenues assumed in Gershwin 4 for 2004. In sum, there was a \$456 million gap between the 2004 budget and the assumptions in Gershwin 4. This discovery led to a presentation to the Executive Council on December 15, 2003.

All Executive Council members, except Tilton, attended the December 15 meeting. A slide presentation from that meeting identifies the need to “resolve the \$456M budget gap to enable bankruptcy exit.” The presentation also identifies “Possible Hole Filling” measures which include to “Implement § 1114 by July [2004] . . .” During the meeting, each Executive Council member was required to identify savings that he or she could contribute toward filling the \$456 million hole.

Everyone agreed that § 1114 savings should be included in such savings, subject to Tilton's approval. Even assuming the inclusion of § 1114 savings, a \$109 million gap in Gershwin 4 still existed, and necessitated that Peter McDonald cut his already tight operations budget.

Before the December 15 meeting ended, Brace and Fields left the room and called Tilton. Brace and Fields informed Tilton of the \$456 million gap and told him that the Executive Council had agreed that § 1114 savings would be necessary to fill it. Tilton told Brace and Fields he would agree to have § 1114 savings incorporated back into Gershwin 4 but only if every Executive Council member assured him that there were no other sources for those funds. Brace and Fields assured him that the Executive Council had discussed all options and felt the § 1114 savings were necessary. On that basis, Tilton agreed to have those savings incorporated into Gershwin 4, and they were.

8. **Gershwin 4. Incorporating Estimated § 1114 Savings. Is Submitted To Exit Lenders And The ATSB With An Accompanying Narrative Describing United's Business Plan And Exit Strategies**

On December 18, 2003, United filed a supplemental application for a loan guarantee with the ATSB. The application included Gershwin 4 and a narrative ("the ATSB narrative") which explained United's business plan and exit strategies. Gershwin 4 included estimated savings from § 1114 relief. The ATSB narrative stated that United intended to secure a reduction in medical benefits from its retirees by initiating proceedings under § 1114 in early 2004. The same information was provided to the exit lenders.^{11/}

United did not provide the unions with the Gershwin 4 model that it submitted to the ATSB, which incorporated estimated savings from § 1114 relief, or the ATSB narrative, which stated that

^{11/} In our interviews, the exit lenders did not appear to have focused on or be particularly concerned regarding estimated savings from the contemplated changes to retiree medical benefits pursuant to § 1114.

United had decided to initiate § 1114 proceedings in early January 2004. Nor did United provide this information in any form to the unions. United also did not provide this information or copies of any of these documents to the Creditors' Committee, at least until after the ATSB filing was made on December 18, 2003. Therefore, there is no indication that the unions or Creditors' Committee knew that United included § 1114 savings in the ATSB submissions until after December 18.

9. **The Transmittal To The Officers And Directors Of United Of A Redacted Version Of The ATSB Narrative**

Following the submission of the ATSB application, Paul Lovejoy, United's General Counsel, asked his assistant to prepare a cover letter to transmit to United's Board of Directors along with a copy of the ATSB narrative. His assistant prepared a letter to the Board that stated in pertinent part: "As discussed in Glenn [Tilton's] letter to you yesterday, enclosed is a copy of the narrative portion of United's ATSB filing. Please note that much of the information in this filing is not public and I would ask that you treat it with the usual degree of confidentiality." Before sending this letter along with the ATSB narrative, Lovejoy's assistant sent Lovejoy a copy of the e-mail for his review. Lovejoy approved it and both the letter and narrative were sent on December 23, 2003, over Lovejoy's signature.

Unbeknownst to the Board and Lovejoy, the ATSB narrative had been redacted. Thus, the Board only received a partial copy of the ATSB submission provided by United. Specifically, the section relating to United's intention to commence § 1114 proceedings in early 2004 was omitted. Neither Lovejoy nor his assistant was aware that the ATSB submission had been redacted before it was sent to the Board.

According to Brace, portions of the ATSB narrative discussing § 1114 relief and limited other issues were redacted from copies sent to United's Board and later to its Officers due to past confidentiality breaches by United's Officers. Brace felt that United's decision to seek § 1114 relief

should be delivered directly to the AFA leadership, rather than being indirectly discovered through United's Board and/or Officers.

Consequently, Brace told Kazzaz to redact the narrative portion of the ATSB submission that discussed § 1114. Kazzaz directed Gulsen Sanyer to make the redactions. Sanyer asked Kazzaz if she should leave blank spaces in the redacted portions. Although Kazzaz and Brace had not discussed the form of the redacted copies, Kazzaz told Sanyer not to leave blank spaces in the redacted portions. Therefore, the redacted version of the ATSB narrative was created without any indication that a redaction had been made. The redacted version was then delivered to Lovejoy's assistant who, without knowledge of the redaction, sent the redacted version along with Lovejoy's letter to the Board members.

On January 5, 2004, Kazzaz e-mailed United's officers the same redacted version of the ATSB narrative that had been sent to the Board on December 23. Kazzaz's e-mail states: "For your reference, attached is a copy of the ATSB Narrative."

On or about January 7, 2004, the RLM team that was advising United regarding public relations matters noticed that the ATSB narrative given to United's Board had omitted United's intention to seek § 1114 relief. RLM brought this to the attention of Rosemary Moore. Moore stated that she was distressed by the omission - which she assumed was a mistake - and confronted Brace with her discovery. According to Moore, Brace admitted that he had directed the redactions to be made to the ATSB narrative so that the unions would not learn of United's decision to seek § 1114 relief through United's Board. In the course of this discussion, Moore also learned that the same cover page originally used by United in its submission to the ATSB was re-used for the ATSB submissions given to the Board and Officers.

Moore and Brace agreed to visit Tilton together, and they did so at once. Tilton told Brace and Moore that he wanted to act immediately by sending a letter to the Board explaining United's position on seeking § 1114 relief. Moore stated that Brace had made a "bad decision" and admitted to her that the situation had not been handled well.

Shortly thereafter, Moore called Lovejoy and told him what had happened. Lovejoy drafted and sent a supplemental letter to the Board on January 9, 2004. Lovejoy's January 9 letter advised the Board of the company's decision to seek § 1114 relief, although it did not explain that the version of the ATSB narrative that was sent to the Board in December had been redacted. Lovejoy confronted Brace and explained that sending the Board a redacted version of the ATSB submission, without identifying it as such, was poor corporate governance. Brace replied that he believed it was more important to discuss United's decision to seek § 1114 relief with the unions in person, rather than to provide the un-redacted ATSB narrative. In our interview, Brace said that he was unaware that Lovejoy's transmittal letter suggested to the Board that they were receiving the full version of the ATSB narrative.

On March 12, 2004, while my investigation was underway, United sent a letter to its Board that addressed these events. Written over Lovejoy's signature, the letter explained:

Shortly after filing the updated application we created an edited version of the filing for distribution to internal audiences which eliminated any reference to the 1114 process and modified or deleted text on certain other confidential and/or sensitive matters.

* * *

When the package to you was assembled on December 23 (after I had left for the holidays), a decision was made that we should advise union leadership of the decision to pursue the 1114 process in an orderly manner, that our union directors should not learn about this through the updated ATSB application and to send the Board the edited version. Unfortunately, as a result of a communication failure within our team, the document you received was not the same document I thought you would receive and not the document I referred to in my letter to you.

10. Discussions Between United And Gregory Davidowitch Regarding § 1114 Between December 17, 2003 And January 5, 2004

On December 17, 2003, Jake Brace had a telephone conference with the Creditors' Committee, which included Gregory Davidowitch, the AFA's President. In this call, Brace encouraged the Creditors' Committee and the unions to join in a press release that United planned to issue the next day when it filed the ATSB application. The press release would express the joint support of all the parties for the ATSB application. As a result of this call, the Creditors' Committee (which at this time had not been provided with the final Gershwin 4 model or any other information that United intended to submit to the ATSB) issued its own press release supporting the goals of United's ATSB submission. The AFA also issued its own press release supporting the ATSB application.

There is a dispute about an exchange that occurred in a subsequent call on December 17 between Brace and Davidowitch. Specifically, Davidowitch contends that he asked Brace two questions: (1) are there any surprises in the ATSB submission?; and (2) does the ATSB application incorporate estimated savings from § 1114 relief? Brace acknowledges that the first question was asked, and both he and Davidowitch agree that Brace assured Davidowitch that there were no surprises. Brace denies, however, that the second question was ever asked or answered. Davidowitch, on the other hand, says Brace answered no to the second question. Regardless of whose version is correct, Davidowitch claims that Brace should have known that Davidowitch would have been quite surprised to learn that the ATSB submission included § 1114 savings and that Davidowitch likely would not have caused the AFA to issue the supportive press release that it did on December 18.

A few days after the ATSB application was filed, Davidowitch learned that it included § 1114 savings. He called Tilton and, without telling Tilton what he had learned about § 1114 being in the ATSB application, asked if United intended to go forward with § 1114. Tilton told Davidowitch that no decision had been made.

Following this call, Davidowitch scheduled a meeting with Tilton on January 5, 2004, to discuss § 1114. On that date, Davidowitch met with Tilton, Brace and McDonald. Davidowitch asked if United had decided to commence § 1114 proceedings, and was informed by both Tilton and Brace that no decision had been made to seek § 1114 relief. According to Tilton, he was scheduled to meet with the Executive Council the next day to discuss whether it was necessary to proceed with § 1114 and he did not intend to make a final decision to seek such relief until after that meeting. Until this conversation on January 5, Brace had believed that the decision to commence § 1114 proceedings had been made on December 15. When Brace heard Tilton say that a final decision had not been made, however, Brace concluded that Tilton had yet to make a final decision regarding § 1114.

At the same January 5 meeting, Davidowitch also asked Brace why United had not sought § 1114 relief during the § 1113 process when United's financial condition was worse. According to Brace's affidavit submitted by United in opposition to the AFA's Motion for the appointment of an examiner, Brace stated that:

I told Mr. Davidowitch that [United] would have pursued changes to retiree health benefits at the time, but that it did not have the "bandwidth" to undertake that effort. . . I explained to Mr. Davidowitch that the resources and manpower necessary for the Section 1113 process precluded [United] from simultaneously pursuing changes on a parallel track under Section 1114.

In his interview, Brace stated that during the § 1113 process and throughout most of the bankruptcy proceedings he believed it likely that United would seek § 1114 relief and would have done so during the first part of 2003 if it had sufficient manpower and resources.

11. The January 5 and 6 Executive Council Meetings

On January 5, 2004, all members of the Executive Council, except Tilton, met and discussed § 1114. First, everyone agreed that it was necessary to seek § 1114 relief to fill the \$456 million gap in Gershwin 4 that had been discovered during the December 2003 budget roll-up.^{12/} Second, the group discussed plans to commence the § 1114 proceedings.

The Executive Council met again on January 6 with Tilton. At that meeting, the Executive Council members informed Tilton of the conclusions that they had reached the day before. Tilton agreed and authorized the commencement of § 1114 proceedings.

12. Conversation Between Kenneth Tank And Maryann Irving

On January 19, 2004, at least two weeks after United decided to commence § 1114 proceedings, there was a conversation between Kenneth Tank, a retired machinist, and Maryann Irving, assistant to Tilton. Both acknowledge that the conversation took place, that Tank called Irving to get Tilton's e-mail address, and that Tank expressed dissatisfaction with United's decision to seek § 1114 relief. According to Tank, Irving also stated that she had been old enough to retire on July 1, 2003, but had not done so since, "they [meaning senior management] indicated to [her] that they were going to make . . . changes [to increase the cost of retiree medical benefits] anyway, so [she] decided to stay." Irving denies having prior knowledge of a decision to seek § 1114 and states

^{12/} Establishing whether it was "necessary" within the meaning of § 1114 will, of course, be United's burden in this proceeding.

that she simply told Tank that she had done her "homework" before July 1, 2003 by talking to others in her office, and learned that § 1114 was always a possibility.

I do not consider these perceptions incompatible, but view them as different recollections of a conversation shaped by differing perspectives. Irving's statement that there was always a possibility that § 1114 would be sought is consistent with other evidence learned during my examination and Tank may have understood this statement as he recalls it. Viewed in this context, nothing about the exchange supports the notion that a decision to seek § 1114 relief was made before December 2003 or January 2004.

III. CONCLUSION

Based upon the above facts, I conclude that United's decision to seek § 1114 relief was not made before July 1, 2003. The decision was made either on December 15, 2003 or January 6, 2004.

The evidence supporting these conclusions establishes that United began analyzing § 1114, as well as many other bankruptcy provisions, shortly before filing bankruptcy. Early in the proceeding, United formed a team to plan for the possible implementation of the § 1114 process, should the decision to seek such relief be made. United's management and officers held different views about the likelihood of seeking § 1114 relief, including Brace who believed since early 2003 that it was likely that United would eventually decide to do so.

In late July 2003, Brace decided to incorporate estimated savings from § 1114 relief into Gershwin 3 based upon Dingboom's discovery of the \$275 million CRAM savings modeling error. In late November or early December 2003, Brace decided to eliminate from Gershwin 4 any such estimated savings because United's cash balances were higher than expected and the company wanted to take a "conservative" approach in its ATSB application. On December 15, 2003, Brace, with Tilton's approval, caused § 1114 savings to be reincorporated into Gershwin 4 to address the

\$456 million gap discovered during the budget roll-up process. The fact that § 1114 savings were inserted into and removed from the Gershwin model more than once supports the conclusion that no decision had been made to seek § 1114 relief until December 15, 2003, at the earliest.

Although there is disagreement as to whether the decision to seek § 1114 relief was made at the December 15, 2003 or the January 6, 2004 Executive Council meeting, there is no question that the decision was made at one of those meetings. Given the limited question that I have been asked to answer, there is no need to determine at which of these two meetings the decision to seek § 1114 relief was made.

Finally, I found no evidence to support the suggestion that United had a financial incentive to induce flight attendants to retire between May 1 and July 1, 2003. We reviewed the work performed by Towers Perrin, which provided cost analyses for United's medical benefits. That work suggests that the increased costs of pension funding and retiree medical benefit payments caused by retirements before July 1, 2003, may actually exceed any estimated savings from § 1114. Moreover, there is no evidence that anyone at United or Towers Perrin ever estimated the number of employees who were likely to retire between May 1, 2003 and July 1, 2003 or the cost savings that might be achieved if employees could be induced to retire during this period in greater numbers than was typical.

Dated: March 18, 2004

Respectfully submitted,



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