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

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

MEMORANDUM IN SUPPORT OF DEBTORS' MOTION TO REJECT THEIR COLLECTIVE BARGAINING AGREEMENTS PURSUANT TO SECTION 1113(c)

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Dated: March 17, 2003

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I. INTRODUCTION AND OVERVIEW.

Let there be no pretense about it: This is a distressing day for the thousands of men and women who have dedicated their careers to United Air Lines. It is also disheartening for the Company to have to ask the best employees in the airline industry to work harder for less pay. Regrettably, the harsh realities of the financial crisis that drove United into bankruptcy have left the Company with no other choice. To preserve the enterprise and the jobs that it can sustain, all of United's employees must equitably share the pain of United's restructuring. Inasmuch as labor is by far the Company's largest cost and United's labor costs are the highest in the industry, United will not be able to survive without reducing these costs substantially.

A. The Financial Imperative.

Until late last week, the timing of today's motion had been driven principally by the covenants insisted upon by United's Debtor-in-Possession ("DIP") lenders, which impose strict and early cost-cutting deadlines. Now, like the rest of the industry, United is also confronting an Iraq-driven revenue shortfall that makes it all the more imperative for the Company and its unions to get United's financial house in order as soon as possible.

To protect their interests, the DIP lenders established monthly milestones based on cumulative EBITDAR (earnings before interest, taxes, depreciation, amortization and aircraft rent) that required a substantial portion of the relief sought by this motion to become effective by the middle of February 2003. The interim wage relief imposed upon the IAM and agreed to by United's four other unions in early January bought the parties ten additional weeks to try to reach a consensual resolution. But the initiation of Section 1113(c) proceedings cannot be delayed any longer. Unless the interim wage relief is made permanent <u>and</u> the balance of the relief being sought by United from its collective bargaining agreements ("CBAs") becomes effective by early

May 2003, it will be impossible for United to remain in compliance with the terms of its DIP financing.

Regrettably, the relief sought by this motion may no longer suffice. As the looming conflict with Iraq draws nearer, pre-war jitters have caused passenger bookings to decline dramatically, further destabilizing an industry still reeling from the aftermath of the September 11 tragedies. Thus, even though a single bomb has yet to drop, United is already in a war scenario vis-à-vis the DIP covenants and may require additional relief to remain in compliance with those covenants. Securing some combination of covenant relief from its DIP lenders and financial assistance from the government is the Company's first choice; asking this Court to order more wage concessions from its hard-working employees is its last. But if United's first choice does not bear sufficient fruit within the next 30 days, the Company will have to turn to its employees for interim wage relief beyond the labor savings in United's Section 1113(c) proposals. And if the conflict becomes a shooting war, United may need even more wage relief to stay in compliance with its DIP covenants.

B. The Transformational Imperative.

Beyond the immediate necessity of staying in compliance with the terms of the DIP financing, United must revamp its business model so as to regain the confidence of the capital markets and thereby emerge from – and stay out of – bankruptcy. Reducing United's labor costs by an average of $2.56 billion per year from 2003 - 2008 is necessary for the Company to bring its costs into line with revenues that have deteriorated to 1994 levels.

Alas, returning to viability will require more than simply reducing costs. To paraphrase one member of the Air Transportation Stabilization Board, this proceeding "is not

just about costs, it's about a [pre-petition] business plan that is fundamentally flawed."[1] To reorganize successfully, United must be freed to respond expeditiously to the ever-changing economics and competitive dynamics of the airline industry. Stated differently, the Company must begin to operate less as "an airline" (at least as that concept has evolved) and more like a "real business" (to be judged by its profits and their sustainability). United's labor costs (including its above-market benefit packages) must be reduced, along with United's other expenses, to competitive levels. Anachronistic work rules that result in pay for time not worked and more employees on the payrolls than are necessary to perform the required work must give way to the realities of doing business in today's ultra-competitive environment. Restrictions on United's ability to maximize its revenues by deploying more and larger regional jets or pursuing strategic alliances with other carriers must fall by the wayside. And limitations on the Company's rights to furlough employees for whom there is no work or to out-source functions that can be done by outside vendors at a fraction of United's current cost must end. The management of a transformed United Air Lines will bear in mind the legitimate interests of its employees in how the Company is run and the type of career opportunities United affords – after all, fostering positive and inclusive working relationships with labor is how "real businesses" are able to succeed. In the end, however, management must be afforded the prerogative to make the "tough decisions" on strategic issues without restrictions of the sort that are now deeply embedded in United's CBAs.

In particular, the Company must secure the flexibility necessary to be able to heed the admonition of the ATSB and others to counteract the "likely effects of continued expansion

[1] Statement of Treasury Under Secretary Peter R. Fisher on ATSB Announcement on United Air Lines (Dec. 4, 2002).

by low-cost carriers in United's markets." United cannot shrink from this competition. To the contrary, securing the flexibility to take proactive steps to counter the challenges posed by Southwest, JetBlue, Frontier, ATA and similar carriers will strengthen United's network and thereby play a critical role in enabling United to reorganize successfully.

C. The Labor Relations Imperative.

As part of righting the ship, the Company and its unions must fashion durable CBAs. The history of the airline industry teaches that concessions in the form of wage reductions lend themselves to "snapping back" when good times appear to be returning, leaving airlines and their employees vulnerable anew to harsh and divisive cycles of profits and losses of the sort that have now put the careers of all United employees at risk. *See generally* Informational Brief at 12 - 19. Accordingly, the foundation of the "asks" constructed by United are permanent changes to work rules and scope provisions whose implementation will result in an efficient enterprise that can afford to offer stable jobs with competitive pay on a sustainable basis. As for future upturns, United is proposing a success sharing plan that will provide monetary rewards to United's employees for their contributions toward United's success.

* * *

United has made every effort to make the process of reducing its labor costs a consensual one. United has opened its books and financial records to its unions, provided them the documents and information necessary to evaluate the Company's proposals and negotiated whenever the unions have desired. But whether by consensual agreement or through a ruling on this motion, the need for United's proposed changes is irrefutable. Thus, despite understandably being displeased that these changes to their CBAs have become necessary, the Company's unions have no "good cause" under Section 1113 for refusing to agree to United's proposals.

It bears reemphasis that, in filing this motion, United is <u>not</u> blaming its employees or their union representatives for United's current crisis. It was entirely appropriate for the Company's unions to have sought the most advantageous terms possible in the years of negotiations that progressively culminated in the CBAs now before this Court. Nor is there any dispute that, during different and better times, the Company agreed to the work rules and other provisions that this motion is revisiting. The real and admittedly unpleasant point is that the CBAs are no longer affordable because of the changed economic environment and different industry dynamics that now confront the Company and its employees.

United also has nothing but admiration for how all of its employees have remained devoted to serving the customers of United Air Lines in these anxious and uncertain times. United's industry-leading performance on key measures is a testament to their continued focus. For its part, United continues to stand ready to negotiate around the clock in the hope that this process can be resolved consensually. But the time constraints of the DIP loan covenants and the Section 1113 process leave the Company with no option but to initiate today the process for rejecting its collective bargaining agreements.

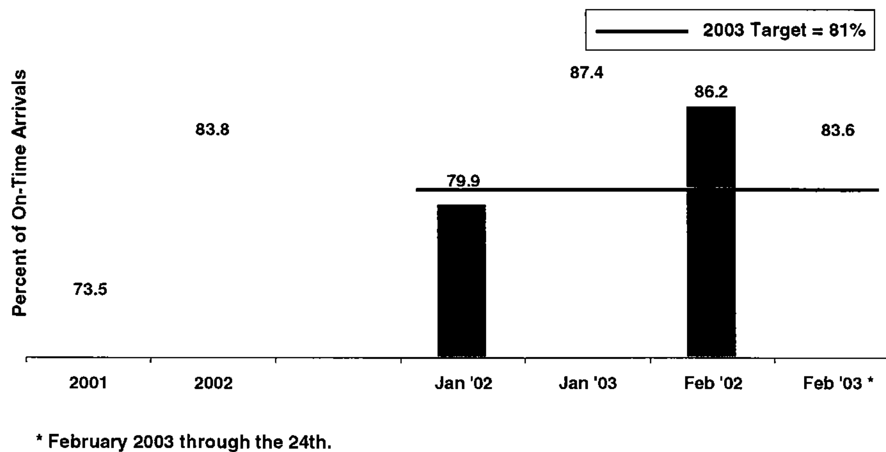
II. UNITED'S REORGANIZATION IS ON TRACK.

United experienced a seamless three months in bankruptcy before the effects of an apparently imminent conflict with Iraq cast another pall over the airline industry. Operational performance continued to be the best in the Company's history. Non-labor earnings improvement programs proceeded apace. Interim wage reductions in January secured much needed EBITDAR improvement and bought more time for CBA negotiations. Because of these developments, the impact of the bankruptcy filing on bookings was less than expected and the cash burn proved lower than projected.

A. United's Operational Performance Exceeded All Expectations.

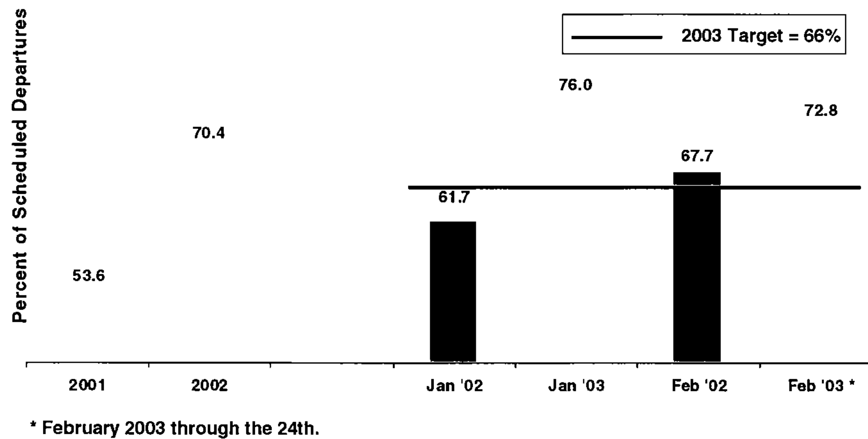
Thanks to its employees, United's operational performance has continued to lead the industry. United's on-time arrival performance improved to record levels in 2002 and continues at industry-leading levels in 2003:

Exhibit 1. UNITED'S ON-TIME ARRIVALS.



United's on-time departure performance also improved to record levels in 2002. This trend too has continued in 2003:

Exhibit 2. UNITED'S SYSTEM DEPARTURE LEVELS.



United canceled only 0.3 percent of its flights in January 2003, also a top-ranking performance. Not surprisingly, customer satisfaction exceeds year-ago levels.

B. United Has Reduced All Of The Expenses Within Its Control.

Before filing for bankruptcy, United strove to reduce every possible non-labor cost except for those relating to the safety of its operations. *See* Informational Brief at 47 - 49. United is redoubling these efforts inside bankruptcy so as to minimize the concessions that will be required of its employees. United has moved forward with plans to reduce the capacity of its mainline fleet by another six percent in 2003, to achieve its previously-announced $1.4 billion in annual earnings improvements, to cut even more in non-labor expenses, to implement a "best practices" program to squeeze out remaining inefficiencies, and to reduce sharply the number of salaried and management personnel and their compensation. United will also exercise its rights under the Bankruptcy Code to achieve additional savings as permitted by this Court. For instance, United is already renegotiating contracts with its suppliers and United Express partners and using the Section 1110 negotiation process to save hundreds of millions of dollars on its aircraft leases.

1. $1.4 Billion In Non-Labor Earnings Improvements By 2004.

Since 2002, United has been implementing various non-labor profit improvement initiatives that it projects will add $1.4 billion to United's earnings by 2004. These previously-announced efforts fall into three broad areas: (i) the execution of strategic projects, such as the US Airways code-share venture, a Lufthansa joint venture, and additional regional jet deployment, collectively projected to improve profits by $586 million in 2004; (ii) a systematic cost reduction program extending from United's flight and airport operations to its procurement practices that will reduce costs by $633 million; and (iii) a series of projects (such as enforcing advance-purchase requirements more strictly and modifying corporate discount programs) aimed

at capturing $228 million in added net profitability. These projects are on track to improve earnings by over $1 billion in 2003 and $1.4 billion in 2004.

2. Additional Cost Reductions In 2003.

To extract still more savings from its operations while maintaining the service levels and market presence its customers demand, United is implementing an additional across-the-board budget reduction in 2003. This reduction has left no part of United untouched. Without impacting the safety of its operations, United is reducing overhead and cutting expenses in its Operating Groups and Customer and Strategy Divisions by as much as it believes customers will tolerate.

Most of the cost-cutting initiatives in United's Operating Groups are additional reductions-in-force of salaried and management employees, not hiring replacements for employees who leave the Company, and furloughs permitted under the existing CBAs. Savings also come from (i) reducing food and beverage offerings on North American flights, (ii) maintaining tighter control of inventory levels of spare parts and other maintenance materials, and (iii) renegotiating contracts with suppliers of engines and parts. In its Customer and Strategy divisions, United has stopped sponsoring all but a few events, closed all remaining domestic ticket offices and accelerated the closing of three additional reservation centers, and reduced technology maintenance spending. United has also eliminated or reduced various brand and product development initiatives and slashed cargo costs.

3. $400 Million Projected In "Best Practice" Savings By 2005.

United is also taking a fresh, top-down look at its entire enterprise. With the help of outside experts, United has embarked on a "best practices" program to scrutinize every single division in the Company. United will implement more efficient practices in use at other

companies to save a projected $400 million in additional cost reductions by 2005. Declaration of Amos Kazzaz ("Kazzaz Decl.") ¶¶ 4 - 6 (Ex. B).[2]

4. $70 Million Projected In 2003 Savings From Renegotiated United Express Carrier Contracts.

United is also negotiating concessions from its United Express carriers. These three independent companies (Atlantic Coast Airlines, Air Wisconsin, and Sky West) operate regional jets under the United Express brand. United collects all revenue for these flights and compensates its express carriers on a "fee per operation" basis. Express carriers also receive additional incentive payments if they reach agreed-upon performance milestones. *See* Declaration of Kevin N. Knight ("Knight Decl.") ¶¶ 4 - 5 (Ex. C).

By renegotiating all of its Express contracts, United has reduced the reimbursements made to the Express carriers by holding all cost estimates at historic levels. In addition, Air Wisconsin has agreed to retire 10 high-cost turbo prop aircraft ahead of schedule. If further renegotiations prove unsuccessful, United will find new carriers to provide Express services at lower rates. *Id.* ¶¶ 6 - 7.

5. $500 Million Projected In Gross Section 1110 Savings.

The Company is actively engaged in reducing the cost of its 463 aircraft that are subject to Section 1110 by renegotiating financing costs down to current market rates and ultimately by rejecting or abandoning certain aircraft. United currently has agreements in principle for long-term and comprehensive restructurings of a substantial number of financing arrangements. The Company remains on track to meet its savings target of over $500 million

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[2] As described below, Exhibit A to this Memorandum summarizes United's proposed changes to each CBA.

annually. Declaration of Steven A. Carlson ("Carlson Decl.") ¶¶ 4 - 5 (Ex. D); *see also* 2/6/03 Hr'g Tr. at 113-27 (Ex. E).

6. $425 Million In Salaried And Management Reductions.

Over the past eighteen months, United has slashed both the number and compensation of its salaried and management personnel. United laid off large numbers of salaried and management employees immediately after September 11, 2001. In total, from September 2001 through the end of 2002, United eliminated over 3,800 salaried and management positions, saving $270 million annually. Declaration of Sara Fields ("Fields Decl.") ¶¶ 4 - 6 (Ex. F).

One week after filing for bankruptcy, United reduced the compensation of the remaining salaried and management employees on a progressive scale starting at a 2.8 percent reduction for employees earning less than $30,000 per year and increasing to an effective reduction of approximately 11 percent for the highest-paid officers. Including their foregone 2002 merit raises, the total reductions range from 5.2 to 15.3 percent. These wage reductions and foregone raises save about $85 million annually from the remaining salaried and management employees. *Id.* ¶¶ 10, 15.

Since January 2003, the Company has eliminated another 1,000 salaried and management jobs. Overall, since September 11, United has reduced management by 35 percent and salaried employees by 39 percent. The total headcount reductions save $340 million annually; the headcount reductions since September 2002 alone account for $105 million each year. Combining the lower headcount with wage reductions and foregone raises, United's savings from salaried and management total $425 million. *Id.* ¶¶ 6, 15.

C. United Secured Interim Wage Relief From Its Employees.

To achieve the required labor savings in time to comply with its DIP covenants, United was prepared to file its Section 1113(c) motion in late December 2002. At that time, unless United secured significant labor cost reductions that took effect by mid-February 2003 (*i.e.*, within the six - seven weeks contemplated for a ruling by the framework established under Section 1113(c)), the Company stood to violate its DIP covenants beginning in March 2003.

As the December filing date drew near, however, an alternative and more consensual path emerged: securing interim wage relief to buy United and its employees an additional ten weeks to exhaust every conceivable means by which to resolve the transformational and labor relations imperatives confronting the Company on a collaborative basis. Through a combination of interim wage reduction agreements ratified by the memberships of ALPA, AFA, PAFCA and the TWU and the entry of Section 1113(e) relief against the IAM on January 10, 2003, United assured itself of at least $100 million of forecasted headroom above the DIP covenants until May 1, 2003. This enabled the Company to postpone its Section 1113(c) motion until today.

D. United Abated Its Cash Burn Rate.

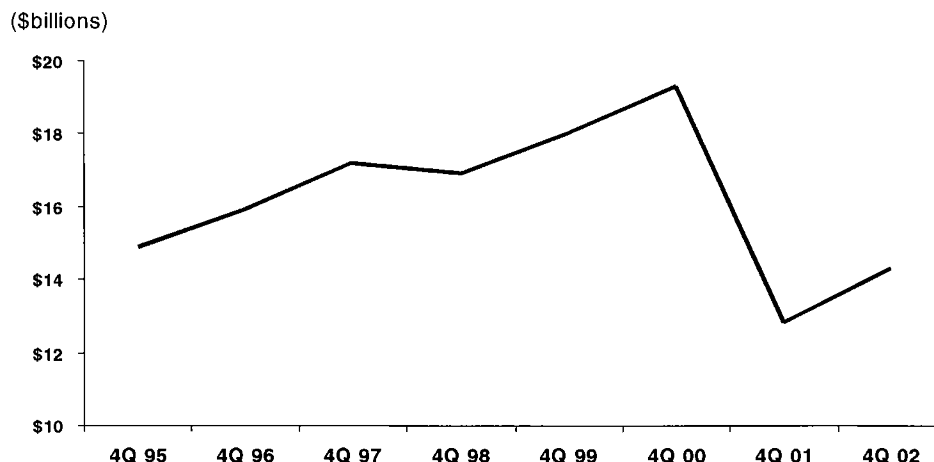
With non-stop expense reductions, interim wage relief and the implementation of various profit improvement initiatives early in the bankruptcy process, United was able to stem its losses. Bankruptcy book-aways came in below projections, also contributing to United's early recovery and helping reduce United's cash burn. United bettered its projected December cash burn by roughly $5 million per day and its projected January cash burn by nearly $14 million per day.

III. EVEN WITHOUT THE CONFLICT IN IRAQ, UNITED COULD NOT HAVE SUSTAINED ITS HIGH-COST BUSINESS MODEL IN THE DIMINISHED REVENUE ENVIRONMENT CONFRONTING THE INDUSTRY.

Unfortunately, these initiatives will not suffice to return United to profitability without permanent and fundamental modifications to the Company's collective bargaining agreements. To the contrary, developments since United initiated these proceedings have served only to underscore the necessity for the Company to restructure the way it does business. *See* Informational Brief at 6 - 9, 22 - 27. In the fourth quarter of 2002, United incurred an operating loss of $927 million and, despite aggressive reductions in non-labor costs and the interim wage relief that began in January 2003, the Company expects to record another operating loss of $877 million in the first quarter of 2003.

United and the rest of the industry remain in the red largely because revenues remain below 1995 levels:

Exhibit 3. INDUSTRY REVENUE DECLINE.



Source: Airlines In Crisis, The Perfect Economic Storm, Air Transport Association Report, March 2003.

Even before the threat of war with Iraq became so palpable, a confluence of factors was causing passengers not to return to the air as quickly as the industry would like. Continuing softness in

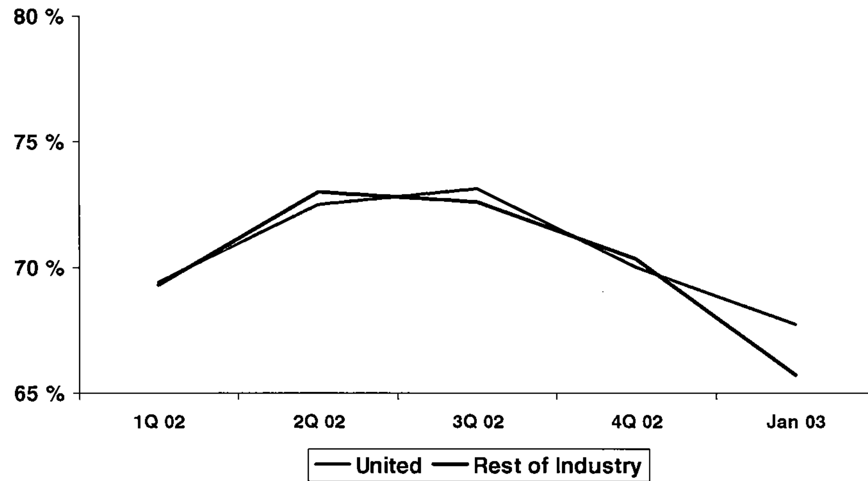
the economy, the lingering fears of terrorist attacks, the hassles associated with tighter security at airports, and improvements in videoconferencing and other alternatives to business trips have all kept passenger traffic depressed. Indeed, the FAA recently pushed back from 2004 to 2006 the year in which it predicts domestic traffic might return to 2000 levels.[3] And the proportion of passengers purchasing higher-priced tickets continues to decline. Even without adjusting for inflation, fares today are on average lower than they were in 1988.[4] And United in particular has continued to lose passengers to low-cost carriers.

To address these factors and the tendency of some passengers to book away from carriers in bankruptcy, United has implemented a number of measures to improve revenue, including advertising, tactical promotions and a business fare structure in over 12,000 markets that features discounts of up to 40-70 percent on business fares. These initiatives have been cash positive and have stimulated demand to fill seats that otherwise would have gone empty:

[3] *Jet Set Fights Low Visibility*, Forbes, March 5, 2003.

[4] *Report Predicts Massive Economic Damage*, Air Transport Association, March 11, 2003.

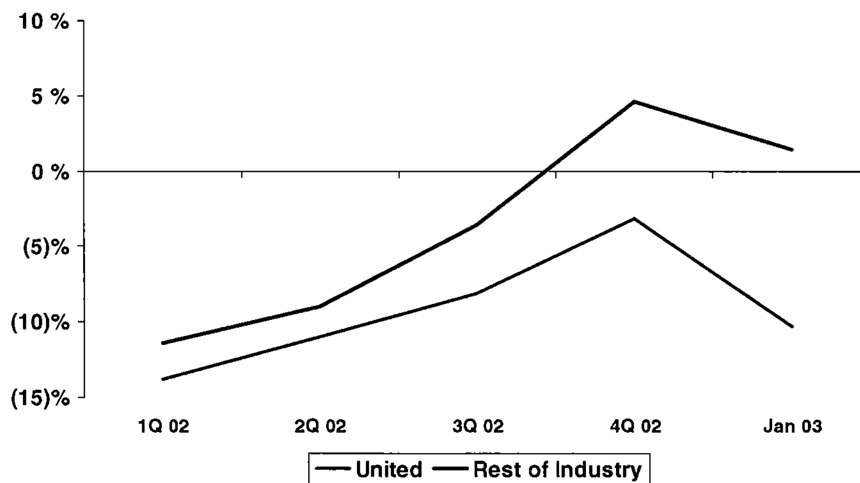
Exhibit 4. **UNITED'S DOMESTIC LOAD FACTOR.**



Source: Air Transport Association Report, January 2003.

But other carriers are outpacing United in passenger unit revenue on domestic routes:

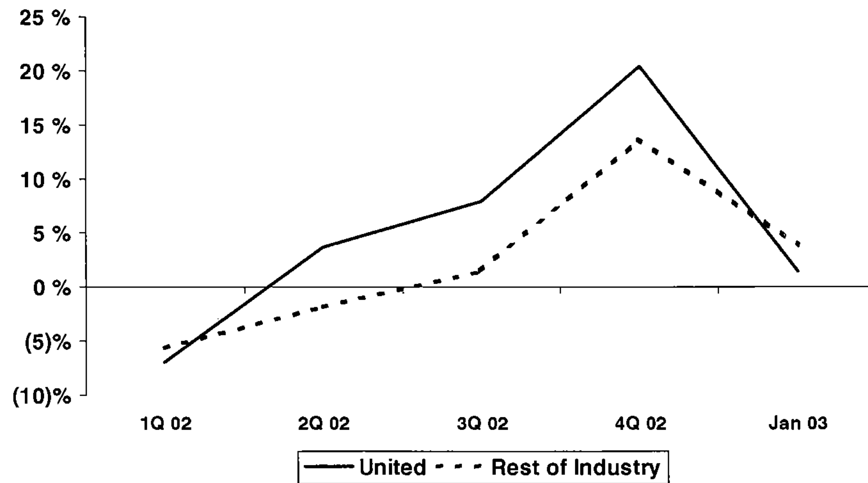
Exhibit 5. **DOMESTIC PASSENGER UNIT REVENUE CHANGE FROM PRIOR YEAR.**



Source: Air Transport Association Report, January 2003.

Meanwhile, the advantage that United had been enjoying in international unit revenue has reversed, in large part because many foreign travelers do not appreciate that United can continue its normal operations while in bankruptcy:

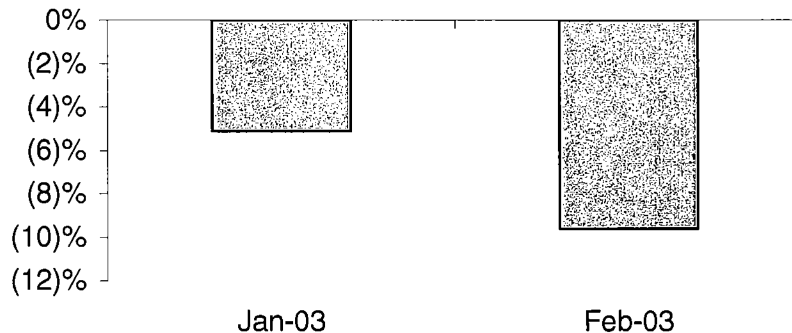
Exhibit 6. **INTERNATIONAL PASSENGER UNIT REVENUE CHANGE FROM PRIOR YEAR.**



Source: Air Transport Association Report, January 2003.

Thus, despite its revenue initiatives, United's drop-off in passenger travel posed a serious challenge even before President Bush started setting March deadlines for Iraq to disarm:

Exhibit 7. **UNITED'S UNIT REVENUE DECLINE FROM PRIOR YEAR, JANUARY - FEBRUARY 2003.**



Source: Passenger Revenue Accounting System.

Importantly, the "prior year" in Exhibit 7 is the beginning of 2002 – only a few months after September 11th. Stated differently, despite its revenue initiatives, United's January and February 2003 revenues remained well below the extremely depressed levels prevailing in the immediate aftermath of the worst crisis ever to hit the airline industry.

IV. THE DIP COVENANTS REQUIRE IMMEDIATE AND SUBSTANTIAL REDUCTIONS IN THE COST OF LABOR, NOW (IN A PRE-WAR ENVIRONMENT) MORE THAN EVER.

As United struggled to stay out of bankruptcy, the capital markets and the ATSB made it painfully clear that, in their view, the cost savings being proposed by United were insufficient to enable the Company to compete successfully in a dramatically-changed industry. To punctuate the point, the Company's DIP lenders conditioned United's DIP financing upon strict covenants that, based on pre-war projections, effectively required United to reduce its labor costs by February 2003 or risk the potential liquidation of its business. Now that war jitters have taken hold, deeper reductions may be required on a temporary basis to weather the latest crisis to confront the airline industry.

A. The DIP Covenants.

Beginning in February 2003 and continuing for every month through November 2003, United must meet milestones for cumulative EBITDAR through that month that were based on financial projections that, with the consent of the DIP lenders, did not account for a then-potential conflict with Iraq. The covenant is "cumulative" because it sums EBITDAR from December 1, 2002 forward.[5] Starting in February 2003 and continuing through April 2003, United must achieve a cumulative EBITDAR of no worse than $150 million below the cumulative EBITDAR that United projected to the DIP lenders for each of these three months. This cushion shrinks to $125 million for the May - July 2003 monthly tests and to just $100 million for the August - November 2003 monthly tests.

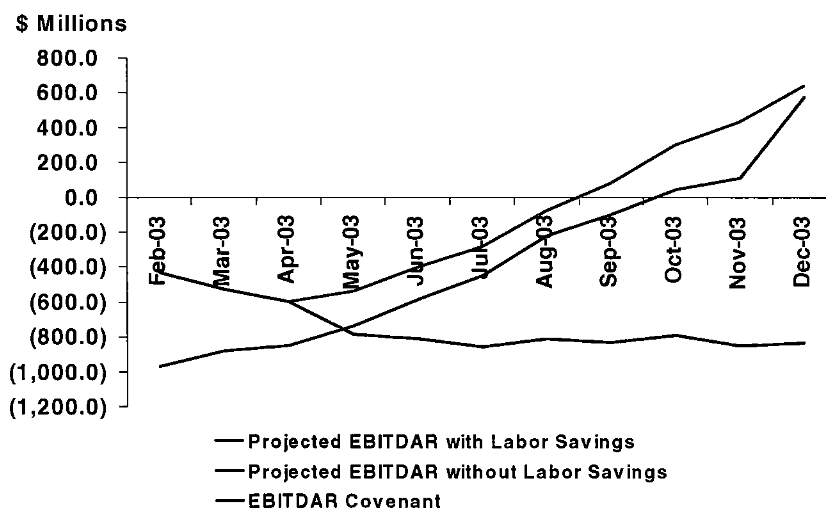
[5] The cumulative nature of the EBITDAR test through November 2002 makes the timing of any relief as important as the amount. Savings that begin in May help the Company meet the cumulative test for May 2003 and every subsequent monthly test of cumulative EBITDAR. Consequently, foregoing savings in May 2003 makes it that much harder for the Company to meet the cumulative monthly milestones in subsequent months and, at the very least, necessitates that future cuts be deeper and ramp in more quickly.

In December 2003, the test converts to a rolling monthly milestone based on EBITDAR for the prior twelve months. For example, the projections upon which the DIP financing was based call for the Company's EBITDAR for January 2003 - December 2003 to be $675 million. The Company has covenanted that EBITDAR for this twelve-month period shall not fall below $575 million, leaving headroom of $100 million. Violating any single monthly covenant results in a default, entitling the DIP lenders to foreclose on their collateral, which encompasses essentially all of the assets needed for United to continue operations.

B. Before The Recent War-Driven Revenue Shortfall, United Was Poised To Continue Complying With Its Covenants By Virtue Of The Savings From Its Proposed CBA Modifications.

United remained on track to satisfy its DIP covenants through the first three months of its bankruptcy. United timed its 1113(c) proposals to begin providing greater savings upon the expiration of the interim wage relief in early May 2003. As of United's February 28, 2003 forecast, these savings would have been sufficient to keep United in compliance with its DIP covenants through December 2003:

Exhibit 8. CUMULATIVE EBITDAR WITH AND WITHOUT 1113(C) SAVINGS VS. COVENANTS, FEBRUARY PROJECTIONS.



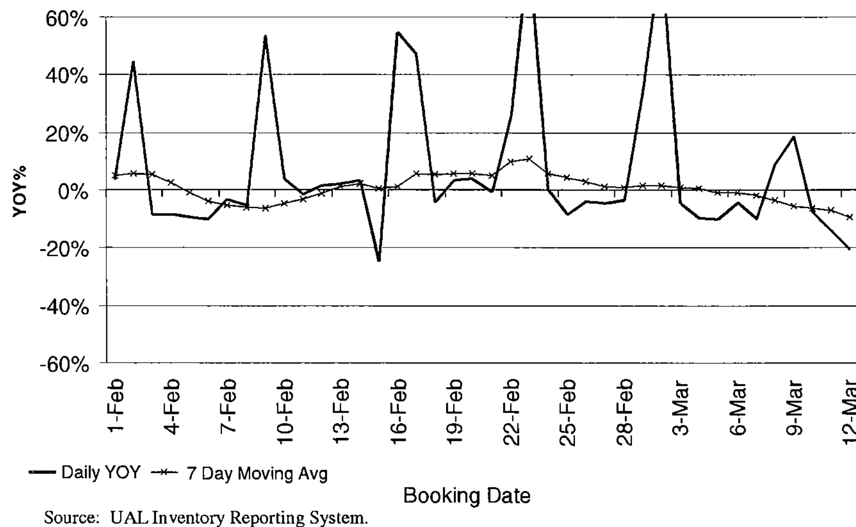
Source: EBITDAR Projections as of February 28, 2003.

But the growing prospect of a war with Iraq has since changed the outlook for the entire industry.

C. Because Of Recent Geopolitical Developments, United Requires Additional Temporary Relief To Offset The Flying Public's War Jitters.

In the wake of the deadlines that have recently been set for Iraq to disarm, United's bookings have begun to drop substantially. Domestic bookings have recently declined:

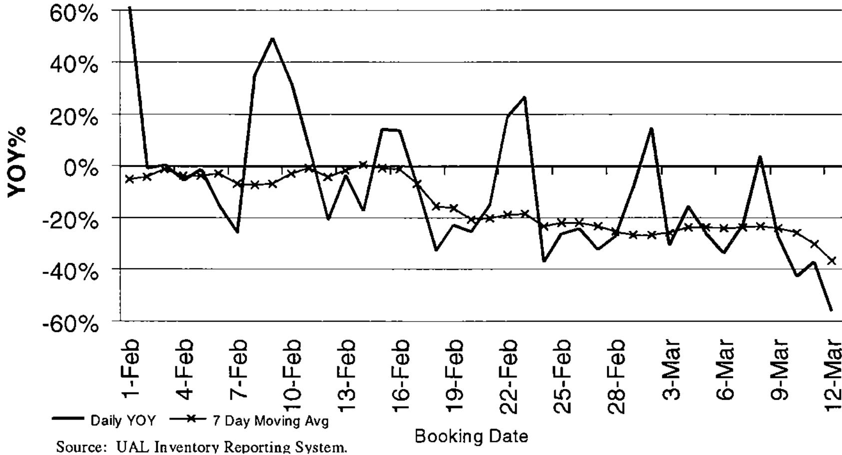
Exhibit 9. UNITED'S DOMESTIC TRAVEL BOOKINGS.



Source: UAL Inventory Reporting System.

As this Court might expect, the drop in international bookings has been more dramatic. Within the past week alone, international bookings have dropped precipitously throughout the industry and, in United's case, are down almost 40 percent against year-ago levels:

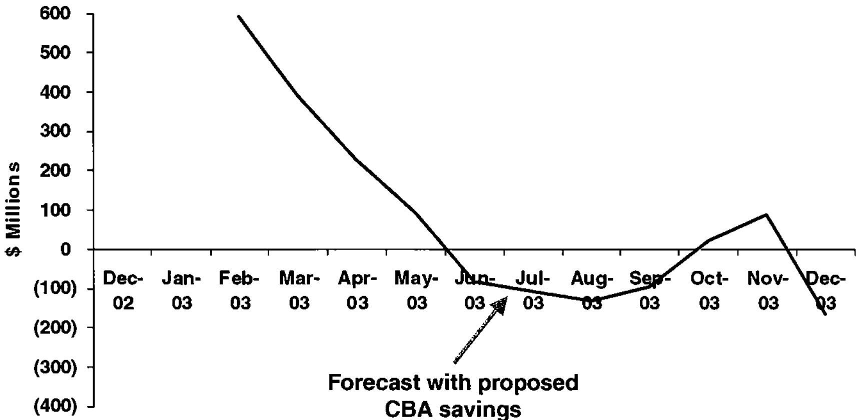
Exhibit 10. **UNITED'S INTERNATIONAL TRAVEL BOOKINGS.**



With war-related jitters increasing and fewer people purchasing tickets, United's near-term revenue forecast through June 2003 has deteriorated by ***$298 million*** from projections made just weeks ago. At the same time, the cost of fuel, United's second largest operating expense, has gone in the opposite direction. United now forecasts that the price of fuel for 2003 will be 19 percent higher than projected in December 2002, adding approximately $300 million in fuel expense. Indeed, for March 2003 alone, the price of fuel is up 40 percent, adding approximately $60 million to United's costs.

These declining revenues and increasing costs are squeezing United's earnings. Under its most recent forecast, even with all of the labor savings sought by United's 1113(c) motion and even if the conflict with Iraq never materializes into a shooting war, United will violate its DIP covenants starting in June 2003 and continuing every month thereafter through September and again in December 2003:

Exhibit 11. CUMULATIVE EBITDAR COVENANT VIOLATIONS REFLECTING IRAQ WAR JITTERS.



Source: EBITDAR Projections as of March 14, 2003.

In anticipation of these developments, United formulated a DIP covenant action plan. Before turning to the details of this plan, however, it bears emphasis that the looming conflict with Iraq is not a United-specific issue. United's domestic and international market shares remain stable, suggesting that the war jitters are affecting all carriers and will continue to do so until they pass. Continental, for example, projects that its transatlantic load factor will be down fifteen percentage points from last year, with April-forward bookings showing softness as well.[6] Other carriers, such as Delta, Japan Airlines and others, have also felt the conflict's effects on bookings.[7] The difference between United and its competitors is that, because the Company is in Chapter 11, United must disclose its Iraq contingency plans – to this Court, the DIP lenders and its other stakeholders.

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[6] *Airlines plead case for aid as war looms*, USA Today, March 12, 2003.

[7] Kathy Fieweiger, *Airlines Face Many Worries, Stocks Sink*, Reuters, March 11, 2003; *Delta Air sees negative Q1 cash flow on war fears*, March 10, 2003.

1. United Is Making Every Effort To Mitigate The Conflict's Impact Before Again Turning To Its Employees.

United is already doing everything it can to offset the impact of these war jitters before having to seek additional wage relief.

a. United Is Cutting Still More Non-Labor Costs.

Previous cost-reduction efforts cut United's non-labor expenses to the bone. United will now do what it can to take those expenses down to the marrow. United will stop replacing many workers who leave the Company, review anew all recent purchasing and capital spending decisions to minimize cash outlays even further, and cancel certain flights. These moves should save an additional $10 million per month.

b. United Is Making Exhaustive Efforts To Obtain Government Assistance.

United is also stepping up its efforts to lobby the government for financial aid. As soon as a war with Iraq became a serious possibility, United joined in the intensive efforts of the country's airlines to obtain substantial war-time relief and financial assistance from the U.S. government. During the past four months, United has worked closely with the major U.S. carriers and the Air Transport Association ("ATA") – the trade association for the major U.S. airlines – to develop a comprehensive government assistance package for the carriers in the event of an Iraqi conflict. This package includes relief from significant taxes and fees, the requirement that the Transportation Security Administration assume all costs for airport security, government-provided terrorism insurance for the airlines, and efforts to moderate jet fuel prices and avoid service interruptions.

United's Chief Executive Officer, Glenn Tilton, has already met with key government officials in Congress and the Bush Administration. In view of last week's developments, United's senior executives will be working with the leadership of the Company's

unions to schedule discussions during the week of March 17 with the White House, the Department of Transportation, the ATSB and Capitol Hill. United will do everything possible to press the industry's case so as to avoid having to ask its employees for more relief.

c. United Has Already Approached Its DIP Lenders And Is Seeking Covenant Relief.

United's Chief Financial Officer, Jake Brace, has already met with a representative of United's DIP lenders to discuss the potential impact of the war and ask the DIP lenders to relax the DIP covenants. Brace stressed that the Company hoped to avoid having to go back to its employees for additional wage reductions beyond those called for by United's Section 1113(c) proposals. The response was that the banks in the DIP syndicate would not be in a position to grant any covenant relief until United was able to present hard data on the effects of the war, which the representative of the DIP lenders presumed at the time would not be available until after a war had started. But the DIP lenders have agreed, at United's request, to expedite the consideration of any request for covenant relief.

Now that new data suggests that United is already suffering the effects of an anticipated war in advance of any actual outbreak in hostilities, Brace is planning to meet with representatives of the DIP lenders during the week of March 17 to press United's case for immediate covenant relief in lieu of additional wage cuts.

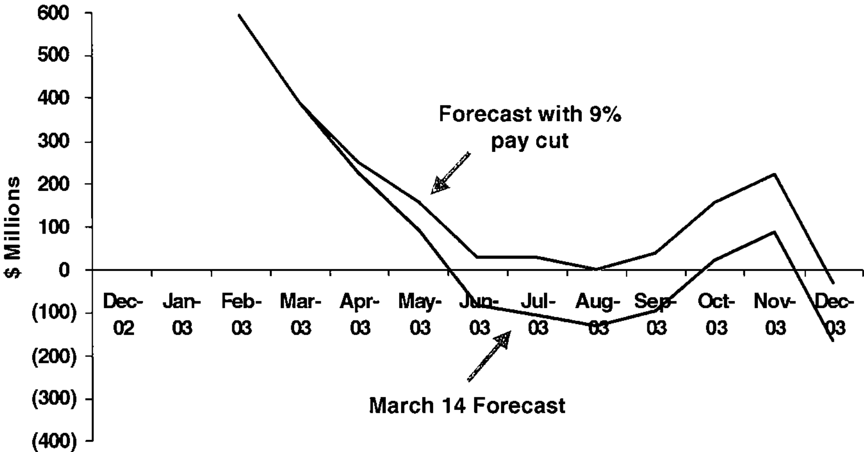
2. Despite United's Efforts, The Company Likely Will Require Temporary Labor Cost Relief.

United hopes to be able to forestall filing a second motion for additional interim labor relief for a month while its DIP lenders give expedited consideration to United's request to relax the covenants and the government decides whether to provide the industry with assistance. But unless United receives sufficient covenant relief or government aid by mid-April, the

Company will have no choice but to press forward with a request for additional interim wage relief.

For example, if the present forecast holds, United projects that it will require an additional nine percent across-the-board reduction in wages (on top of the presently-reduced levels) beginning on April 15 and lasting for three months:

Exhibit 12. **COVENANT CLEARANCE WITH ADDITIONAL 9 PERCENT WAGE CUT.**



Source: EBITDAR Projections as of March 14, 2003.

Even with these additional savings, United would clear its covenants by only $27 million in June, $26 million in July, $1 million in August and $38 million in September. This "cushion" provides the absolute minimum necessary for United to meet its DIP financing requirements. Moreover, given the volatility of the situation, United's forecasts could improve or get worse, especially since United has yet to reforecast revenues beyond June 2003. Either way, United will be prepared to adjust the timing and amount of any wage relief accordingly.

United proposes to apply the same percentage reduction to all employee groups because of the unexpected, emergency nature of the relief (*e.g.*, nine percent reductions for each of the unions and salaried and management employees). This differs from the Company's prior

interim relief agreements and Section 1113(e) motion against the IAM, which were apportioned among the unions based on the Company's proposed permanent wage reductions under Section 1113(c). By contrast, the wage relief required here is based on the immediate – and, the Company hopes, temporary – need to mitigate the financial emergency the Company is facing because of the conflict with Iraq. In addition, the disproportionate reductions effected in January 2003 recalibrated wages to competitive levels. In these circumstances, an equal and across-the-board percentage reduction is most appropriate.

To minimize the burden on lower-paid employees, the Company will reallocate the overall reduction required from salaried and management employees (*i.e.*, the amount represented by an across-the-board reduction applied to all employees in the group) according to a progressive scale (akin to the 2.8 - 11 percent scale used to effect the prior reductions announced on Day One of these proceedings). In addition, the officers of United will take a cut appreciably above the top end of the scale that will be used to allocate reductions among non-officer employees. Similarly, Kirkland & Ellis has volunteered to reduce its fees by the same percentage as United's officers for the duration of the interim relief. United will give each of its unions the option of distributing its membership's share of the interim relief in a progressive manner.

D. If A Shooting War Occurs, United May Need Still More EBITDAR Relief To Meet Its DIP Covenants.

For all the financial impact from the threat of war, the reality of war could be worse. For instance, if passengers react as they did in response to the 1991 Gulf War, revenues for 2003 would fall by 4.4 percent. Some analysts fear a potentially deeper revenue downturn because of a heightened sense of personal vulnerability to retaliatory terrorist attacks. *See, e.g.*, Mark L. Gerchick, *The Potential Financial Impact of a New Iraq War on the Struggling U.S.*

Airline Industry at iii, 20 (Feb. 4, 2003) (projecting 10 percent traffic decline for up to two quarters); UBS Warburg, *Airlines: March Update* at 2 (March 7, 2003) (projecting a 8 - 10 percent revenue decline over 8 months). Then again, because bookings have already dropped so much in anticipation of war with Iraq, the overall decrease may be less than was experienced in 1991. Indeed, if the war proves to be a short and successful campaign, United's revenues could improve as the anxiety of the flying public is alleviated.

Again, either way, United will be prepared to adjust the amount and duration of any additional interim relief from its employees accordingly. If revenues were to deteriorate further, United would first exhaust all efforts to reduce all other costs, to obtain government aid or to secure sufficient covenant relief from its DIP lenders before asking for additional sacrifices from its employees. In addition, United is already closely monitoring passenger traffic and will be prepared to reduce its flight schedule as may be warranted by considerations such as the actual number of cancellations and no-shows in the aftermath of the bombing or shooting. If those efforts proved unsuccessful, however, United's only remaining option would be to secure additional relief from all of its employees beyond the nine percent reduction that may already be required a month from now to offset the impact of war jitters on United's revenues. As United recently advised the leadership of its unions, the additional reduction could conceivably be as high as an additional nine percent or higher (for a total of 18 percent or higher) under unfavorable circumstances. In the end, the effects of the war will remain uncertain until the conflict unfolds, meaning that the amount and duration of any interim relief will have to be adjusted accordingly.

* * *

A national emergency has forced United to alert this Court that the Company may soon be forced to ask for the last thing the Company wants: further wage reductions from its employees. Before asking the Court to reduce its employees' wages, United will do everything it can to offset the war's impact on its operations and financial performance. Regrettably, unless the Company receives government assistance or covenant relief from its DIP lenders, United will have no other recourse but temporary labor cost reductions to stay in compliance with its DIP covenants.

V. UNITED'S PLAN FOR TRANSFORMATION.

Even before the conflict in Iraq began to depress industry revenues, the DIP lenders were requiring the Company to secure labor cost savings as one of the first orders of business in these bankruptcy proceedings. In doing so, the DIP lenders reinforced the clear and unmistakable signal that United received from the capital markets and the ATSB in late 2002. Heeding this "wake up" call, the Company substantially refined its comprehensive business plan to achieve a competitive cost structure and thereby transform United into a compelling value proposition for investors.

United's plan capitalizes on the Company's strengths – a well-balanced and comprehensive route network, a young and simplified fleet, a skilled employee base, and a brand name equal to that of any carrier in the industry. As before, the Company's mainline service will remain the heart and soul of its business and continue to be tailored to the needs of the business traveler. Yet transforming United to meet the challenges of today's airline industry will require much more – specifically, a suite of synergistic, cost-competitive product lines and marketing relationships that can augment and strengthen United's mainline network and thereby increase the overall relevance of the United brand to more customers. By diversifying its product

offerings, United can continue to cater to its mainline business travelers and compete directly with low-cost carriers for leisure and price-sensitive fliers.

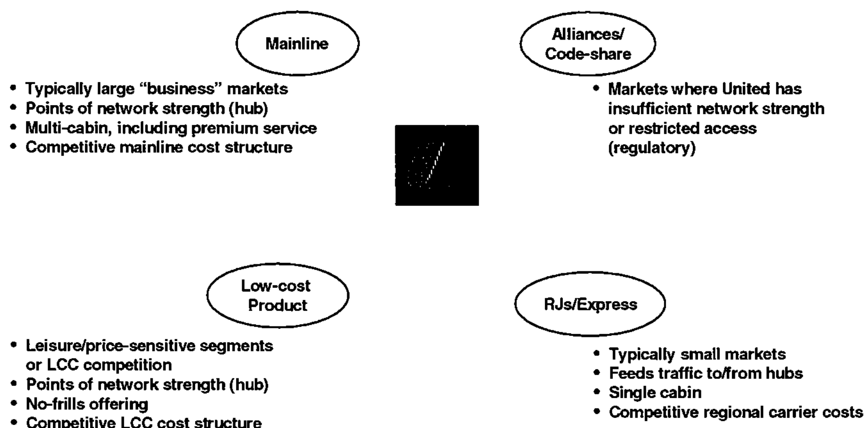
Exhibit 13. OPTIMIZING THE NETWORK.

▭ Primary drivers

Market characteristics					
Typical size	Network strength	Competitive intensity	Customer mix	Example	Appropriate network offering
Medium, large	High	Low-no LCC or minimal share	Mix of business and leisure travelers (more high-yield mix)	Chicago-New York	Mainline
Medium, large	High	High-current or probable LCC market	Leisure/price-sensitive dominated (more low-yield mix)	Chicago-Las Vegas	Low-cost offering
Small	High	Mixed	All travelers	San Francisco-Eugene	Express
All	Low	Mixed	Business and leisure travelers	Pittsburgh-Phoenix New York-Frankfurt	Alliance/code-share

In this respect, United proposes to launch a low-cost/low-fare, "no frills" product positioned to compete effectively with low cost carriers. The Company will also need to deploy more and larger regional jet aircraft under the United Express sub-brand to provide enhanced connectivity to smaller markets. Finally, the Company will require the flexibility necessary to pursue alliance and revenue-sharing relationships as market developments dictate. These initiatives will enable United to shift resources as dictated by an uncertain revenue environment and ever-changing competitive landscape. In particular, developing diversified product offerings will allow United to offer the optimal "mix" to match up with its various and varied competitors:

Exhibit 14. UNITED'S PLAN FOR TRANSFORMATION.



One key barrier, however, stands in the way of United's plan to return to profitability: the Company's collective bargaining agreements. The CBAs' wages, benefits, and work rules prevent United from setting mainline fares that are competitive with those of other carriers and still profitable for the Company. A complex web of restrictions embedded in the CBAs' scope provisions preclude the Company from enhancing its network by creating a low-cost carrier, deploying more and larger regional jets or freely pursuing code sharing and other alliances. United's proposals clear the path for United to become a strong and dynamic airline that can compete on a sustainable basis – nothing less, but nothing more.

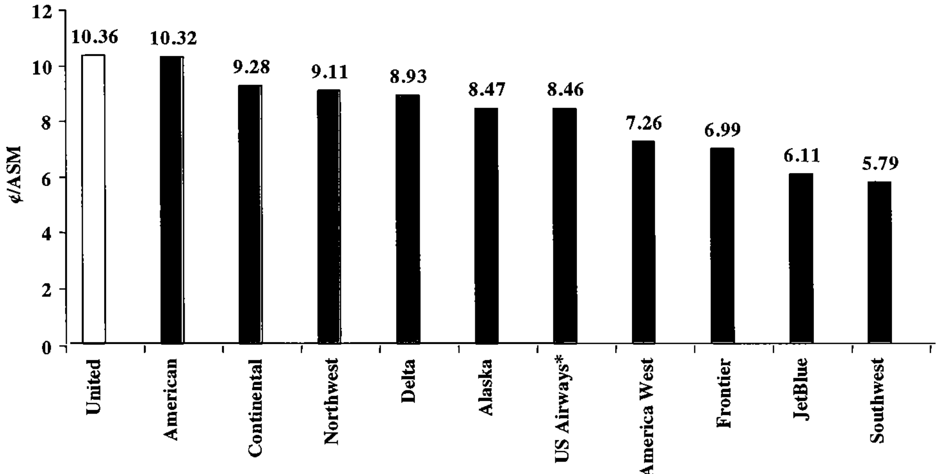
A. United's Mainline Service Will Remain The Core Of The Airline, But Its Costs Must Come Down.

The most promising avenue for United to return to profitability is to exploit the reach and breadth of its hub-and-spoke network, which enables the Company to provide service on a frequent basis to city pairs throughout the world. United's network has long been its single greatest competitive advantage.

Against this backdrop, United's plan is to enhance – and not reduce – the relevance of its mainline product by improving service and focusing even more than before on the needs of business travelers (such as a simplified business fare structure, improved pre-flight

check-in and handling, and better contact centers) while maintaining its frequent flyer program. At present, however, the success of this strategy is challenged by the fact that United has the highest cost per available seat mile ("CASM," the standard measure for airline costs) in the industry on a stage length-adjusted basis.[8]

Exhibit 15. STAGE LENGTH ADJUSTED TOTAL OPERATING UNIT COSTS PER ASM,[9] 01/02 - 09/02.



*Note: Includes significant projected cost reductions resulting from bankruptcy reorganization.

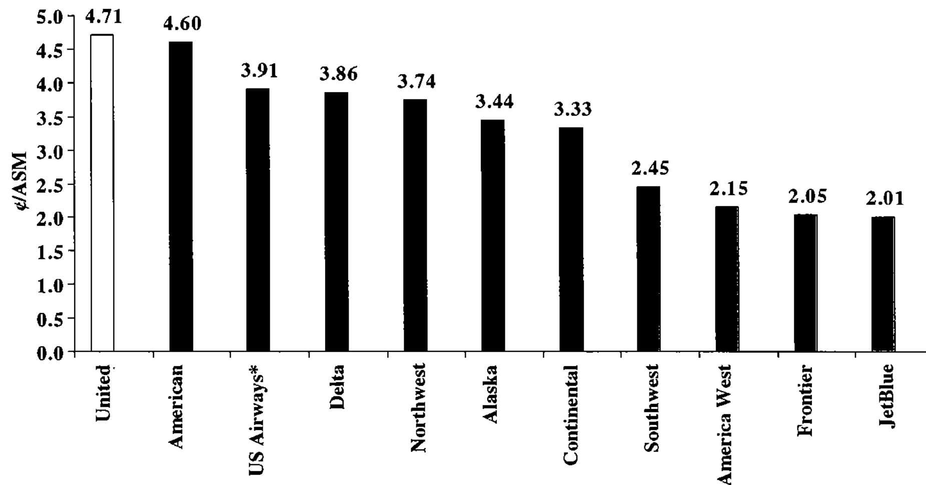
Source: U.S. DOT Form 41 data, stage-length adjusted to 1,223 miles.

The Company's labor cost per ASM, also the highest in the industry, is the principal driver behind its industry-worst CASM:

[8] Adjusting for stage lengths, that is, the average distance of an airline's flights, is a generally accepted practice in the industry. Per mile costs decline as average flight distance increases because costs not related to distance (*e.g.*, overhead and landing fees) are spread over a greater number of miles. Thus, a carrier that flies longer routes (such as United) seemingly incurs lower unit costs than an airline that flies mostly shorter routes (such as U.S. Airways) simply because of the difference in flight lengths. To filter out this distortion, "stage length adjusted" costs are calculated as though the other airlines' routes were the same length as United's routes.

[9] Exhibits 15 and 16 reflect total operating cost per ASM excluding (1) special charges, (2) costs reflecting significant non-core subsidiary activities (*e.g.* the costs incurred by UAL's fuel trading subsidiary), and (3) the implied interest on aircraft operating rents to normalize for aircraft financing differences. The costs are adjusted to a stage length of 1,223 miles, United's average stage length as of January through September 2002.

Exhibit 16. STAGE LENGTH ADJUSTED LABOR COSTS PER ASM, 1/02 - 9/02.

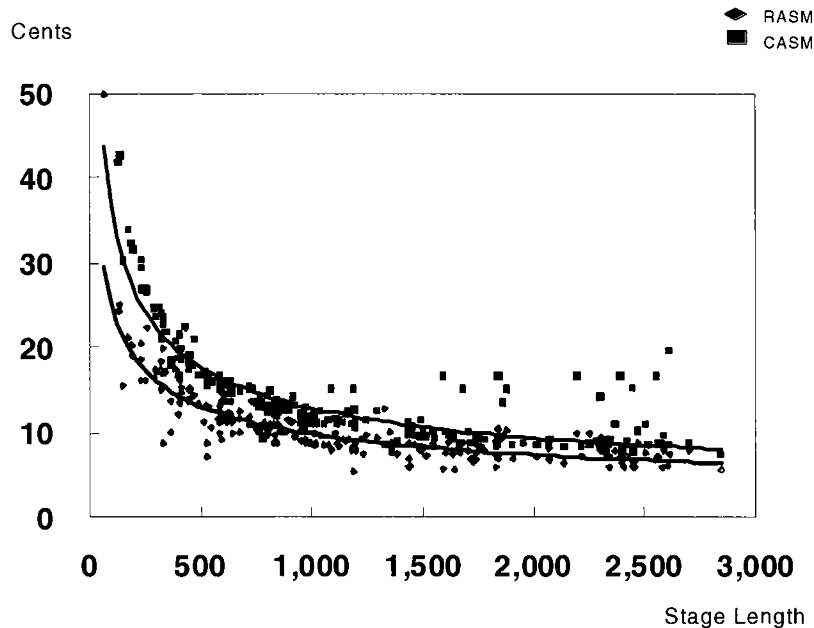


*Note: Includes significant projected cost reductions resulting from bankruptcy reorganization.

Source: U.S. DOT Form 41 data, stage-length adjusted to 1,223 miles.

And because these high costs have persisted even as United's revenues have collapsed, United has been losing money on the majority of its mainline routes:

Exhibit 17. REVENUES AND COSTS BY MARKET, 2002.



Source: United Profitability Reporting System, Jan.-Oct. 2002, excluding interest expense.

For United to be competitive, it must bring its mainline costs in line with those of its network competitors. And because all of the pre-deregulation carriers except for Southwest are losing money, United's cost targets need to reflect the likelihood that United's major network carriers will reduce their costs from current levels. Success for United, therefore, will be possible only by targeting a cost level toward the low end of the scale for full-service network carriers.

Indeed, on the eve of UA's bankruptcy filing, the other major network airlines were themselves starting to come to grips with labor costs they could no longer afford. *See* Informational Brief at 59 - 63. These cost-cutting efforts have intensified since United's filing. American Airlines last month announced a plan to cut labor cost by $1.8 billion annually: $660 million from pilots, $350 million from flight attendants, $620 million from mechanics and ground workers, $80 million from ticket agents, and $100 million from management.[10] US Airways returned to its unions for an additional $200 million in annual labor savings (on top of the $840 million in annual labor savings the airline had already obtained) and went back a third time to terminate its pilots' pension plan.[11] Northwest recently announced the need for $1.2 billion in annual labor savings and asked its pilots for wage roll-backs to pre-1996 wage levels and for significant changes in work rules and benefits.[12] And Delta will begin talks with its

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[10] AMR Corporation, *Untitled Presentation to Unions* 11-12 (Feb. 4, 2003); Martin J. Moylan, *Northwest wants 20% pilot wage cuts*, Pioneer Press, Feb. 26, 2003.

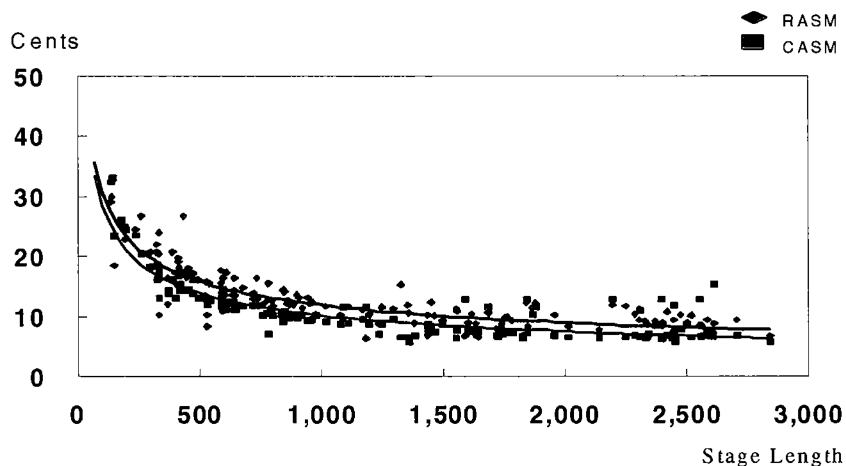
[11] Micheline Maynard, *Judge Rules US Airways Can End Pilots' Pension*, N.Y. Times, Mar. 3, 2003; Martin J. Moylan, *Northwest wants 20% pilot wage cuts*, Pioneer Press, Feb. 26, 2003; Micheline Maynard, *US Airways to Cut Costs $1.8 Billion a Year*, N.Y. Times, Dec. 22, 2002.

[12] *Airline costs veer off course*, Pioneer Press, March of 2003; *Airline turmoil growing*, Chicago Daily Herald, Feb. 27, 2003; Martin J. Moylan, *Northwest wants 20% pilot wage cuts*, Pioneer Press, Feb. 26, 2003; *Northwest Tells Workers It Must Overhaul Union Pacts*, The Wall Street Journal, Feb. 11, 2003.

pilots this month on the contract changes it believes are necessary to compete with other carriers.[13]

United is already closing part of this cost gap through its extensive cost reduction programs, contract renegotiations, salaried and management cuts, and reduced fleet costs from the Section 1110 process. But the remainder must come from a reduction in United's largest and most uncompetitive costs: the wages, work rules, and benefits of its CBAs. Only by achieving significant labor cost reductions can United's mainline service profitably compete in most markets:

Exhibit 18. REVENUES AND COSTS BY MARKET WITH REQUESTED LABOR SAVINGS, 2005.



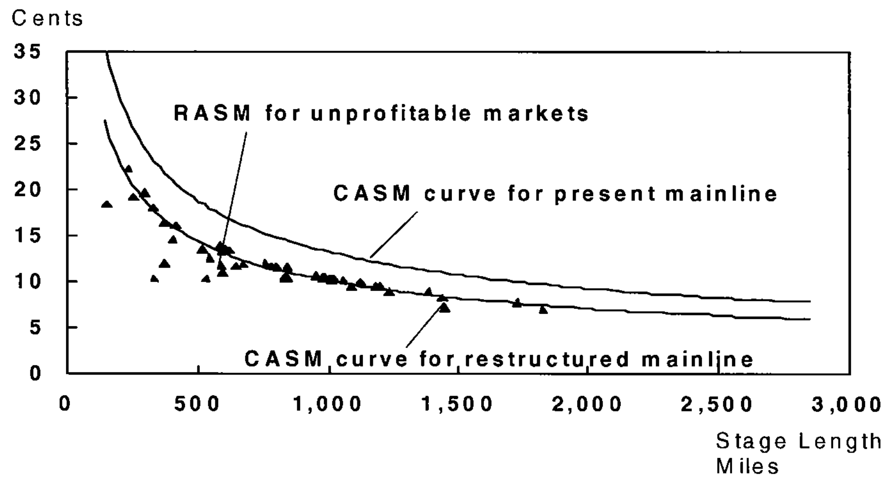
Source: United Profitability Reporting System.

B. United's Low-Cost Product.

Even with competitive mainline costs, however, United's mainline cannot achieve segment profitability on nearly 30 percent of its domestic routes:

[13] *Delta to talk with pilot union about labor cuts*, Dallas Bus. J., Feb. 27, 2003; *Delta, Pilots Union to Discuss Labor Cuts*, Miami Herald, Feb. 26, 2003.

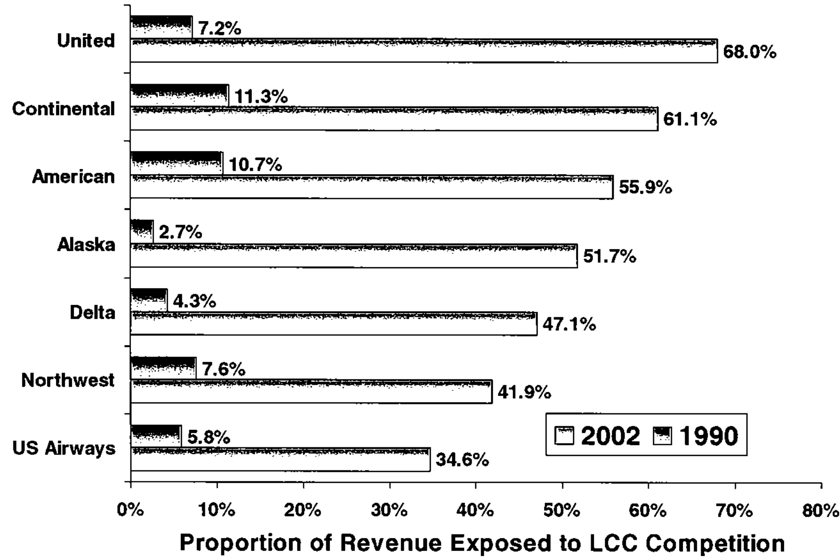
Exhibit 19. THIRTY PERCENT OF MARKETS ARE UNPROFITABLE EVEN WITH MAINLINE LABOR SAVINGS.



Source: U.S. DOT DB1A.

With the onslaught of low-cost carriers now penetrating more and more of United's network (Informational Brief at 40 - 45), United must compete with those airlines head-on. Indeed, United has no other choice because it is the major network carrier with the greatest exposure to low-cost carriers, especially in its hubs of Chicago (Southwest, ATA and soon JetBlue) and Denver (Frontier). Overall, United generates nearly 70 percent of its domestic revenue in markets with low-cost carrier presence, roughly twice that of US Airways and 20 percentage points more than Delta:

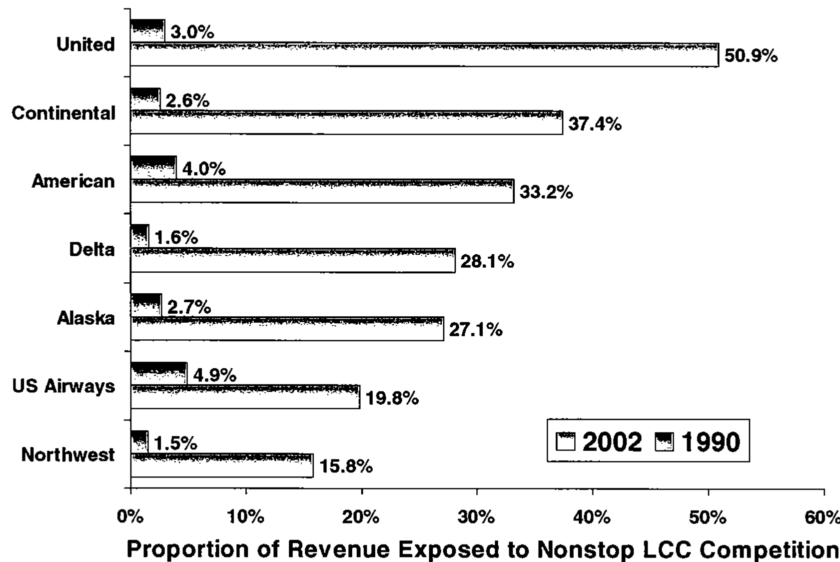
Exhibit 20. PROPORTION OF DOMESTIC REVENUE GENERATED IN MARKETS WITH LCC COMPETITION.



Source: U.S. DOT DB1A and T100 Databases.
Notes: Data for 2002 is for the first and second quarters. Competition requires a single LCC with a 5% marketshare of O&D passengers.

Considering only markets with non-stop low-cost carrier competition, United's exposure relative to its peers is even more pronounced:

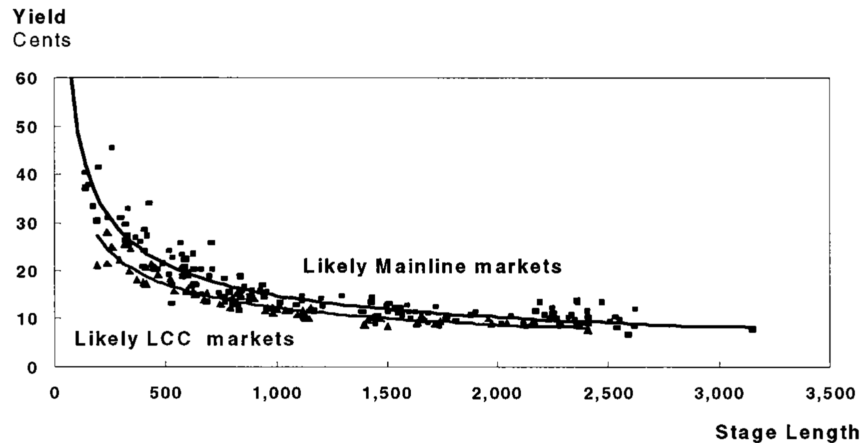
Exhibit 21. PROPORTION OF DOMESTIC REVENUES GENERATED IN MARKETS IN NON-STOP LCC SERVICE, 1990 VS. 2002.



Source: U.S. DOT DB1A and T100 Databases.
Notes: Data for 2002 is for the first and second quarters.

To rise to this challenge, United must develop a new product with costs comparable to those enjoyed by the low-cost carriers. United can do so by fielding a new low-cost product that will target certain traditionally low-yield routes and leisure destinations where the actual or anticipated yield is inadequate to sustain mainline service:

Exhibit 22. UNITED'S PROJECTED MARKET DIVISION.



Source: UAL Planning Analysis, U.S. DOT DB1A.

United's low-cost product will strengthen the overall network <u>and</u> therefore the mainline operations by maintaining the flow of connecting traffic from markets that would likely otherwise be abandoned altogether, along with the jobs that these routes support. Based on the current competitive outlook, United envisions that its low-cost product may fly approximately 30 percent of United's total domestic ASMs by 2008. These station and route conversions should enable United to attract and retain price-conscious leisure and business travelers on a profitable basis and, in the process, augment the network affordably.

1. The Requirement Of A Genuinely Competitive Cost Structure.

The major network carriers, including United, recognized the business need for a "low-cost product" more than a decade ago, when low-carrier competition was a much smaller part of the marketplace. Over the last decade, four carriers have attempted to create a low-cost

product as an "airline within an airline" – Shuttle by United, US Airways' MetroJet, Continental Lite and Delta Express. None of these efforts were successful for more than a couple of years, however, because they did not achieve genuinely competitive labor costs at the outset and/or because labor costs dramatically increased when the major carriers' unions negotiated substantial wage increases. Today more than ever before, any alternative that attempts to compete against Southwest or JetBlue without sustainably competitive costs is unlikely to succeed. To create a successful low-cost product, United must achieve <u>and</u> maintain a level of costs that will enable genuine and profitable competition against low-cost carriers.

For this plan to work, United must secure rates of pay, hours of service and working conditions comparable to those enjoyed by low-cost carriers. United's plan also envisions maximizing the operational efficiency of its low-cost operations by flying more efficient planes that would be scheduled for greater utilization than aircraft on the mainline. The low-cost airline is expected to feature low fare, "low frills," but reliable and consistent service. United's low-cost service will differ from that of other low-cost carriers, however, by virtue of its relationship with mainline United, United Express and the Star Alliance. For example, United's low-cost product will benefit substantially from enhanced connectivity with the world's most extensive route network. And there will be other advantages, such as low-cost customers being able to earn and redeem Mileage Plus awards.

2. United's Proposed Structure.

In its initial design of the LCC, United sought to avoid the fate of other low-cost efforts by creating a separate subsidiary with separate collective bargaining agreements, separate employees and separate seniority lists. United believed that the subsidiary model, patterned after the relationship between a number of major airlines and their wholly-owned regional carriers, would provide lower initial costs and greater durability than the "airline within an airline" model.

United's unions generally have acknowledged the need to create a low-cost product, but they vociferously opposed separate collective bargaining agreements and separate seniority lists. In response to these concerns, United devised an alternative structure using separate "bid areas" within the United agreements. In an effort to reach a consensual agreement, United revised its proposals shortly before filing the present motion to present the unions with a "single CBA" option to create a cost-competitive LCC.

Under United's modified LCC design, employees would bid into the low-cost operation based on their United seniority, and would remain United employees subject to the United CBAs. Once in the bid area, they would be leased by United to the low-cost subsidiary. The wages, benefits and work governing employees assigned to the LCC would be set forth in a "side letter" to the United agreements, the typical method used by carriers and unions in the airline industry to establish special terms applicable to employees assigned to a specific operation.

The wages, benefits and work rules set forth in United's proposed side-letter are substantially the same as United proposed for the separate collective bargaining agreements, and are based on the wages, benefits and work rules that are typically provided by the low-cost carriers with which United seeks to compete. As detailed at pages 69 - 70, these terms would result in an anticipated CASM of roughly 7.2 cents – still about 15 percent higher than Southwest, but almost 25 percent lower than United's CASM target for its mainline operations.

3. The Necessity For A Distinct Low-Cost Entity Within United.

To compete effectively over the long term, United must ensure that competitive cost levels are maintained over time and do not gradually converge with the higher costs in the mainline operation. Achieving this objective over the long term necessitates that the low-cost carrier be established as a distinct subsidiary, separate from the United mainline. This will

enable the creation of a distinct culture and a focused workforce that can execute the low-cost business model in a fashion similar to successful low-cost carriers by allowing for terms of employment that are based on those in place at other low-cost carriers and are tied to the carrier's performance. Otherwise, mainline wage increases or decreases would tend to spill over to the low-cost carrier (and vice versa) even when not justified by the profitability (or lack thereof) of that operation.

As a separate and distinct entity, United's low-cost operation would also be positioned to overcome three additional hurdles that have compromised prior efforts to create a "carrier within a carrier." First, if established as a distinct entity, the low-cost carrier can attract talented management who will be dedicated entirely to the new enterprise. Second, a separate low-cost subsidiary can independently attract capital. Third, creating a distinctive low-cost offering will avoid customer confusion over the product they are purchasing and the level of service they can expect to receive when flying on this segment of United's network. Simply stated, separateness is important to demonstrate to the capital markets that United's low-cost offering will be more than another expedient solution that is doomed to failure.

Although separate in form, the LCC will be structured in a way that is complementary to the labor agreements in place at the mainline. Unlike the failed attempts to create an "airline within an airline," United's proposal encompasses all employees, not just pilots, and sets all of the terms (wages, benefits and work rules) at low-cost carrier levels, as opposed to just wages. And although United believed the regional model promised greater durability, it has built several conditions into its proposals that should achieve the same goals. First, United has requested that the LCC side-letter have a term four years longer than the basic agreement so that increases at the mainline do not automatically make the LCC uncompetitive.

Second, United has proposed that, if United agrees voluntarily to increase LCC wages or benefits during the term of the side-letter, as happened with Shuttle by United, the LCC will have no further obligation to "lease" employees from United. Finally, United has proposed that upon the contractual end date of the parties' CBAs, the parties will submit proposals over unresolved terms to a neutral arbitrator. The arbitrator's role, as provided by the parties' contract, will be to choose the contract terms that best maintain labor costs and operational capabilities competitive with those at other low-cost carriers, with the requirement that the terms produce a total CASM for the United LCC that is no higher than 110 percent of the average CASM of the five largest low-cost carriers at the time of the arbitration.

By setting objective metrics for terms and conditions of employment at the LCC that will be enforced as necessary by a neutral party on a going-forward basis, United proposes to create a low-cost product with durably competitive costs – again, nothing less, but nothing more. By doing this, United believes that it can avoid a future in which the mainline gradually shrinks over time, as low-cost carriers continue to use their superior cost position to take share from the mainline. Instead, the LCC can become a powerful competitive weapon that enables the entirety of United Air Lines to compete effectively and grow in the future.

4. The Obstacles Posed By United's Present CBAs.

United's current CBAs, particularly the one with its pilots, contain a variety of scope provisions that preclude United from creating a low-cost subsidiary. The ALPA scope provision requires that any mainline flying for any company owned in whole or in part by UAL be done by United employees under the terms of the existing pilot agreement. ALPA CBA 1-B, 1-B-1. This restriction saddles United's LCC with the same high labor costs and inefficient work rules that exist on the mainline, far above what United needs to compete against Southwest and others. Moreover, the pilots' CBA sets minimums on United's fleet size and the number of

hours the Company must fly, preventing United from shifting planes and unprofitable routes over to the low-cost carrier. *Id.* at 1-H-3, 1-H-4. The CBAs of other employee groups likewise impede United's ability to launch a new LCC. The flight attendants' CBA, for example, prohibits United from establishing or purchasing an "alter-ego" airline, whereas the IAM CBAs contain a variety of restrictive terms held over from the long-abandoned "Shuttle by United" initiative. AFA CBA, Letter at 293, ¶¶ A, B; IAM CBAs, Letters 94-2. United must be freed from these restrictions for its new low-cost product to prove successful and thereby lend integral support to the mainline.

C. United Express And Regional Jets.

The deployment of additional and larger regional jets in the United Express network is another critical component of United's plan for transformation. Regional jets (RJs) are smaller aircraft that enable United to expand its network to lower-volume destinations that cannot be served profitably with United's mainline aircraft or to supplement United's mainline service to high-volume markets at off-peak departure times when fewer passengers are flying. The increased use of regional jets will feed additional passengers to United's mainline and low-cost flights, capture revenue in (and provide service to) markets or flights where demand is insufficient, and extend United's presence to markets that United otherwise cannot profitably serve.

Despite the many advantages of RJs, the pilots' CBA restricts the number of RJs the Company can deploy (*see* App. B at 36 - 39) and therefore places United at a significant competitive disadvantage, especially with respect to Delta and Continental:

Exhibit 23. REGIONAL JET FLEETS FEEDING MAJOR HUB AND SPOKE AIRLINES.

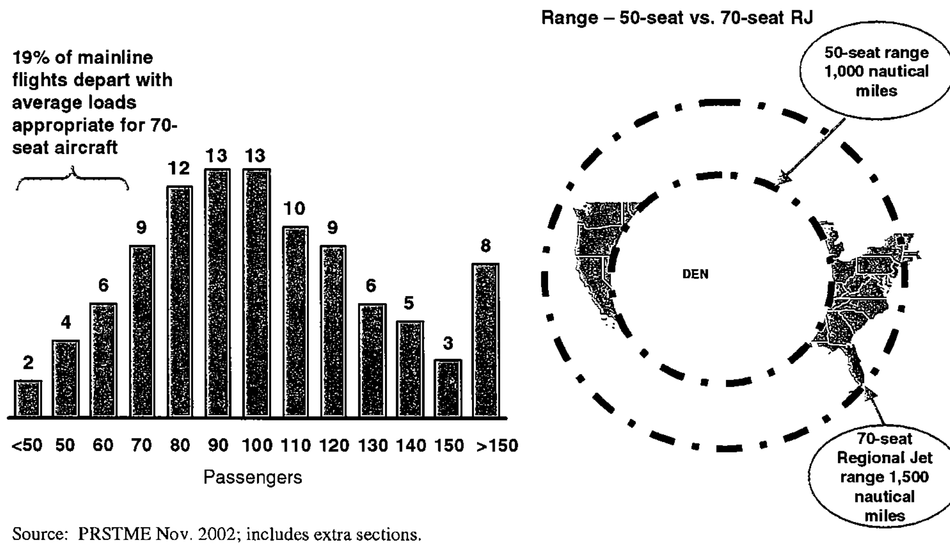
	RJ's in Operation YE 2002	% of Mainline Fleet
Delta	299	54
Continental	188	50
America West	33	23
United	128	23
US Airways	70	22
American	169	20
Alaska	16	16
Northwest	53	12
INDUSTRY	1015	30

Source: SSB Fleet Handbook – April 2002.

The pilots' CBA also limits the routes RJs can travel and the total number of seat miles they can fly. Unless these restrictions are dropped, United will not be able to take advantage of the increased revenues and network breadth regional jets offer.

Nor can United any longer afford the pilot agreement's prohibition on regional jets with more than 50 seats. ALPA CBA 1-B-2, 1-M-12, 1-M-28. Using 70-seat regional jets will significantly improve financial results by better matching capacity with demand. In particular, the flexibility to use aircraft in this size category would provide United with an economical option between 50 and 100 seat planes. Seventy-seat RJs have a 50 percent greater range than 50-seaters and would allow United Express carriers to serve more markets that cannot sustain mainline service but could profitably fill jets with more than 50 seats:

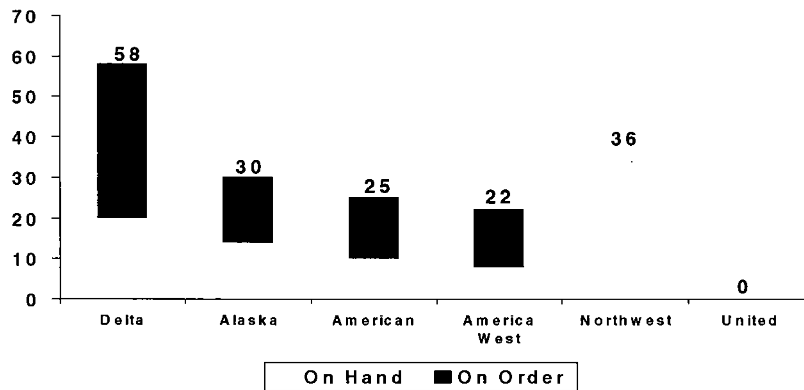
Exhibit 24. BENEFITS OF 70 SEAT RJS.



Source: PRSTME Nov. 2002; includes extra sections.

Express affiliates of other carriers (such as Delta, American, America West and Alaska Air) currently use 70-seat RJs, again leaving United at a competitive disadvantage:

Exhibit 25. DEPLOYMENT OF 70 SEAT RJS.



Source: SSB 2002 Fleet Handbook.

D. United's Code-Share And Other Alliances.

Alliances like United/US Airways and Continental/Delta/Northwest are changing the domestic competitive environment. Through the Star Alliance and its code share alliance

with US Airways, United can provide customers more choices and participate worldwide in markets that its own network cannot serve directly for economic or regulatory reasons.

An alliance is a collaborative marketing arrangement between carriers, which typically includes reciprocal frequent flyer program participation, code-sharing of flight operations and, increasingly, revenue sharing activities. "Code-sharing" means that flights operated by other carriers are listed in the computer reservation systems as United flights (listed as "UA*") and vice versa. As with regional jets, United can generate connecting traffic through code sharing and other alliances as a source for greater revenue. For example, United projects that its code share agreement with US Airways will generate more than $200 million per year. And, through expanded code-sharing and the initiation of a revenue sharing agreement with Lufthansa that deepens the two airlines' existing Star Alliance relationship, United expects to generate an additional $63 million annually over the next five years. Cargo alliances or joint ventures also represent an untapped source of revenue.

United's pilot agreement, however, severely restricts the Company's ability to enter into code-share and other alliances. *See* Appendix ("App.") B at 32 - 36. United may only permit another domestic carrier to use its code on one percent of the ASMs on domestic flights by United pilots (ALPA CBA 1-C-2-a-(1)) and may not code share flights between any two of the following types of locations: United's hubs, other "key airports" (defined to include Washington-National, JFK, LaGuardia, Miami, Newark and Seattle/Tacoma) and cities from which non-stop United flights to foreign destinations arrive or depart. *Id.* at 1-C-2-a-(2). A host of international code-sharing restrictions also suppress United's ability to profit from the Star Alliance and other international relationships. *See* App. B at 34 - 36. Removing these

limitations is necessary to provide United with the flexibility to pursue additional code sharing and revenue sharing agreements in the future.

To be sure, United's unions have agreed in the past to modify the CBAs to allow such arrangements, but not without strings attached. For example, ALPA gave the Company the contractual relief necessary to allow a code share agreement with US Airways, but only after months of negotiations during which ALPA extracted a new commitment by the Company to an administratively complex formula guaranteeing a certain amount of flying for United's pilots. In the future, such negotiations must be two-way negotiations between United and its potential partners and not three-way negotiations that vest United's unions with the power to veto strategic arrangements with other airlines that would best serve United's customers (and, therefore, the Company).

VI. UNITED'S UNIONS, LABOR AGREEMENTS, AND BARGAINING HISTORY.

A. Overview Of United's Unionized Work Force.

As of March 1, 2003, United has a total of approximately 76,000 employees worldwide, including approximately 72,000 U.S.-based employees.[14] United's U.S. collective bargaining relationships are subject to the Railway Labor Act. As set forth below, about 85% of United's U.S.-based employees are represented by unions under eleven separate collective bargaining agreements:

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[14] These figures do not include employees who work for the three independently owned and operated United Express partners (Atlantic Coast Airlines, Sky West and Air Wisconsin).

Exhibit 26. UNITED'S WORK FORCE.

Craft or Class	No. of Employees	Union	Contract Duration	United Exhibit No.
Pilots	8,200	ALPA	10/26/00-09/01/04	300
Flight Attendants	18,100	AFA	10/01/97-03/01/06	400
Mechanics & Related	10,300	IAM	03/14/02-07/11/05	400
Fleet Technical Instructors and Related	150	IAM	11/10/00-04/12/04	401
Maintenance Instructors	58	IAM	12/20/00-07/11/05	402
Ramp (fleet service) and Storekeepers (stock clerks)	8,200	IAM	05/14/02-10/31/04	430
Public Contact Employees (PCE) (passenger service and reservations agents)	13,000	IAM	05/14/02-10/31/04	431
Food Service Employees	187	IAM	05/14/02-10/31/04	432
Security Officers	67	IAM	05/14/02-10/31/04	433
Dispatchers	173	PAFCA	07/12/00-12/31/04	700
Meteorologists	18	TWU	12/01/00-05/31/05	—
Engineers	359	IFPTE	No Contract[15]	—
Salaried[16]	2,500	Non-Union	—	—
Management	6,500	Non-Union	—	—
International Non-Management	4,100	Non-Union	—	—
TOTAL	**71,902**			

United's three largest unions are ALPA, AFA and IAM. The IAM represents a total of nearly 32,000 United employees in the United States under seven collective bargaining agreements. IAM District 141-M represents the Mechanics and Related Employees, Fleet

[15] The International Federation of Professional and Technical Employees ("IFPTE") was recently certified as the representative of United's professional engineers. 30 N.M.B. 24 (2002). Bargaining on a first contract has not yet begun.

[16] Salaried employees are primarily non-exempt administrative staff, *i.e.*, office and clerical.

Technical Instructors and Related Employees, and Maintenance Instructors.[17] IAM District 141 represents the Public Contact Employees, Ramp and Stores Employees, Security Officers and Food Service Employees of United. IAM District 141 also represents approximately 450 employees who work under a collective bargaining agreement at United's subsidiary, Mileage Plus, Inc. ("MPI").[18]

B. United Bargained Hard With Its Unions To Try To Achieve Labor Contract Changes Necessary To Save The Company.

United has sought consensual labor cost reductions from its unions almost continuously since the Fall of 2001. These efforts culminated pre-bankruptcy in an agreement for $5.8 billion in reductions spread over 5 and one-half years, which were built into United's application for loan guarantees with ATSB. On December 4, 2002, however, the ATSB voted not to approve United's proposal. The ATSB concluded that United's revenue projections were too optimistic and that, in any event, the Company could not sustain its cost structure even with $5.8 billion in labor cost reductions. The ATSB's decision left the Company with no choice but to enter Chapter 11.

Like the ATSB, the Company's DIP lenders cast doubt on United's revenue projections. To obtain financing, United was required to reformulate its financial projections with significantly lower revenue forecasts and appreciably higher cost reductions than those submitted to the ATSB. The result is that United requires much deeper reductions in all aspects

[17] On March 7, 2003, the Aircraft Mechanics Fraternal Association ("AMFA") filed a petition with the National Mediation Board seeking to represent United's mechanics and related employees. IAM General Vice President of Transportation Robert Roach stated that "AMFA's intrusion at this critical stage introduces potentially fatal distraction into an already precarious situation." Press Release, IAM Transportation Department, *AMFA Raid Threatens UAL's Future* (March 7, 2003).

[18] Because Mileage Plus, Inc. ("MPI") has its own collective bargaining agreement with the International Association of Machinists, MPI joins United Air Lines, Inc. in this motion to reject.

of its operations, including labor, to stay in compliance with the DIP covenants, exit from bankruptcy <u>and</u> stay out of bankruptcy.

Working consensually toward this end with the leadership of its unions became the Company's highest post-filing priority. Senior executives flew to Boston to meet with the unions' financial advisors on December 10. At that meeting, the Company discussed its business plan and highlighted the need for $2.4 billion in annual labor cost reductions. The Company also detailed the main drivers behind this figure: the more modest revenue projections, the capital market feedback, and the need to achieve clear financial imperatives. United made the same presentation to the leaders and/or negotiating committees of each of United's unions on December 12.

On December 11, United began sending the unions the financial models used to formulate the Company's business plan as well as the information provided to the DIP lenders and the ATSB. United walked the union advisors through these models during a December 15 conference call, answering all the questions they raised. Three days later, the Company sent the unions additional information about the models.

On December 13, United presented each of its unions' leaders and/or negotiating committees with a "Section 1113 Proposal" that detailed United's proposed changes to that union's collective bargaining agreement. The Company sent valuations of these proposals to each union by January 3, and has since updated these numbers as necessary to ensure they are based on the most current information. United also provided detailed back-up information explaining how it valued each item on the term sheets. On January 31, United sent the unions its 277-page Plan for Transformation, an updated long-term financial plan, and a cash flow forecast.

On February 12, United alerted its unions that, because of changed economic conditions and a number of refinements to the Company's analysis, the labor cost reductions necessary to achieve the Company's financial benchmarks now totaled an annual average of $2.233 billion in unionized labor expenses, coupled with $331 million per year in salaried and management reductions. The Company also provided specific savings targets for each union and gave each union United's term sheet proposals for all the other unions. The Company responded to questions about the revised total and allocation in a letter to each union on February 20. The Company explained that the total was somewhat higher than the original $2.4 billion estimate in part because of more aggressive cost-cutting by other network carriers, which in turn required United to make deeper cuts to become competitive.

At meetings, in telephone calls and in letters with and to each union, United has stated its desire to bargain around the clock and has met dozens of times with its unions. United has sent to all of its unions boxes of information and gigabytes of electronic data containing detailed back-up relating to its contract proposals, financial condition, and business plan initiatives. United has explained its low-cost carrier proposal and answered hundreds of benefits questions. United has provided volumes of information in response to constant union requests. In fact, to move negotiations along, United has run alternative work rule scenarios suggested by its unions, including a number of different monthly maximum hour and minimum days off combinations for ALPA and different kinds of part-time ramp worker rules for IAM 141, as well as their counterproposals. In short, there can be no doubt that United satisfied the unions' need for information.

Detailed descriptions of the negotiating histories and information sharing with each of the unions are set forth in the following declarations attached to this Memorandum:

Declaration of Charles Vanderheiden (ALPA) (Ex. G); Declaration of Frank R. Colosi (AFA) (Ex. H); Declaration of Susan Franzella (IAM 141M) (Ex. I); Declaration of Irene Gaughan (IAM 141) (Ex. J); Declaration of H. Gerry Anderson (Ex. K); and Declaration of Michael Dingboom (Ex. L).

VII. THE CHANGES PROPOSED BY UNITED.

United presented its final Section 1113(c) term sheets to each of its unions at various points over the last week. The Company explained that, in the absence of consensual agreements before March 17, these proposals would be the ones submitted to the Court as the modifications necessary for United's successful reorganization.

By necessity, United's proposals are detailed and complex. The costs of the Company's CBAs are not attributable just to high wages or a few work rules that lend themselves to one- or two-page summaries. Instead, the CBAs impose an extensive web of work rules and scope provisions, many of which are unique to the airline industry and some of which exist only at United. Regrettably, it follows that the proposed changes to the CBAs are almost as numerous and almost as complex. Accompanying this memorandum are eight Appendices that navigate through the CBAs and the proposals pertaining to each. To provide the Court with a "road map" of the Company's proposals, Exhibit A to this Memorandum summarizes all the changes necessary to each of the CBAs for United to execute its Plan for Transformation. For each material change, Exhibit A lists the current provision, how United proposes to modify the provision, the expected annual cost savings from each change, and the pages in each Appendix where a more in-depth discussion can be found. Appendices B through G provide much greater detail and, on a CBA-by-CBA basis, explain the rationale for each and every change United requests, with the exception of benefits.

United explains its proposed common benefits plan and the CBA changes needed to implement it in Appendix A. Appendix H details United's low-cost initiative and, in particular, clarifies that United has not asked its employees to blindly accept unspecified terms of employment at the low-cost carrier. Quite the opposite, United has detailed to its unions (i) the proposed scope and structure of the low-cost product, (ii) the changes to the existing CBAs that are required to facilitate the creation of the LCC, and (iii) the principal terms and conditions of employment for the LCC workforce, including wages and benefit programs that are competitively benchmarked to those offered by Air Tran, ATA, Frontier and JetBlue.

A. United's Proposed Contract Modifications Are Necessary For The Company To Reorganize Successfully.

Although some of the changes United proposes may seem minor standing alone, when combined they achieve the savings required to satisfy the covenants in the DIP loan and to reorganize successfully as a competitive airline for the long term. In the radically changed industry environment, the Company can no longer endure expensive labor contracts that inevitably require divisive concessions whenever the Company is caught in an economic downturn. *See* Informational Brief at 15 - 16. Indeed, operating within the constraints of this vicious cycle has put the jobs of all United employees at risk. The modifications proposed by United will put an end to this cycle. These changes will provide United employees with stable jobs at an efficient, vibrant and sustainable enterprise. To this end, United framed its contract proposals around four guiding principles: productivity, flexibility, durability and equity.

B. United's Proposals Will Increase The Productivity Of Its Workforce.

Archaic work rules, many of which were negotiated during the regulated era, limit the productivity of United's very capable employees. Through an ever-continuing series of negotiations, additional rules were incrementally layered on top of each other so as to culminate

in hidden costs for the Company's operations that are no longer affordable. United will continue to offer its employees fair and market-appropriate compensation, but the productivity of the Company's work force must improve if United is to be able to compete successfully and ultimately emerge from bankruptcy.

United's pilots, for example, on average work 43 to 45 "block hours" per month.[19] Declaration of Captain Henry Krakowski (attached to App. B at Ex. 304) ¶ 4. Other airlines in the industry are able to schedule considerably more flying time for their pilots. Having such low pilot productivity places United at a serious competitive disadvantage. United estimates that its proposals would increase its average pilot flying time closer to the levels maintained by Continental and Southwest. *See* Informational Brief at 54.

United proposes to achieve this greater efficiency in part by modifying certain pilot and flight attendant ratios-in-guarantee ("RIGs"). These complex formulas guarantee pay and credit time for work or time spent away from home base, regardless of the block hours actually flown. Receiving credit for hours not worked limits productivity because the CBAs also set maximums on the amount of time United can use its pilots and flight attendants. Modifying some of the applicable RIGs, increasing the maximum hours and reducing days off will make United's on-board employees far more productive.

United also proposes to eliminate "vacation overrides" that allow pilots and flight attendants to stretch out scheduled vacation time. An "override" occurs when a vacation overlaps with any part of a scheduled ID, which is a clustered schedule of consecutive days of

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[19] "Block hours" are the amount of time that elapses between the disengagement of the brakes at the departure gate and the reengagement of the brakes at the arrival gate.

flying time.[20] When that happens, the employee does not have to fly any part of the ID, and yet receives full pay for the entire trip. *See* ALPA CBA 11-C. Thus, with a little planning, a more senior pilot or flight attendant can take an entire month off by bidding for a flight schedule in which all of the IDs overlap a previously scheduled vacation of a shorter duration. *See* Information Brief at 11 - 12.

United's CBAs also require the Company to pay for pilots and flight attendants to stay in downtown hotels as opposed to less expensive hotels near airports where layovers are over 14 and 13 hours respectively. *See* ALPA CBA 4-B-1-b(5); AFA CBA 6.B.5. United also employs 472 skilled mechanics at 18 stations whose primary duty is to perform "receipt and dispatch" (*e.g.*, pushback) duties that easily could be performed by lower-paid employees, as they are at many other United stations and at most other carriers. *See* App. D at 4 - 5; Declaration of Sherri Kawell ("Kawell Decl.") (attached to App. D at Ex. 503) ¶ 10. For instance, having United's existing ramp or customer service employees perform receipt and dispatch during their downtime could save nearly $40 million annually. App. D at 2.

As a final example of productivity limitations, United suffers a cost disadvantage in ramp operations because the current agreement places strict limits on how many ramp employees can be part time, the number of hours part-timers can work in a week, and how close together United must set part-time shifts. App. E at 3 - 4. In addition, United cannot lay off a single full-time ramp employee at a location while any part-time ramp employees remain on the

[20] As defined by the pilot CBA, an "ID" or "trip" is a "series of flight segments, starting with the initial departure from the pilot's domicile and ending with the final arrival at the pilot's domicile, which are combined as a package for preparation of pilot schedules or for assignment to a pilot." ALPA CBA 2-R.

payroll at that location. Relaxing these restrictions will result in enhanced productivity and create another means of achieving cost savings for United. App. E at 1.

C. United's Proposed Contract Changes Will Create The Flexibility Needed To Adapt To An Unpredictable Revenue Environment.

United's contract proposals seek to eliminate the restrictions embedded in the Company's CBAs that impede management's ability to make and implement strategic decisions with the speed and flexibility required in a rapidly evolving marketplace. These restrictions prevent management from reducing costs and adjusting the size of the work forces even when necessary for the Company to adapt to changing circumstances. Moreover, the Company's CBAs prohibit United from taking advantage of revenue and profit-enhancing opportunities, even when they would not result in the furlough of any existing employees.

Among the more restrictive provisions are no-furlough provisions applying to all pilots who are past their initial probationary period and to most IAM-represented employees hired before late January 1994. *See* ALPA CBA 1-H-1; IAM Mechanics CBA Letter 94-5M. United cannot furlough these employees for economic reasons, crippling the Company's ability to respond effectively to changing economic or competitive conditions. ALPA CBA 1-H-5-d.

United's pilot CBA also limits the Company's ability to take advantage of a variety of different business opportunities that could improve United's profits and the strength of its network. App. B at 26 - 34. For instance, the pilot CBA imposes a host of artificial restrictions on RJs, such as limiting the size of RJs and the routes they can fly. App. B at 30 - 31. The pilot contract also limits United's ability to enter into code-sharing and other revenue and profit sharing agreements. *Id.* at 27 - 30. These restrictions impair management's ability to adapt as necessary to economic downturns and changing market conditions. Without such

limitations, United could fully implement its Plan for Transformation and add millions of dollars in revenue.

United's collective bargaining agreements with its IAM-represented employees also limit United's ability to outsource functions such as cabin cleaning and handling cargo that could be performed less expensively but equally well outside the Company. *E.g.*, IAM CBAs, Art. 2. For example, United is required to pay members of IAM 141M up to $27.89 per hour in wages and benefits to clean the interior of aircrafts even though the Company could out-source this non-core function at $6.50 - $10.50 per hour for a total savings of $34 million per year. *See* Declaration of Barbara Forrest ¶ 8 (attached to App. D. as Ex. 506). Removing such outsourcing restrictions on non-core activities is critical to the success of United's reorganization. Using more efficient outside vendors would save millions of dollars each year without any loss of quality or impact on safety. *Id.*

Finally, the ALPA and IAM CBAs prohibit United from disposing of or closing a wide array of assets, including any of the Company's pilot bases and three maintenance centers. *See* ALPA CBA "US Airways Code Share Letter"; IAM Mechanics CBA, Art. 2.F. The Company's business plan calls for streamlining operations by concentrating pilot bases and maintenance hangars into fewer, more efficient facilities. *See* App. B at 39; App. D at 11 - 12. Consolidating facilities would save millions of dollars.

D. The Proposals Provide Durable Savings Necessary For United To Emerge From Bankruptcy As A Viable Entity.

United's labor cost restructuring cannot be another expedient, short-term fix to tide the Company over until another economic downturn. The capital markets are demanding enduring changes that will allow United to recover its financial strength. United has proposed a

term of six years for its new CBAs, which is the term of the agreements recently entered into by many of the same unions in the US Airways bankruptcy.

Concentrating on work rules and scope provisions also makes United's proposals more durable. Historically, reductions in wages quickly "snap back" when good times appear to be returning, leaving the airline vulnerable to a cycle of limited profits followed by deep losses that recur the next turn in the business cycle. Only by remaining consistently profitable can United avoid repeating the demoralizing process of furloughs and downsizing that the Company is now necessarily enduring to survive. Permanent changes in the Company's work rules and scope provisions that will result in enhanced productivity and profitability are the only way for the Company to achieve lasting stability and growth.

For the same reasons, United proposes to establish a profit-sharing program that, in lieu of sharp wage increases that inevitably lead to later concessions, will fairly reward United's loyal employees for their efforts in saving the Company. This results-oriented approach is both prudent and necessary, because seeking too little in the way of concessions now in lieu of a share of potential profits in the future poses far too great a risk of bumping up against the DIP covenants and, beyond that, of falling short in restructuring the Company in a fundamental manner of the sort required to exit bankruptcy successfully.

E. United's Proposals Treat All Employees Equitably And Fairly.

The proposals also fulfill United's fourth principle of ensuring that all United employees are treated fairly and equitably. United's proposals seek to allocate the savings to be achieved in a fair manner across the different employee groups and labor contracts. Because productivity restraints in some of the CBAs have multiplied more quickly over the years than in others, there are necessary differences among the unions in the proposed balances between

productivity enhancements and wage or benefit reductions. It is the variations in the CBAs' wages, work rules and scope provisions that drive the differences in the Company's proposals:

Exhibit 27. **SUMMARY OF SAVINGS SOUGHT BY UNITED.**

($ in Average Annual Thousands)

Cash Savings, 2003-2008	Direct Compensation Items	Benefits	Productivity and Other	Total	Percent
ALPA	$683,000	$269,000	$166,000	$1,118,000	43.6
AFA	130,000	111,000	72,000	314,000	12.2
IAM 141M	160,000	71,000	118,000	349,000	13.6
IAM 141	215,000	118,000	112,000	445,000	17.3
PAFCA	3,186	1,210	62	4,458	0.2
TWU	434	101	28	563	0.0
SAM	172,000	61,000	102,000	334,000	13.0
TOTAL[21]	$1,364,000	$631,000	$570,000	$2,565,000	100.0

Note: Based on Mainline ASMs as of Dec. 9, 2002 and Projected Headcounts as of January 2003 (ALPA), November 2002 (IAM), January 2003 (AFA), mid-year 2002 (PAFCA), mid-year 2002 (TWU) and January 2003 (SAM).

The overall savings may eventually be greater than these targets as United transitions certain routes within the network from the mainline to the low-cost carrier (by approximately $5 million per 1 percent of network capacity).[22]

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[21] The numbers in Exhibit 27 may not add exactly due to rounding.

[22] In addition, the savings that United will actually secure from its proposed modifications as of May 2003 will differ from those set forth in Exhibit 27 because ASMs have been reduced since December 9 and employment levels have dropped (by virtue of voluntary retirements, furloughs permitted by the CBAs and other measures). The Company is valuing its proposed modifications based on this "snapshot" of the Company at a prior point in time as an accommodation to the unions' insistence upon being provided with fixed targets for savings and fixed allocations. For instance, United has calculated that its proposed wage reductions for flight attendants will save $130 million per year based on a projected headcount of approximately 18,000 flight attendants as of January 2003. Yet because 900 flight attendants have been furloughed since then, the savings to be realized from the Company's proposals will be less (because not as many flight attendants will be absorbing the proposed reductions). For the purposes of the negotiations and these proceedings, however, the Company will fully credit the AFA with the earlier and larger figure.

United did not begin with any pre-set contribution or allocation targets among its unions. Instead, the Company focused on proposing changes to its labor contracts that are necessary for United to execute its business plan and emerge from bankruptcy as a healthy entity. Relatively higher wages and more restrictive work rules enjoyed until now by certain groups meant that those groups were unavoidably slotted for a proportionately larger share of the sacrifices necessary for the Company's reorganization. For instance, United proposes to implement a number of common scheduling rules and equal per diem rates for pilots and flight attendants. *See* App. B at 14 - 16, 51 - 52; App. C at 13 - 14, 18 - 19, 24 - 25, 36 - 42. Protest as either group might, this is in no way unfair or inappropriate; to the contrary, this is what equity requires.

F. United's Proposal For A Common Benefit Plan.

United also seeks equity through the implementation of common benefits for <u>all</u> United employees – union and non-union alike. Declaration of Virginia Grady ("Grady Decl.") (attached to App. A at Ex. 200) ¶ 10. United currently sponsors more than fourteen employee benefit plans, incurring large administrative costs. United proposes common benefit terms for all employee groups, which will achieve three objectives: (1) to offer an affordable benefit package that continues to exceed the average benefits among U.S. employers; (2) to simplify administration and reduce related costs; and (3) to avoid competition among employee groups (and unions) and efforts by any one group to leapfrog the benefits available to other United employees.

United also has proposed a common pension plan as a key part of its effort to cope with a massive – and unaffordable – future funding obligation facing the Company. Unless steps are taken <u>now</u> to reduce unaccrued liabilities, the Company will be required to pour an estimated \$5.5 billion to \$7.5 billion into those plans over the next six years, beginning in the

third quarter of 2003. Declaration of Tim Marnell ("Marnell Decl.") ¶ 9. To successfully emerge from bankruptcy and maximize its chances of doing so without having to address accrued pension liabilities as well, United must begin to reduce this cost burden immediately. *See* App. A, Section III(B).

VIII. UNITED HAS SATISFIED THE REQUIREMENTS OF SECTION 1113(c).

Section 1113(c) of the Bankruptcy Code permits a debtor who satisfies a number of procedural and substantive prerequisites to reject a collective bargaining agreement. After bargaining in good faith and sharing relevant information with its unions, the debtor must make proposals to modify its existing CBA that are "necessary to permit the reorganization" of the debtor. 11 U.S.C. § 1113(b)(1)(A). Ultimately, rejection is appropriate if the unions refuse to agree to the debtor's "necessary" proposals "without good cause" and "the balance of the equities clearly favors rejection." 11 U.S.C. § 1113(c). Courts generally have broken down the requirements for rejection into a nine-part test:

> (1) the debtor in possession must make a proposal to the union to modify the collective bargaining agreement;
>
> (2) the proposal must be based on the most complete and reliable information available at the time;
>
> (3) the proposed modifications must be necessary to permit the reorganization of the debtor;
>
> (4) the proposed modifications must assure that all creditors, the debtor and all the affected parties are treated fairly and equitably;
>
> (5) the debtor must provide the union such relevant information as is necessary to evaluate the proposal;
>
> (6) between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union;

(7) at the meetings, the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement;

(8) the union must have refused to accept the proposal without good cause; and

(9) the balance of the equities must clearly favor rejection of the collective bargaining agreement.

See, e.g., *In re Garofalo's Finer Foods, Inc.*, 117 B.R. 363 (Bankr. N.D. Ill. 1990); *In re American Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984); *In re Amherst Sparkle Mkt., Inc.,* 75 B.R. 847, 849 (Bankr. N.D. Ohio 1987). Although the debtor must ultimately establish each element by a preponderance of the evidence, the unions bear the burden of production on requirements five, seven and eight. *See In re Family Snacks, Inc.*, 257 B.R. 884, 892 (B.A.P. 8th Cir. 2001); *In re Mile Hi Metal Sys., Inc.*, 899 F.2d 887, 892 (10th Cir. 1990); *American Provision*, 44 B.R. at 909 (citing *In re Martin*, 698 F.2d 883, 887 (7th Cir. 1983)); *In re Texas Sheet Metals, Inc.*, 90 B.R. 260, 263 (Bankr. S.D. Tex. 1988).

United has satisfied each requirement. Since filing for bankruptcy, United has made proposals to each of its unions for labor cost reductions that would slow the Company's losses and give it a chance to return to profitability. The Company based these proposals on the most up-to-date information available, including capital market feedback regarding the Company's revenue projections. Throughout this period, United made its books and financial records available to the unions, revealing the dire state of the Company's finances. United repeatedly met with its unions to bargain in good faith over the proposals and will continue to do everything possible to reach consensual solutions sufficient to save the Company.

The proposed modifications are necessary for the Company to avoid the potentially disastrous results of defaulting on its DIP covenants, to bring its costs into line with revenues, and to exit from bankruptcy as a successful enterprise for the long term. United's

proposals treat all employees fairly, with differences in the proposed treatment of each union mostly reflecting differences in the costliness of the respective contracts. Other stakeholders, such as the Company's officers, salaried and management employees, aircraft lessors, and trade vendors, have already contributed substantially to United's cost-cutting efforts, making the requested labor reductions fair and equitable. *See*, *e.g.*, Fields Decl. ¶¶ 4 - 15; Carlson Decl. ¶¶ 4 - 5; Knight Decl. ¶¶ 4 - 7. Under these circumstances, the unions lack "good cause" for refusing to accept the changes that must be made to the CBAs for United to survive.

A. United Has Made Reasonable Proposals To Its Unions, Each Based On The Most Complete And Reliable Information Available.

United presented post-petition term sheets to each union specifying proposed modifications to the labor contracts on December 13. United derived its proposals from a business plan that incorporates feedback the Company received from the ATSB, its DIP lenders and the capital markets. In formulating its proposals, United used revenue and cost projections that the DIP lenders and ATSB had already scrutinized and tested, the Company's most recent cash forecasts, the best estimates of the distress impact and "bookaways" caused by the Chapter 11 filing, and evaluations of competitor responses. Based on these projections, United developed labor cost reductions that, when combined with the Company's non-labor initiatives, would provide the savings necessary to satisfy the Company's DIP loan covenants and allow United to exit (and stay out of) bankruptcy as an enterprise capable of competing for the long term.

B. United Has Provided Its Unions With All Of The Information Reasonably Necessary To Evaluate The Company's Proposals.

Consistent with its long-standing policy of opening its books to its unions,[23] United has provided the representatives of its unions all the models and data they need to evaluate the Company's proposals. United provided a complete set of its financial projections and models to each union at the start of the bankruptcy proceeding, and on January 31 sent updates based on the Company's Plan for Transformation. The Company hosted calls and meetings about these models, and provided additional information requested by union advisors. United has explained to its unions why the Company revised its prior revenue projections, what assumptions it used to calculate the distress impact of bankruptcy, and what savings and profit improvements the Company would obtain from non-labor initiatives. United's efforts prompted IAM 141 to tell its members over a month-and-a-half ago that United provided the unions with all the information they needed: "Our [economists and other professional] advisors now report that all requested information needed to cost and evaluate the plan and potential bargaining proposals have been furnished by the company."[24]

Throughout this process, United has sought to make information available as soon as possible. In addition, when any one union has requested information of interest to all unions, such as details about United's financial status or common benefits proposal, United has produced that information to all of its unions so as to make certain that everyone received everything,

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[23] Starting with the 1994 ESOP agreement, United regularly provided information to ALPA and the IAM on the Company's financial performance. In addition, during the 2000-2002 collective bargaining processes with ALPA and the IAM, United made available to all of United's unions the costing models and other information upon which United based its proposals; Company and union experts conferred regularly to resolve any disagreements on the costs or value of specific terms.

[24] Randy Canale, "To: District 141 Members at United Airlines," (Jan. 31, 2003), *available at* http://www.iam141.org/ual.htm.

regardless of which union asked for it. The Company has also done its best to respond to all union requests for information, such as valuing alternative proposals and providing back-up data. When requests for information were onerous, the Company negotiated compromises to provide the unions the information they truly needed.

Stated differently, United has done everything reasonably within its power to ensure that its unions have been provided full and complete data on which to base their decisions. Indeed, it was in United's own interests to do so. The hope was that, by providing this data to the unions, the necessity of United's proposals would be made clear, thereby increasing the likelihood of a negotiated resolution for the benefit of all concerned. This comprehensive sharing of information more than satisfies Section 1113's requirements. *See, e.g.*, *In re Bowen Enters., Inc.*, 196 B.R. 734, 741 (Bankr. W.D. Pa. 1996) (information-sharing requirement satisfied where debtor promptly provided union with cost analysis of proposed modifications and financial information the union requested); *In re Appletree Mkts., Inc.*, 155 B.R. 431, 438 (S.D. Tex. 1993) (debtor fulfilled duty by opening books to union and providing reports and other information enabling union to evaluate the debtor's proposal and formulate its own); *In re Big Sky Transp. Co.*, 104 B.R. 333, 335 (Bankr. D. Mont. 1989) (requirement satisfied where "the Debtor supplied its financial data and business plans to the union [and] met with union representatives and members to discuss and explain the data").

C. United Has Conducted Good-Faith Negotiations With Its Unions And Stands Ready To Continue Meeting With Them At Any Time.

As set forth above, United has engaged in negotiations with its unions over these proposed CBA changes. After having negotiated for months on the labor savings necessary to keep the Company out of bankruptcy, United began post-petition discussions with the unions' financial experts on December 10, 2002, the day immediately following its bankruptcy filing.

On December 13, United and the unions began negotiation sessions that have continued on every day when union representatives have made themselves available.

The modifications from the initial December 13 term sheets embodied in the proposal being presented to the Court today confirm that United has made every good faith attempt to meet the unions' concerns, short of compromising the cost reductions and profitability enhancements that are essential to the Company's reorganization. Among other things, United has demonstrated flexibility by adjusting, wherever possible, to the unions' suggestions regarding the Company's proposals.

In particular, United did not give its unions a "take it or leave it" proposal for a low-cost carrier. United originally proposed a low-cost product that would be a stand-alone, separate subsidiary with separate CBAs and separate seniority lists. In response to the reservations to this structure expressed by its unions, United proposed a solution designed to achieve durable labor costs for the LCC without separate CBAs and seniority lists. Moreover, United is not wedded to its proposal such that it will not consider additional proposals from its unions, the Creditors Committee or others on how best to respond to the competitive threat of LCCs. United's proposal leaves ample room to continue to explore alternative solutions. But United will most certainly require some such solution and the flexibility under its CBAs to implement that solution.

Company representatives have stood ready to meet non-stop with the unions regarding these and innumerable other issues in the hope of being able to negotiate a consensual agreement. Over the past three months, United has provided information requested by the unions

and participated in hundreds of hours of negotiations.[25] And United will continue negotiating with all its unions in the sincere hope that it can reach agreements so the Court will never have to decide this motion. In short, United has bargained with its unions for three months and provided voluminous and detailed information about its financial condition and why labor cost reductions are necessary; courts have approved rejection in far less compelling circumstances. *See In re Royal Composing Room, Inc.*, 62 B.R. 403, 409 (Bankr. S.D.N.Y. 1986) (four days between filing petition and delivering proposal; application to reject filed one day after proposal), *aff'd,* 78 B.R. 671 (Bankr. S.D.N.Y. 1987); *In re Century Brass Prods., Inc.,* 55 B.R. 712, 716 (Bankr. D. Conn. 1985) (four days between proposal and filing of application), *rev'd on other grounds,* 795 F.2d 265 (2d Cir. 1986), *cert. denied,* 479 U.S. 949 (1986); *In re Blue Diamond Coal Co.,* 131 B.R. 633, 644 (Bankr. E.D. Tenn. 1991) (proposal on same day the petition was filed).

D. The Proposed Modifications Are Necessary For United's Reorganization And Long-Term Success.

Section 1113 authorizes rejection of CBAs when the proposed modifications are "necessary to permit the reorganization of the debtor." The necessity factor is at the heart of the decision whether to permit rejection. *Garofalo's Finer Foods*, 117 B.R. at 371 (necessity "is most persuasive evidence of cause to reject"); *accord In re Kentucky Truck Sales, Inc.*, 52 B.R. 797, 806 (Bankr. W.D. Ky. 1985) ("the primary question in a balancing test is the effect the rejection of the agreement will have on the debtor's prospects for reorganization"). Although the Seventh Circuit has not yet addressed the issue, the Second and Tenth Circuits have clarified that

[25] Moreover, United negotiated for months prior to bankruptcy, reaching agreements with all of its unions for cost reductions that United hoped would stave off bankruptcy. These pre-petition negotiations further evidence the Company's good faith bargaining.

the debtor must prove "that its proposal is made in good faith, and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully." *Truck Drivers Local 807, Int'l Bhd. of Teamsters v. Carey Transp., Inc.*, 816 F.2d 82, 90 (2d Cir. 1987); *see also Mile Hi Metal Sys.*, 899 F.2d at 892-93. In other words, "'necessary' means a modification that will result in a greater probability of a successful reorganization than if the contract were allowed to continue in force." *In re Walway Co.*, 69 B.R. 967, 973 (Bankr. E.D. Mich. 1987); *see also Carey*, 816 F.2d at 89 (framing the issue of necessity as "whether rejection would increase the likelihood of successful reorganization").

And, while the Third Circuit in *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers*, 791 F.2d 1074, 1088-89 (3d Cir. 1986) adopted a narrower view of what "necessary" means, its interpretation has been almost uniformly rejected by other courts. *See Mile Hi Metal Sys.*, 899 F.2d at 892. Indeed, this Court has declined to follow *Wheeling-Pittsburgh* in the past. *See Garofalo's Finer Foods*, 117 B.R. at 373. So have other courts within the Seventh Circuit. *See, e.g., International Union, United Auto., Aerospace & Agric. Implement Workers, UAW v. Gatke Corp.*, 151 B.R. 211, 213 (N.D. Ind. 1991); *In re Indiana Grocery Co., Inc.*, 136 B.R. 182, 192-93 (Bankr. S.D. Ind. 1990); *In re Express Freight Lines, Inc.*, 119 B.R. 1006, 1014 (Bankr. E.D. Wis. 1990). This Court should likewise follow the Second Circuit's *Carey* standard.[26]

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[26] Moreover, even under the more restrictive standard of *Wheeling-Pittsburgh*, United's proposed changes still qualify as "necessary" under Section 1113. Under *Wheeling-Pittsburgh*, modifications are necessary if liquidation of debtor would result without the modifications. 791 F.2d at 1089. Liquidation is precisely what will happen if United does not begin to achieve the requested labor cost savings by May 1, 2003. The Company will soon violate its DIP covenants, which would permit the DIP lenders to foreclose on United's assets and leave United with no option but to liquidate. Thus, United's proposals satisfy any definition of "necessary." *See In re Nat'l Forge Co.*, 279 B.R. 493, 501 (Bankr. W.D. Pa. 2002) (finding necessary prong satisfied where debtor's secured lenders would liquidate the company without labor cost reductions).

Under the *Carey* standard, modifications are "necessary to permit the reorganization" if they are needed to secure the debtor's "ultimate future" by restoring the debtor to "financial health." *Carey*, 816 F.2d at 89. In other words, changes are necessary if, without them, the debtor cannot compete outside of bankruptcy for the long-term: "A debtor can live on water alone for a short time but over the long haul it needs food to sustain itself and retain its vigor." *Id.* at 89-90. "To hold that 'necessary' requires minimal changes in the collective bargaining agreement may well result in meaningless and unsuccessful reorganizations." *In re Valley Steel Prods. Co.*, 142 B.R. 337, 341 (Bankr. E.D. Mo. 1992); *see also Mile Hi Metal Sys.*, 899 F.2d at 892-93; *Appletree Mkts.*, 155 B.R. at 441-42; *Indiana Grocery*, 138 B.R. at 47; *Gatke*, 151 B.R. at 213 (concurring that the "Second Circuit's longer term focus, which encompasses the ultimate success of reorganization rather than merely the avoidance of immediate liquidation, is more consistent with the statute").

1. United's Proposed Changes Are Necessary Because Reorganization Will Not Be Possible Without Them.

United crafted its 1113(c) proposals to achieve the cost reductions, management flexibility, and profitability improvements required for the Company to exit bankruptcy without the need for a return ticket. Although United has remained open to union proposals to trade off or adjust one item against another, there are three bottom-line objectives from which the Company cannot waver:

First, United must reduce its labor costs to meet its DIP covenants. Indeed, United believes that the prospects for covenant relief from its DIP lenders (in lieu of additional interim relief) would be enhanced considerably if United and its unions could reach consensual agreements on the CBAs and thereby demonstrate that the Company is addressing its transformational and labor relations imperatives. If United violates its DIP covenants, the DIP

lenders will be entitled to foreclose on the assets that are essential for United's operation. This would place the Company at immediate risk of liquidation.

Second, to attract exit financing and to stay out of bankruptcy, United must transform from the carrier with the highest costs in the industry to a competitive carrier with a cost structure at the lower end of the major network carriers. United must also field a new product that is capable of prevailing on a sustainable basis in head-to-head competition with low-cost carriers. With a shrunken cost structure and a low-cost leisure product, United can achieve a sustained return on invested capital and an acceptable credit rating.

Finally, to secure long-term financial health, United requires durable changes to its collective bargaining agreements. United must reduce inefficiencies embedded in age-old CBA work rules, unlock the handcuffs on management's ability to adapt to a changed competitive environment, and institute a uniform benefits program and competitive wages for all employees. These changes are necessary for United to meet the long-term structural challenges and inherent downturns in this cyclical industry.

a. Absent Significant Short Term Labor Cost Reductions, United Will Default On Its DIP Covenants.

As set forth at pages 25 - 26 of United's Informational Brief, United made every effort to secure financing prior to filing for bankruptcy. Despite its repeated attempts, United could find no lender – not even the United States government agency charged with stabilizing the airline industry in the wake of September 11 – willing to extend it financing outside of bankruptcy. United was forced to secure access to capital in the form of an in-court DIP Credit Facility. But even with the protections of the Bankruptcy Code, the lenders remained concerned about United's extraordinarily high costs and, by design, conditioned their loan on various performance covenants that cannot be met without immediate and sizable labor cost reductions.

Unless the cost savings sought by United's Section 1113 proposals begin to take effect in May 2003, United will not be able to meet its EBITDAR requirements even if the conflict with Iraq were resolved today, entitling the DIP lenders to foreclose on United's assets. This alone proves that rejection is necessary to permit reorganization. *See Nat'l Forge*, 279 B.R. at 501 (finding necessary prong satisfied where debtor's secured lenders would liquidate the company without labor cost reductions); *Walway*, 69 B.R. at 973 (changes are "necessary" if reorganization success more probable with proposed changes than with existing contract).

b. Substantially Reduced Labor Costs And Increased Revenues Are Necessary To Meet The Short- And Long-Term Requirements Of The Capital Markets.

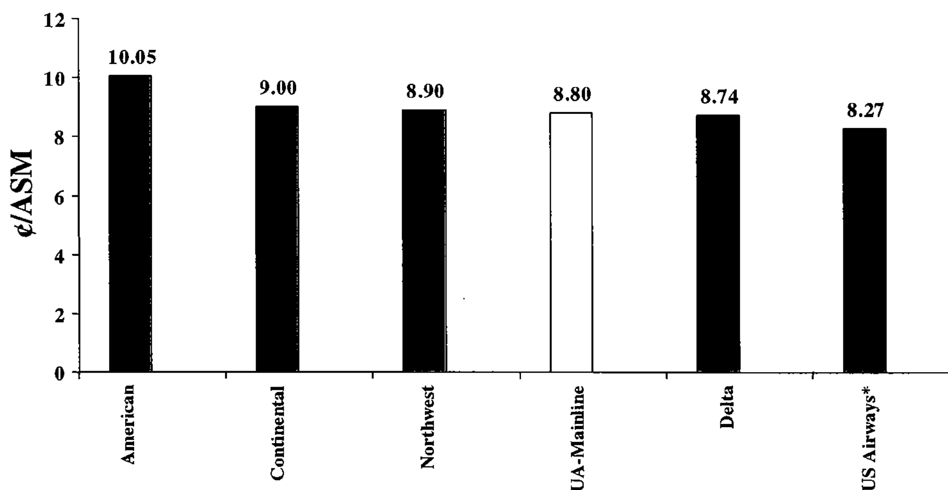
The second and equally fundamental reason why United must achieve its proposed labor cost reductions is that the Company can no longer survive with such high labor costs. Given the new economic realities facing the airline industry – *i.e.*, lower prices, more competition, and lower revenue – United can no longer afford the terms of its CBAs. Both the financial community and the ATSB recognized this undeniable fact. Even United's unions have acknowledged and warned their members that United's labor costs are unsustainable.[27] To emerge from bankruptcy and avoid a return trip, United must pass three financial criteria that its current CBAs condemn the Company to fail: achieving a competitive cost structure, generating

[27] In the words of the Association of Flight Attendants, the "mature segment of the industry, including United, is vulnerable unless a sustainable balance of revenue and expense is found." Association of Flight Attendants, *Why United is at Risk,* available at http://www.unitedafa.org/features/concessions_main.htm (December 1, 2002) (emphasis added). Similarly, a letter written by Randy Canale and posted the IAM District 141 website on November 25, 2002 stated: "While difficult to accept, this giant American corporation, with its large fleet, enviable routes and modern facilities is facing the most serious crisis in its long history," available at http://www.iam141.org/ual.htm#ualvote11-27-02 (December 24, 2002).

shareholder value, and attaining an acceptable credit rating. United's business plan satisfies all three criteria.[28]

(i) **Competitive Cost Structure.** United's mainline labor cost reductions, when combined with a competitive cost structure at its low-cost subsidiary, position United to compete with major network carriers for traditional mainline traffic:

Exhibit 28. TARGETED MAINLINE STAGE-LENGTH ADJUSTED TOTAL UNIT COSTS FOR 2005.[29]



*Notes: Includes significant projected cost reductions resulting from bankruptcy reorganization.

The same holds true for the LCC product on lower-yield routes:

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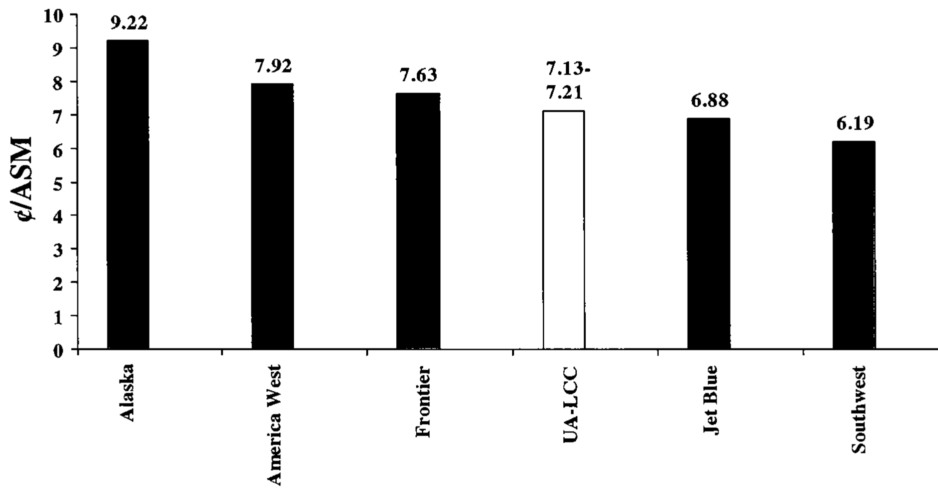
[28] Of these three criteria, the Company's plan considered the level of savings required to achieve a competitive cost structure to be the most important. By achieving a competitive cost structure, United will generate shareholder value and attain an acceptable credit rating. The minimum level of savings required to satisfy the latter two metrics, in contrast, would not be enough to yield a competitive cost structure.

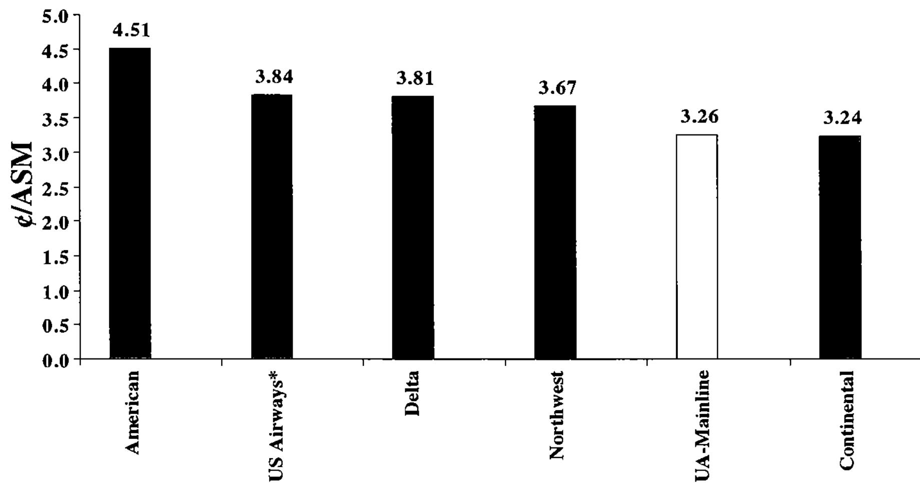
[29] The figures in both Exhibits 28 and 30 reflect 2002 unit costs according to U.S. DOT Form 41 data adjusted to a stage length of 1,341 miles, the average projected stage length of United's mainline in 2005. As a result of their recently-announced cost-cutting initiatives (pages 31 - 32), United anticipates that Delta and the reorganized US Airways will be able to hold their costs constant through 2005 and is therefore targeting the lower CASMs that these competitors would otherwise be able to exploit to United's competitive disadvantage.

Exhibit 29. TARGETED LCC TOTAL STAGE-LENGTH ADJUSTED UNIT COSTS FOR 2005.[30]



United can become cost competitive only by reducing its mainline labor costs to competitive levels:

Exhibit 30. TARGETED MAINLINE STAGE-LENGTH ADJUSTED UNIT LABOR COSTS FOR 2005.

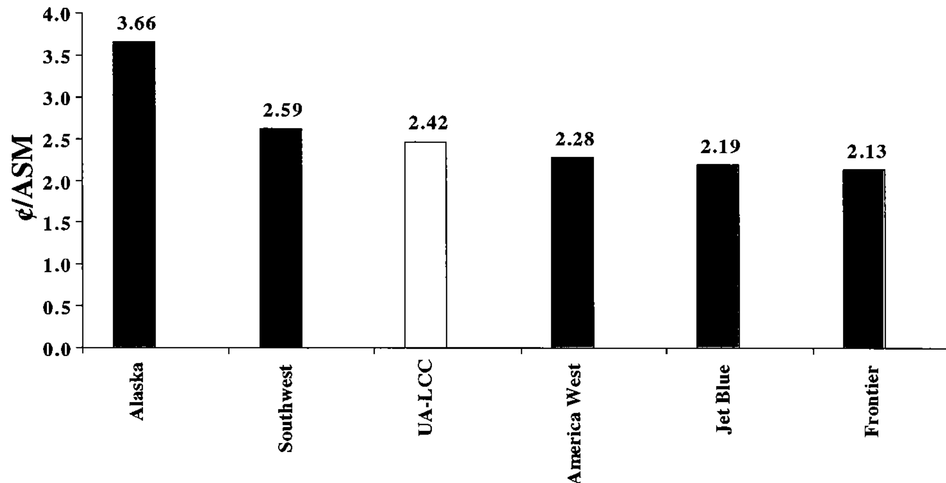


*Note: Includes significant projected cost reductions resulting from bankruptcy reorganization.

[30] The figures in both Exhibits 29 and 31 reflect 2002 unit costs according to U.S. DOT Form 41 data adjusted to a stage length of 902 miles, the average projected stage length of United's LCC product in 2005.

Competing head-on with low-cost carriers necessitates competitive labor costs on its low-cost product as well:

Exhibit 31. TARGETED LCC STAGE-LENGTH ADJUSTED UNIT LABOR COSTS FOR 2005.



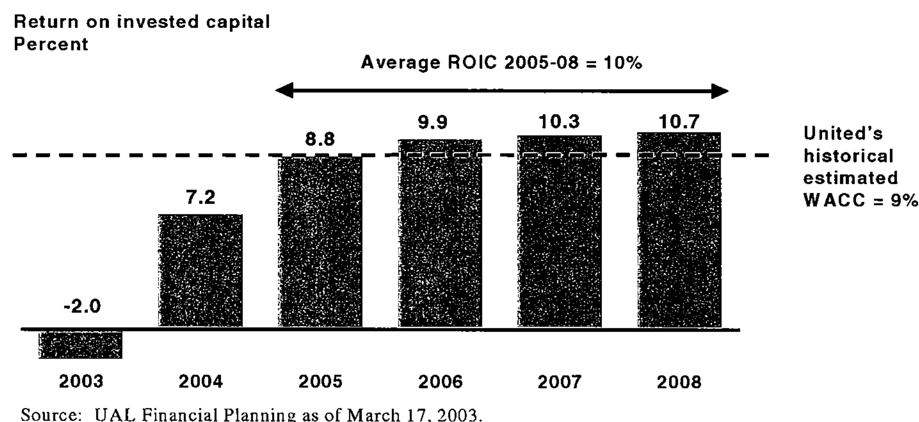
Without a competitive cost structure, United is left with a Hobson's choice. United can keep its fares high in an attempt to cover its costs, but lose increasingly price-conscious passengers to other airlines in the process. Or United can maintain its market share by matching fares at competitive levels, only to bleed money while its competitors remain profitable. It is only with the lower costs in the Company's proposals that United will be able to adjust its fares to fly competitively on all routes and still earn a profit.

(ii) **Creating Shareholder Value.** With the lower costs achieved by its CBA proposals, United can generate shareholder value. United's Plan for Transformation measures shareholder value by comparing return on invested capital ("ROIC") to its weighted average cost of capital ("WACC"), the metric considered to provide the most accurate gauge of a company's performance. *See*, *e.g.*, Tom Copeland, et al., VALUATION at 163-64 (John Wiley 2d ed. 1995). ROIC measures a company's cash return on its capital, while WACC measures the cost a

company has to pay for its capital. If a company's ROIC is greater than its WACC, shareholders will invest in the company because the value of their shares increase; if ROIC is less than WACC, then the return available to shareholders will be lower than what investors would generally expect to receive in return for an investment. With a ROIC greater than WACC, United can create an attractive value proposition for potential investors.

The proposed labor savings are an indispensable component of the Plan for Transformation that will provide United with a projected ROIC in excess of its WACC from 2005 to 2008. In other words, United will be able to earn profits on its capital that are greater than its costs to acquire that capital:

Exhibit 32. SHAREHOLDER VALUE WITH PROPOSED CHANGES.



Source: UAL Financial Planning as of March 17, 2003.

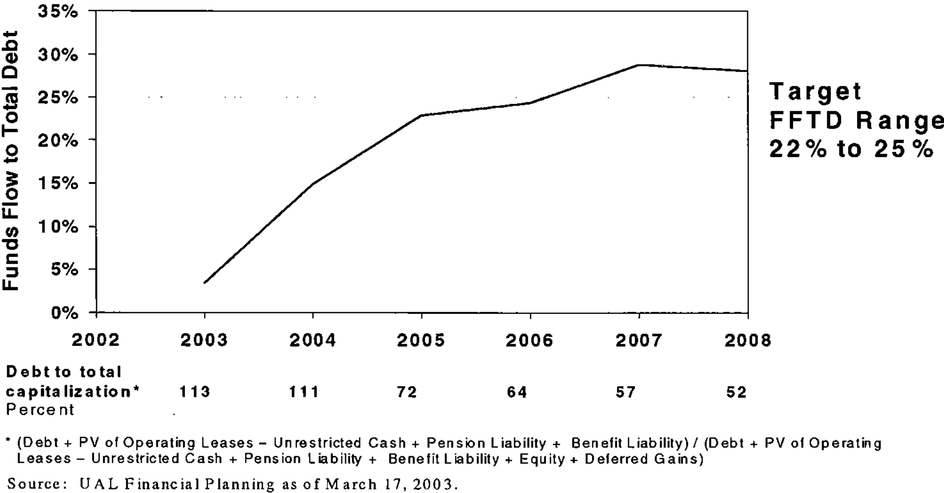
By achieving these earnings projections, United will generate shareholder value to the benefit of all of the Company constituents (including labor), attract capital (both to exit and stay out of bankruptcy) and remain competitive for the long term.

(iii) Acceptable Credit Rating. The savings in the Company's proposal also should place United on the cusp of an investment grade credit rating (BBB-/BB+). This credit rating will facilitate United's consistent long-term access to debt financing for its aircraft and other capital assets on better terms and at less expense. (Southwest, for example, is presently

rated an A by Standard & Poor's.) Of significant concern to potential creditors and investors, with a credit rating below BBB-/BB+, United's "capacity or willingness to meet its financial commitments" would likely be impaired by any "adverse business, financial, or economic conditions." Standard & Poor's, Long-Term Issuer Credit Rating BB.

A key determinant of airline credit ratings is the carrier's cash flow compared to its total debt. A carrier with a higher cash flow compared to its debt is less likely to default on its loans and thus will be a more credit-worthy borrower that is charged less by lenders. United's business plan provides a funds flow to debt ratio just above what the Company needs to obtain a near-investment-grade credit rating and thereby ensure its long-term access to debt financing on acceptable terms:

Exhibit 33. FUNDS FLOW TO TOTAL DEBT WITH LABOR SAVINGS.



In sum, the Company's plan transforms United into a viable competitor capable of attracting equity and debt investments. Achieving these financial imperatives is necessary for the Company's reorganization. Put simply, United's proposals make a successful reorganization possible, whereas leaving the present contracts in place (even with the interim wage relief extended on a permanent basis) would make it impossible to reorganize. Rejection under these

circumstances is appropriate. *Carey,* 816 F.2d at 89 (rejection appropriate if it "would increase the likelihood of successful reorganization"); *Walway*, 69 B.R. at 973 (same).

2. "Necessary" Changes Can Extend To Work Rules And Whatever Other Provisions That Must Be For The Company To Return To Financial Health.

The Company built its labor proposals from the bottom up. The Company did not base its term sheets on a predetermined allocation, such as percent of labor costs, and then work backwards to determine what terms should be cut. Instead, after setting the overall competitive cost target, the Company determined the "necessary" changes to each union's collective bargaining agreement based on three goals:

(i) Reducing inefficiencies that, for example, result in pay for time not worked;

(ii) Targeting industry-leading productivity levels by eliminating contract provisions that require United to employ more workers than it needs; and

(iii) Decreasing the cost of benefits and increasing equity among United's employee groups by establishing common health and pension plans.

After valuing the changes that served these goals, United reduced wages by the amount necessary to achieve a competitive cost structure.

United's approach meets the "necessary" requirement of Section 1113. "Necessary" changes need not be limited to wages alone. They can also include changes to work rules, benefits and scope provisions. *See* 11 U.S.C. § 1113; *Carey*, 816 F.2d at 86. Section 1113's authorization of modifications to "employees' benefits and protections" has been interpreted broadly. For example, the relief granted in *Carey* went well beyond wages and approved rejection based on proposals that included changes to health and pension benefits, overtime, workers' compensation and disability, and scheduling and assignment rules. *Carey*, 816 F.2d at 86. Like United today, the debtor in *Carey* needed these wide-ranging modifications

to increase efficiency and productivity, upgrade its levels of service, and thereby stop its losses and reorganize successfully. *Id.*; *see also In re Hoffman Bros. Packing Co.*, 173 B.R. 177, 187 (B.A.P. 9th Cir. 1994) (eliminating dues checkoff and seniority); *In re Maxwell Newspapers, Inc.*, 981 F.2d 85 (2d Cir. 1992) (rejecting a guarantee of lifetime employment); *Appletree Mkts.*, 155 B.R. at 439-40 (approving rejection of requirement that 50 percent of hours be worked by full-time employees in 5-day, 40-hour weeks).

United's proposed changes also achieve the flexibility the Company needs to carry out its business plan. Securing flexibility is "necessary" to adapt to a rapidly-changing industry. For example, in *Royal Composing Room*, the Second Circuit allowed the debtor to eliminate restrictions on management's ability to determine lay offs and work assignments. *In re Royal Composing Room, Inc.*, 848 F.2d 345, 350 (2d Cir. 1988). After noting that Section 1113 allows more than "bare bones" relief, the court held that the nature of the debtor's industry required "long-term flexibility in order to have a truly successful reorganization, one that results in a healthy company emerging from the process." *Id.* In particular, the Second Circuit emphasized that the debtor need not show "the necessity of every conceivable future use of the flexibility it now requires." *Id.* at 350.

Like the debtor in *Royal Composing Room*, United must be freed to respond expeditiously to the ever-changing economics and competitive dynamics of the airline industry. Contractual restraints over management decision-making that may have been affordable in better and different times – such as whether to furlough employees, outsource work, use more RJs or enter into strategic alliances – are no longer tenable. The Company's long-term survival hinges on its ability to adapt "[i]n an industry where rapid change has been the rule." *Royal Composing Room*, 848 F.2d at 350.

E. United's Proposed Modifications Treat All Stakeholders Fairly And Equitably.

1. Every Stakeholder Is Participating In The Sacrifices To Save United.

All of United's employees, and indeed all of the Company's stakeholders, are sacrificing equitably to save the Company. Equity under Section 1113 means "fairness under the circumstances, not a comparative dollar-for-dollar concession." *Walway*, 69 B.R. at 974 (citing *In re Allied Delivery Sys. Co.*, 49 B.R. 700, 703 (Bankr. N.D. Ohio 1985)). The purpose of § 1113(b)(1)(A) is to "spread the burden of saving the company to every constituency while ensuring that all sacrifice to a similar degree." *Carey,* 816 F.2d at 90. A debtor thus need only show that all stakeholders are sacrificing to some degree. *Id.*; *see also Texas Sheet Metals*, 90 B.R. at 269; *Indiana Grocery*, 138 B.R. at 48 (noting that, because "[c]omparing the specific burdens assumed by . . . differing parties is like comparing apples to oranges," bankruptcy courts are "left with only the general guidance that equity means fairness under the circumstances").

United's proposals fairly and equitably apportion the cost of saving United among its various unionized work groups, between union and non-union employees, and between the Company's employees and other stakeholders. The allocations of savings among the unions reflect differences in the number and severity of work rules and scope restrictions in their different contracts, as well as the groups' relative starting wages as measured against the competition. The law is clear that such an approach is fair and equitable. *See Allied Delivery Sys.*, 49 B.R. at 702-03 (reducing higher wages by a greater percentage is fair and equitable); *Indiana Grocery*, 138 B.R. at 48 (equalizing wages of two different unions was fair and equitable treatment, even though one union took a larger percentage cut than the other).

United's proposals also fairly and equitably apportion the burden between its unionized and non-unionized work forces. The Company's salaried and management employees

were already being paid appreciably below market when their salaries were cut by 2.8 to 10.7 percent on December 16, 2002. *See* Fields Decl. ¶ 10. Including their foregone 2002 merit raises, the total reductions range from 5.2 to 15.3 percent. The Company's officers' base compensation has been reduced by an average of 11 percent. Moreover, as part of its restructuring efforts, the Company began to eliminate almost one thousand positions among its management personnel starting in January 2003. Combined with a reduction of over two hundred managers during the last few months, United's salaried and management ranks on the payroll today will be less today than at any time since 1994. *Id.* ¶ 4.

Because of this downsizing, all of the Company's officers and management have assumed increased responsibilities in the reorganized company for considerably less pay. These sacrifices are thus on par with those being requested from the Company's unionized employees. Indeed, reducing management compensation any further would destabilize United at a critical juncture when the Company is implementing a new and ambitious business plan. *Id.* ¶ 8. *Cf. Carey*, 816 F.2d at 90; *Indiana Grocery*, 138 B.R. at 48 (finding management cuts fair and equitable where if their "salary were much lower, [they] would look for other employment"); *Allied Delivery Sys.*, 49 B.R. at 702 (reducing wages for all non-union employees on a graduated scale based on earnings was fair and equitable compared to union reductions); *Bowen Enters.*, 196 B.R. at 734 (holding that raising wages of non-union managerial employees was fair and equitable where those wages were lower than the wages of some non-managerial union employees).

Finally, the fiscal crisis affecting United has led to sacrifices by non-labor stakeholders, including:

- **Shareholders:** Following the tragic events of September 11, 2001, United indefinitely suspended payment of its $.05/share dividend. United later

suspended dividends on its preferred stock as well. Most significantly, shareholders have since lost almost all of the value of their stock.

- **Unsecured Creditors:** United's bankruptcy likely will leave its unsecured creditors with claims worth significantly less than the original debt owed to them by United.

- **Vendors:** Airbus and Boeing, United's aircraft frame vendors, and Pratt & Whitney and International Aero Engines, the Company's aircraft engine vendors, allowed United to defer $1.4 billion in aircraft and engine purchases in 2003 and 2004, even though the Company was obligated contractually to accept these aircraft.

- **Suppliers:** United's suppliers, who provide aircraft maintenance and parts, catering, and various services, accepted significant price reductions. United saved $80 million in price reductions or avoided price increases over 2001 and 2002, and will save more than $40 million annually from 2003 to 2005. United will use the Section 365 rejection process to obtain further concessions or switch to lower-cost suppliers, costing these suppliers even more money. This is in addition to the fact that many of these suppliers are also unsecured creditors who likely will lose much of the value of the debts owed them by United.

- **Aircraft Lessors:** As part of the Section 1110 process, United estimates that it will save $500 million in annual aircraft rental costs over the next five years. United's lessors will bear these losses.

- **Travel Agents:** United has eliminated the payment of base commissions to travel agents, costing agents $150 million in annual revenue.

These sacrifices leave no doubt that United has spread "the burdens of saving the company to every constituency." *Garofalo's Finer Foods*, 117 B.R. at 370. The only exceptions to this rule have been retirees. To date, United has not determined that it is necessary at this juncture to seek a distress termination of United's pension plans. Additionally, although United continues to analyze whether it will become necessary to seek to reduce retirees' medical benefits, United's present proposal does not include any such reductions. Circumstances may change, however, necessitating that the Company expressly reserve the right to revisit these issues as may be warranted by future developments.

2. United's Employees Will Share In The Company's Upside Through Profit Sharing And Incentive Plans.

Some of the unions have protested that United is seeking wage and benefit cuts that are deeper than necessary to restore United to the levels of profitability targeted in its Plan for Transformation. Quite frankly, United hopes that the unions are correct and that business passenger traffic and overall revenues rebound to those enjoyed in better times. To put its money where its mouth is, United is offering its employees a guaranteed share in the upside of the success that will be made possible by the concessions that United must ask of them today. All United employees will be eligible for profit-sharing payments based on the overall financial performance of the Company.

United will begin making such payments upon achieving the pre-tax profit margins set forth in its Plan for Transformation – specifically, 7 percent in 2004, 12 percent in 2005 and 13 percent in 2006 forward. Employees will be paid a fixed percentage of any pre-tax profits above these levels on a pro rata basis according to employee salaries. Payments will be made annually, and employees will have the option of receiving cash or a 401(k) deferral. This proposal is consistent with plans elsewhere in the airline industry and other industries.

United also proposes to supplement the profit-sharing plan with a Performance Incentive Plan that will entitle employees to incentive payments (*i.e.*, a multiple of a percentage of salary) based on the performance of the units in which they work. Performance will be measured according to categories such as financial performance (*e.g.*, pre-tax margin), operational performance (*e.g.*, on-time performance), customer satisfaction (*e.g.*, intent to repurchase) and employee engagement (*e.g.*, lost time). The targets will be established on a yearly basis and will be set at levels that account for the Company's financial condition and provide incentives that are appropriate under the circumstances. United intends to dedicate

hundreds of millions of dollars to this Performance Incentive Plan per year from 2004 - 2008, subject to achievement of the financial and other performance thresholds. United is also prepared to commit that the same performance criteria will be applied to unionized employees, non-unionized employees and executives in each unit.

F. The Unions Have No Good Cause For Refusing To Accept United's Proposals.

United does not dispute – indeed, it readily admits – that its unions have good reason to be upset about the economic realities that make United's proposals necessary. Bankruptcy was United's last choice, and the Company shares the disappointment of its unions that these steps are now necessary. But the necessity for a substantial overhaul of United's CBAs is beyond serious dispute, meaning that the unions' displeasure over the size of the concessions being requested by United does not give them "good cause" to reject United's proposals. A union cannot base its rejection "from the standpoint of its self-interest." Rather, everyone's focus must instead be placed on what is necessary to permit reorganization under Chapter 11:

> the Union may often have a principled reason for deciding to reject the debtor's proposal and which may, when viewed subjectively and from the standpoint of its self-interest, be a perfectly good reason. However, the court must review the Union's rejection utilizing an objective standard which narrowly construes the phrase "without good cause" in light of the main purpose of Chapter 11, namely reorganization of financially distressed businesses.

In re Salt Creek Freightways, 47 B.R. 835, 840 (Bankr. D. Wyo. 1985); *see also Kentucky Truck Sales*, 52 B.R. at 805 (holding that the "good cause" requirement must be interpreted narrowly); *Indiana Grocery*, 138 B.R. at 50 ("Though this stance might indeed benefit [the union] employees more than wage concessions if [the debtor] is indeed doomed to fail, this purely

selfish concern cannot be good cause for refusing to cooperate with a debtor's good faith efforts to reorganize.").

Courts repeatedly have recognized that where, as here, the proposed modifications are "necessary" and "fair and equitable," the unions' rejections lack good cause. *See Walway*, 69 B.R. at 974 ("The legislative history of § 1113 indicates that 'good cause' is not a barrier to rejection if the proposal contains the specified 'necessary' modifications."); *Allied Delivery Sys.*, 49 B.R. at 704 ("If the proposal is necessary and is fair and equitable...then the union's refusal to accept it on the basis that the proposal is unjust...is not for good cause."); *Amherst Sparkle Mkt.*, 75 B.R. at 853 (where "[t]he Union understood that the Debtor would not survive financially unless it received a certain level of concessions," but failed to produce "sufficient economic evidence or testimony to controvert the financially distressed position demonstrated by the Debtor," rejection was not for good cause).

United made its proposals in good faith based on the requirements of the capital markets and its business judgment as to how best to satisfy those requirements. Each line item of the Company's proposals represents a building block toward the success of the plan. For any union to suggest that a particular item in isolation is unnecessary to permit reorganization would amount to an improper attempt to deconstruct the plan bit by bit and avoid the union's obligation to act with good cause. "To determine whether a debtor's proposed modifications to a CBA are necessary, a court must focus on the total impact of the changes in the debtor's ability to reorganize, not on whether any single proposed change will achieve that result." *Appletree Mkts.*, 155 B.R. at 441; *see also Royal Composing Room*, 848 F.2d at 347-48 (rejecting union argument that CBAs cannot be rejected if any one part of the proposal is not necessary because "the focus should be on the proposal as a whole").

On balance, United is not seeking anything more than what is necessary for it to meet the DIP covenants, exit bankruptcy, and stay profitable for the long term. United is continuing to cut costs everywhere else (except for cuts that would impact the safety of its operations) and now must ask for its unionized employees to make up the difference in what the Company needs to reorganize successfully. In short, United's proposals treat all parties fairly and equitably, and the unions have no "good cause" to reject them.

G. The Balance Of The Equities Favors Rejection.

The balance of the equities also overwhelmingly favors the rejection of United's collective bargaining agreements. United must implement the terms in its proposals so it can continue to serve millions of customers and employ tens of thousands of workers. Denying United's motion would sound the Company's death knell.

In determining whether the balance of the equities favor rejection of a collective bargaining agreement, courts look to six separate factors:

(1) the likelihood and consequences of liquidation if rejection is not permitted;

(2) the cost-spreading abilities of the various parties, taking into account the number of employees covered by the bargaining agreement and how various employees' wages and benefits compare to those of others in the industry;

(3) the likely reduction in value of creditors' claims if the bargaining agreement remains in force;

(4) the likelihood and consequences of a strike if the bargaining agreement is voided;

(5) the possibility and likely effect of any employee claims for breach of contract if rejection is approved; and

(6) the good and bad faith of the parties in dealing with the debtor's financial dilemma.

See Carey, 816 F.2d at 93 (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 525-26 (1984)); *Texas Sheet Metals*, 90 B.R. at 272. Courts view each factor through the lens of Chapter 11 and its underlying purpose: "the primary question in a balancing test is the effect the rejection of the agreement will have on the debtor's prospects for reorganization." *Kentucky Truck Sales*, 52 B.R. at 806; *see Bildisco,* 465 U.S. at 527 (balancing of the equities must be undertaken in light of the ultimate goal of Chapter 11 – the success of the reorganization).

1. In The Absence Of Significant Labor Cost Reductions, United Risks Being Forced Into Liquidation.

Liquidation is a distinct possibility if United does not achieve its proposed labor cost reductions. Without labor cost reductions, United will violate its DIP covenants in May 2003. This will entitle the DIP lenders to foreclose on the assets essential to United's operation, forcing a shutdown and ultimately, liquidation. *See Indiana Grocery*, 138 B.R. at 50 (permitting rejection where denying motion would likely force the company into liquidation); *Kentucky Truck Sales*, 52 B.R. at 806.

The consequences of liquidation for all United stakeholders would be catastrophic. In particular, liquidation would mean that all of United's employees would lose their jobs. With the downsizing of most other carriers, many (if not most) of United's employees would be unable to find other jobs in the airline industry. Moreover, even those of United's employees able to find jobs at other airlines would go to the bottom of the seniority list at their new employers, likely with significantly lower pay and less attractive work conditions than exist in United's 1113(c) proposals.

The flying public would also suffer if United ceased operations. United is the second largest air carrier in the United States, transporting hundreds of thousands of passengers to destinations all over the world. United's disappearance would deal a staggering blow to a

national transportation system already weakened by the events of September 11 and their aftermath. United also plays an indispensable role in maintaining the competitiveness of the U.S. airline industry, again to the ultimate benefit of passengers.

2. United's Proposals Would Still Compensate The Company's Unionized Employees At Or Above Industry Norms.

In assessing the equities of United's proposals, this Court should bear in mind that, as a starting point, United's unionized employees enjoy pay and benefit levels under their CBAs considerably better than those of workers in comparable jobs in the United States and comparable to (if not better than) those of workers at most other U.S. airlines. The wage structure presently in place at United exceeds that of other major and national airlines[31] by 10 - 39 percent; mid-size airlines by 23 - 62 percent; and regional airlines by 58 - 189 percent. Even when compared to the largest airlines, United's unionized employees' wages exceed the average wage by 6 - 20 percent for all employee groups except flight attendants.

When the wages of United's unionized employees are compared with those paid in other industries, the differences are even more dramatic. Outside of the airline industry, United's current wages exceed those available to people who perform similar tasks in other industries by 56 - 93 percent. The numbers speak for themselves:

[31] For the purposes of this analysis, (1) the "major and national airlines" include Continental, Delta, American, US Airways, Northwest and Southwest; (2) the "mid-size airlines" include Air Tran, Alaska, America West, ATA, Frontier, JetBlue and Midwest Express; and (3) the "regional airlines" include Allegheny, Piedmont, Sky West, Comair, American Eagle, Atlantic Coast, ExpressJet and Air Wisconsin.

Exhibit 34. UAL WAGE PREMIUM AT CURRENT UAL RATES.

Employee Group	Majors and Nationals	Mid-Size	Regionals	Big-Six	Non-Airline
Pilots	37.1%	56.0%	188.8%	20.1%	Highest Paid
Flight Attendants	9.3%	23.2%	48.0%	-1.8%	N/A
Mechanics	17.8%	34.5%	58.0%	4.8%	93.7%
Utility	22.0%	42.2%	62.9%	9.1%	56.6% to 80.5%
Ramp	31.2%	54.4%	70.7%	11.6%	87.3%
Stores	27.4%	47.3%	65.7%	12.1%	57.3%
CSR	38.5%	65.1%	76.4%	16.5%	63.4%
RSR	37.0%	65.2%	N/A	14.2%	63.4%

Source: Airline Industry Relations Conference Data.

Thus, even at the reduced wage levels in United's proposals, most of United's employees will still be paid more than they would be able to earn if United was forced to liquidate. As summarized in Exhibit 38, United's proposed mainline wages will

- exceed the average wages paid at major and national airlines for utility, ramp, stores and public contact employees;
- will be essentially the same as the average for pilots, flight attendants and mechanics; and
- will exceed by 12 - 36 percent the average for mid-size airlines and by 32.3 - 105.1 percent for regional airlines.

United will pay its mainline employees at levels comparable to the pay received by employees at United's closest competitors and better than the pay received from employees at most other airlines, particularly as the other legacy carriers implement their own already-announced cost-cutting programs. *See* pages 31 - 37; Informational Brief at 59 - 64. Finally, as compared to similar employees in other industries, United's employees will still earn better wages.

Exhibit 35. WAGE PREMIUM AT PROPOSED UAL RATES FOR MAINLINE EMPLOYEES.

Employee Group	Majors and Nationals	Mid-Size	Regionals	Big-Six	Non-Airline
Pilots	-2.7%	10.8%	105.1%	-14.7%	Highest paid
Flight Attendants	-0.5%	12.1%	34.7%	-10.6%	N/A
Mechanics	2.4%	17.0%	37.5%	-8.9%	68.5%
Utility	6.2%	23.7%	41.7%	-5.1%	36.3% to 57.0%
Ramp	14.5%	34.7%	48.9%	-2.6%	62.9%
Stores	11.1%	28.5%	44.5%	-2.2%	36.9%
CSR	20.7%	43.9%	53.7%	1.6%	42.1%
RSR	19.4%	43.9%	N/A	-0.4%	42.1%

Source: Comparison of Term Sheets Against Airline Industrial Relations Conference Data.

United will pay the employees who work at the low-cost product fairly as well:

Exhibit 36. WAGE PREMIUM AT PROPOSED UAL RATES FOR LCC EMPLOYEES.

Employee Group	Mid-Size	Regionals
Pilots	-0.7%	83.8%
Flight Attendants	-3.4%	16.0%
Mechanics	13.8%	33.7%
Customer Service Agents	-4.2%	2.4%

Source: Airline Industrial Relations Conference Data.

In short, as painful as the Company's wage cuts will regrettably be, United's proposed wages are comparable with or exceed those available elsewhere. Moreover, the Company's employees will be more secure in these jobs as United adopts a sustainable, long-term cost structure that will make it unnecessary to lurch from crisis to crisis.

3. The Railway Labor Act And Bankruptcy Code Would Not Allow United's Employees To Strike.

A strike after rejection would spell the end of United, as the Company's employees themselves no doubt readily recognize. But even if a strike were a plausible scenario, the Railway Labor Act ("RLA") would operate in combination with the Bankruptcy Code to prevent the Company's employees from striking.

Congress passed the RLA "to prevent, if possible, wasteful strikes and interruptions of interstate commerce." *Detroit & Toledo Shore Line R.R. Co. v. United Transp. Union*, 396 U.S. 142, 148 (1969). The RLA imposes an obligation upon carriers and their unions "to make every reasonable effort to negotiate a settlement and to refrain from altering the status quo by resorting to self-help while the Act's remedies were being exhausted." *Id.* at 149.[32] As for Section 1113, it enables the debtor to reject its labor contracts in a way that permits the debtor's successful reorganization, "while protecting it from the union's refusal to accept the changes without a good reason." *Maxwell Newspapers*, 981 F.2d at 90.

Consistent with the interplay between the RLA and Section 1113, United has never intended simply to "abrogate" its CBAs and leave its employees without specific terms of employment or the protections of the RLA. To the contrary, United intends to abide by the proposals upon which its rejection motions were predicated and that this Court finds were refused by the unions without good cause. Especially under these circumstances, permitting a union to strike following a successful Section 1113 motion would undermine both statutes. A

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[32] Unlike the National Labor Relations Act ("NLRA"), which does not contain any general anti-strike policy, *see Buffalo Forge Co. v. United Steelworkers*, 428 U.S. 397, 409 (1976), the primary purpose of the RLA is to prevent strikes, *Texas & New Orleans R.R. v. Brotherhood of Ry. S.S. Clerks*, 281 U.S. 548, 565 (1930). Thus, an NLRA union's obligation not to strike arises only from its collective bargaining agreement, while a RLA union's obligation not to strike arises from the statute itself and does not depend on whether an agreement is in place.

strike would (i) permit a union to interrupt commerce after turning down a proposed contract modification "without good cause," and (ii) destroy the debtor's ability to reorganize. Although no cases have explicitly addressed the issue, the only way to give effect to both statutes is to require the unions to complete the RLA Section 6 bargaining process before engaging in self-help. Because the unions therefore should not be able strike post-rejection, rejection would not place United's ability to reorganize at risk.

4. The Risk Of Employee Rejection Damage Claims Is Superior To The Risks Associated With Liquidation.

Whether employees will have rejection damages claims is unsettled. Although some cases state or imply in dicta that employees may bring such claims,[33] the only court to have squarely addressed this issue has ruled that a Section 1113(c) rejection does not give rise to employee damage claims. *Blue Diamond Coal*, 147 B.R. 720 at 731 (rejecting union's damages claims because it was "difficult to believe that Congress provided for rejection of a collective bargaining agreement under § 1113, but neither defined the status of any claim which might result from that rejection nor provided a remedy for the breach cognizable under the Bankruptcy Code").

Even if cognizable, employee damages claims would not prevent the Company's reorganization. For one thing, any post-rejection damages claims would be pre-petition, general unsecured claims. *See Bildisco*, 465 U.S. at 531; *In re Continental Airlines Corp.*, 901 F.2d 1259, 1265 (5th Cir. 1990), *cert. denied*, 506 U.S. 828 (1992); *In re United States Truck Co.*, 89 B.R. 618, 624 (Bankr. E.D. Mich. 1988) (lost future wages stemming from rejection should be

[33] *See, e.g., Carey*, 816 F.2d at 93; *In re Moline Corp.*, 144 B.R. 75, 78-79 (Bankr. N.D. Ill. 1992), *Garofalo's Finer Foods*, 117 B.R. at 371.

considered unsecured debts). These claims would not prevent the Company from reorganizing, whereas unsustainably high labor costs unquestionably will.

Moreover, any employee claims would be small. To begin with, the duration for which employees can claim damages will be limited to the period until the Company would have ceased operations absent rejection. *See Continental Airlines*, 901 F.2d at 1260. In United's case, under the Company's current projections, this likely would be only a couple of months, given that the DIP Lenders will be entitled to foreclose in June 2003 if labor cost reductions are not achieved. And at worst, Section 502(b)(7) of the Bankruptcy Code would serve as a backstop limiting all claims to damages accruing in a one-year period following rejection. *See, e.g., In re N & T Assocs.*, 78 B.R. 285, 288 (Bankr. D. Nev. 1987) (CBA is an "employment contract" within meaning of section 502(b)(7)'s one-year damages cutoff); *Baldridge v. Continental Airlines Holdings, Inc.*, 257 B.R. 658, 663 (Bankr. D. Del. 2000); *In re Continental Airlines Corp.*, 64 B.R. 865, 873 (Bankr. S.D. Tex. 1986).

Further, for employees who are not currently covered by anti-furlough provisions, any damages they can claim from being laid off or furloughed will be limited to their severance or furlough pay. Because the Company could have furloughed or laid them off even under the contract, they cannot claim any additional damages. Finally, United could assert several affirmative defenses to rebut any far-reaching damages claims. In short, because the unions may not have any cognizable post-rejection damages claims, and even if they do such claims would be small, United's post-rejection reorganization efforts would proceed unhindered.

5. If United's Proposals Are Not Implemented, Creditor Claims Will Be Impaired Severely.

A number of factors will destroy almost any value creditors receive if United cannot change the terms of its CBAs. Without the labor cost reductions, United's DIP Lenders

will be entitled to foreclose on their collateral starting in May 2003. Because this collateral includes virtually all of the Company's assets that were not encumbered prior to bankruptcy, precious little (if anything) would be left for unsecured creditors. The interests of the unsecured creditors are plainly best served by United's remaining a viable going concern that can continue to generate revenue and return to profitability.

6. United Has Acted In Good Faith At All Times.

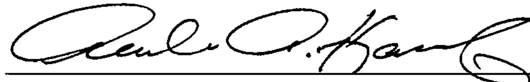
For the past eighteen months, United has made a good faith attempt to work with the unions to resolve the Company's financial crisis. Notwithstanding this filing, United will continue to move heaven and earth to try to forge a consensual resolution. United has been candid with its unions at all times, opened its books for review, and expressed a willingness to bargain at any time. United did everything possible to stay out of bankruptcy, filing only after it became painfully clear that United would run out of cash without DIP financing. With the very existence of United now hinging on the Company's obtaining changes to the terms of its collective bargaining agreements, United simply has no choice but to proceed to seek rejection at this juncture.

IX. CONCLUSION

With the earnest hope that continued bargaining with its unions will render a ruling from this Court unnecessary, the Debtors and Debtors-in-Possession respectfully request the authority to reject their collective bargaining agreements pursuant to 11 U.S.C. § 1113(c). Even with that authority, the Company will continue to make every effort to reach consensual agreements before exercising this right under the Bankruptcy Code.

Dated: March 17, 2003

Respectfully submitted,



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