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
	)	Hearing Date: January 15, 2003

ASSOCIATION OF FLIGHT ATTENDANTS' OBJECTION TO DEBTORS' MOTION FOR ENTRY OF AN ORDER PURSUANT TO 11 U.S.C. §§ 105(a), 363(b) AND 365 OF THE BANKRUPTCY CODE AUTHORIZING DEBTORS TO CONTINUE THEIR KEY EMPLOYEE RETENTION PROGRAM IN THE ORDINARY COURSE OF BUSINESS

The Association of Flight Attendants ("AFA"), a creditor of the above-captioned debtors and debtors in possession ("Debtors") and the collective bargaining representative for United Airline's 24,000 flight attendants, Debtors' largest employee group, hereby submits its objection to Debtors' motion to implement a key employee retention program ("KERP") pursuant to Bankruptcy Code Sections 105(a), 363(b), and 365. ("KERP Motion").

The proposed KERP is not a valid exercise of Debtors' business judgment, nor are its terms fair and reasonable. First, Debtors have not demonstrated a real need for the KERP because statistics provided by the company fail to substantiate Debtors' claim of a sudden spike in voluntary turnover. Second, Debtors' proposal comes at a critical juncture in negotiations with United's union-represented employees. At the same time as Debtors expect rank and file workers to forfeit a substantial percentage of their wages, they want to confer upon management employees significant improvements in their compensation and benefits. In fact, the concessions the Debtors' seek from

the flight attendants will, to a large degree, be consumed by the estimated cost of the KERP. It is obviously inequitable to finance an enriched severance and retention program with the wage reductions of employees whose average annual income, pre-concession, is less than $35,000. Debtors' failure to consult with labor regarding the KERP proposal -- or even consider the impact of the proposal on their flight attendants and other employee groups -- indicates a lack of proper business judgment. Lastly, based upon the specific terms of the KERP, the cost of this plan is not set or in any way circumscribed. In fact, it affords the Debtor a virtual blank check. For this reason alone the motion should be denied.

STATEMENT OF FACTS

I. Background Facts.

1. On December 9, 2002, Debtors filed a petition in this Court under Chapter 11 of the Bankruptcy Code. Simultaneous with the petition, Debtors filed the KERP Motion seeking authorization to implement a key employee retention program.

2. Also on the first day of these proceedings, Debtors filed a motion seeking authorization to obtain post-petition debtor-in-possession financing ("DIP Financing Motion"), which this Court granted. The Court's authorization permitted Debtors to enter into two DIP facilities, the "Bank One DIP" and the "Club DIP". The Bank One DIP is a stand alone amortizing term loan in the amount of $300 million that is immediately available to Debtors. DIP Financing Motion, ¶ 38. The Club DIP is a $1.2 billion loan, with $500 immediately available and the remaining $700 million becoming available as Debtors achieve certain financial targets. Id., ¶ 39.

3. Specifically, under the terms of the Club DIP, Debtors must meet certain monthly targets for cumulative consolidated EBITDAR (earnings before interest, taxes, depreciation,

amortization, and rent) beginning on February 28, 2003. Id., ¶ 39 and Ex. A at 17. In addition, Debtors must not exceed certain monthly targets for capital expenditures beginning March 31, 2003. Id., Ex. A. at 16-17. At all times, Debtors must maintain cash reserves of at least $200 million. Id., Ex. A at 18. These financial targets are "subject to a relatively small margin of error." Id., ¶ 42.

4. Failure to meet these financial targets could cause the DIP lenders to declare Debtors in default on their loan agreements. DIP Financing Motion, ¶ 42. According to the Debtors, a default, and the resulting foreclosure on collateral, "will spell the end for Debtors." Id.

II. The Status Of Labor Negotiations Between Debtors And Their Unionized Employees.

5. Also on the first day of these proceedings, Debtors filed an Informational Brief in which they asserted that reduction of Debtors' labor costs was a key element of Debtors' plan for a successful reorganization. Informational Brief, at 2-3, 11-16, 49-59. The Debtors avowed that "continued cooperation from the Company's unions will be critical" in order to achieve the labor savings sought. Id. at 46. Debtors also made clear, however, that they would seek to reject the employment agreements of their union-represented employees pursuant to Section 1113 of the Bankruptcy Code, if consensual agreements on labor-cost savings could not be reached. Id., at 3.

6. From the outset of these proceedings, Debtors and their unions have engaged in negotiations in an attempt to reach consensual agreement on the reductions in labor costs sought by Debtors. Nevertheless, Debtors were prepared to file a Section 1113(c) motion to set aside their union labor contracts on December 26, 2002.

7. United's unions, however, were able to secure an agreement from Debtors to postpone their Section 1113(c) filing, and instead seek interim wage relief from this Court pursuant to Section 1113(e). Accordingly, on December 27, 2002, Debtors filed a Conditional Emergency Motion To

Reject Their Collective Bargaining Agreements Pursuant to Section 1113(c) And To Set A Hearing For Interim Relief Under Section 1113(e) ("Conditional 1113(c) Motion").

8. As set forth in the Conditional 1113(c) Motion, Debtors will withdraw the motion and further agree not to refile the 1113(c) motion prior to March 15, 2003 if certain conditions precedent are satisfied. The conditions precedent include ratification by union membership of interim pay-cuts as follows: 29% from ALPA; 9% from AFA; 13% from PACFA; and 13% from TWU. In addition, upon ratification, Debtors will seek an order under Section 1113(e) for interim pay-cuts of 13% from IAM. Conditional 1113(c) Motion, at ¶ 5.

9. Debtors assert that satisfaction of these conditions would permit them to meet the financial targets set forth in the DIP financing agreements. Conditional 1113(c) Motion, at ¶ 3. If any of these conditions are not met, Debtors claim that they will immediately proceed to a Section 1113(c) hearing. Conditional 1113(c) Motion, at ¶ 5.

III. Terms Of The Proposed KERP.

10. The proposed KERP has two elements: (1) the Retention Plan; and (2) the Severance Plan. The features of each aspect of the proposed KERP are described below.

A. The Retention Plan.

11. According to the written terms of the Retention Plan, participation is open to all active, regular full-time and part-time management employees "who are formally selected by the Company and the Chief Executive Officer of UAL to be included in the Plan." KERP Motion, Ex. A at 1. As of December 14, 2002, Debtors had 7,555 active, regular full-time and part-time

management employees. Answers To Interrogatories, at 2.[1] The Retention Plan does not specify any criteria to be used in selecting employees for participation in the Plan.

12. Bonuses under the Retention Plan are to be calculated by assigning each employee chosen to participate to a tier, and multiplying the employee's annual base pay by the percentage amount for the appropriate tier. KERP Motion, Ex. A at 1. The tiers are as follows:

Tier	**Percent of Annual Base Pay**
I	75% - 125%
II	40% - 60%
III	25% - 35%
IV	5% - 20%

Id. For other than officers, assignment of a participating employee to a tier and selection of the corresponding bonus percentage "will be determined by, and in the sole discretion of, the Chief Executive Officer of UAL in light of each employee's mission critical skills, responsibilities and/or duties necessary to achieve the goals of the Company in successfully emerging from Chapter 11." Id. at 1-2. The bonus percentage for officers is to be determined by the Compensation Committee of the Board of Directors of UAL Corporation. Id. at 2. The Retention Plan sets forth no criteria for the assignment of bonus percentages to officers.

13. Unless otherwise specified in the written notice provided to each selected participant, bonuses under the Retention Plan, other than for Tier IV, will be paid in two installments: (1) 50% within ten months following the effective date of the Retention Plan; and (2) 50% upon the effective date of a confirmed plan of reorganization. Id. at 2. Tier IV awards are to be made in a single installment within ten months following the effective date of the Retention Plan. Id.

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[1] Debtors' answers to the interrogatories served upon them by AFA are attached hereto as Exhibit 1.

14. If a participating employee is terminated (other than for cause) or involuntarily transferred to a non-eligible job classification, the employee still receives the next scheduled bonus installment under the Retention Plan. Id. at 3. No bonus is paid to an employee who prior to the date the bonus is payable voluntarily terminates, voluntarily transfers to a non-eligible job classification, or is terminated for cause. Id.

15. The Retention Plan also provides for $2 million in bonuses to be distributed by the UAL Chief Executive Officer, in his sole discretion. Id. at 2. The Retention Plan provides no criteria to govern bonus awards from the $2 million pool.

16. As of the filing of the KERP Motion, Debtors estimated the cost of the Retention Plan at $34 million, including the $2 million discretionary fund. Friske Aff., ¶ 14. This estimate assumed that 603 employees would participate in the Retention Plan, specifically all of Debtors' officers, half of Debtors directors, and all of Debtors' section managers. Answers To Interrogatories, at 4. Two days before the deadline for this Objection, Debtors informed AFA that they had revised their estimate to $20.1 million, including the $2 million discretionary fund, assuming the participation in the plan of 306 unidentified employees.

17. The Retention Plan provides that: "The Company reserves the right, in its sole discretion, to amend or terminate this Plan at any time." KERP Motion, Ex. A at 3.

B. The Severance Plan.

18. The Severance Plan included in Debtors' proposed KERP has two components: (1) the Executive Severance Policy, as discussed in Debtors' KERP Motion at ¶¶ 59-63; and (2) traditional severance for management employees below the officer level, which is only discussed in the Affidavit of Douglas J. Friske at ¶ 16, filed in support of the KERP Motion. When Towers,

Perrin prepared their initial estimates of the cost of the Severance Plan, 10,412 management and non-management employees were eligible to participate in the plan. Answers To Interrogatories, at 6.

19. The Executive Severance Policy provides for the following severance benefits:

Component	**Executive Vice Presidents and Senior Vice Presidents**	**Vice Presidents**	**Directors**
Salary	2 years	2 weeks per year of service - Min: 6 months; Max: 15 months	2 weeks per year of service - Min: 3 months; Max: 12 months
Bonus	Pay actual bonus that would have been earned for the severance period	Pay actual bonus that would have been earned for the severance period	Pay actual bonus that would have been earned for the severance period
Flight/Healthcare Benefits	2 years	Equal to severance period	Equal to severance period
Pension Credit	Discretionary	Discretionary	Discretionary

KERP Motion, ¶ 62.

20. For management employees other than officers and directors, Debtors plan to continue the current UAL severance practice of two weeks of base salary for each year of service, with a minimum of four weeks pay and a maximum of one years pay. Friske Aff., ¶ 16.

21. Towers, Perrin originally estimated the costs of the Severance Plan at $65.4 million. Answers To Interrogatories, at 6. In response to AFA's discovery requests, Debtors provided the calculations used to support this $65.4 million estimate. Id. These calculations, however, were based on lower benefit levels than those provided for in the Executive Severance Policy presented to this Court, and did not reflect the bonuses, flight and healthcare benefits, and discretionary pension benefits provided by that policy. Id. at 5. Debtors subsequently revised their estimate to

$75 million, assertedly to take into account the provisions of the finalized Executive Severance Policy, and pay and staff reductions subsequent to the original estimate. Id. at 6. However, Debtors provided no calculations to support their revised estimate. Id. Debtors have now informed AFA that the estimate for the Severance Plan has been or is being revised again, but, as of the filing of this objection, Debtors have failed to provide AFA with any information regarding the revised estimate.

IV. Debtors' Statistics Regarding Turnover.

22. In support of the KERP Motion, Debtors present certain statistics regarding officer and director turnover. At present, Debtors have approximately 7,555 active, regular full-time and part-time management employees, including approximately 36 officers and approximately 200 directors. Answers To Interrogatories, at 2; KERP Motion, ¶ 37.

23. With respect to director turnover, Debtors assert that "[t]raditionally, the rate of director turnover has been less than 10% per year. In the 360-day period prior to the Petition Date, the rate of officer turnover is nearly 11%." KERP Motion, ¶ 41. In response to AFA's discovery request for the rate of voluntary director turnover for the years 1996 through 2002, Debtors admit that their rate of voluntary turnover for directors was 11.7% in 2000, 15.5% in 2001, and 10.8% in 2002. Answer To Interrogatories, at 6. Debtors asserted that they "lack accurate, available data for voluntary turnover between 1996 and 1999." Id.

24. With respect to officer turnover, Debtors assert that "[t]raditionally, the rate of officer turnover has been approximately 2.5% per year. However, during the 360-day period prior to the Petition Date, the rate of officer turnover has exceeded 10%." KERP Motion, ¶ 38. In response to AFA's discovery request for the rate of voluntary officer turnover for the years 1996 through 2002, Debtors asserted that their rate of voluntary turnover for officers was 2.5% in 2000, 2.4% in 2001,

and 9.8% in 2002. Answer To Interrogatories, at 6. Debtors asserted that they "lack accurate, available data for voluntary turnover between 1996 and 1999." Id.

25. Debtors also provide anecdotal evidence regarding turnover by identifying several officers and directors who have left Debtors for other employment. KERP Motion, ¶ 39, 42. Debtors, however, fail to specify when these officers resigned their employment. Id.

26. In the KERP Motion, Debtors provide no information regarding turnover among the approximately 7,319 management employees below the level of officers and directors, despite the fact that these employees are eligible to participate in both the Retention Plan and the Severance Plan. Through discovery, AFA requested turnover rates for these management employees from 1996 through 2002. In response, Debtors asserted that they "lack accurate, available data to answer this interrogatory." Answers To Interrogatories, at 7.

ARGUMENT

27. Section 363(b)(1) of the Bankruptcy Code provides that a debtor-in-possession, "after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business of business, property of the estate."[2] 11 U.S.C. § 363(b)(1). The purpose of the notice and hearing provision of Section 363(b)(1) is to subject non-ordinary course transactions to the scrutiny of creditors and the court.

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[2] Debtors also caption their motion as arising under Sections 105(a) and 365 of the Bankruptcy Code, but do not specifically argue in their motion that they are entitled to relief under those code provisions. KERP Motion, ¶¶ 67-69. Accordingly, AFA does not address the applicability of Sections 105(a) and 365.

28. When a debtor seeks under Section 363(b)(1) to implement a key employee retention program, bankruptcy courts will only approve such a program "if the Debtor has used proper business judgment in formulating the program and the court finds the program to be 'fair and reasonable.'" In re Aerovox, Inc., 269 B.R. 74, 80 (Bankr. D. Mass. 2001) (citing In re Interco, Inc., 128 B.R. 229, 234 (Bankr. E.D. Mo. 1991)). "[T]he determination of whether to approve such plans turns on the facts and circumstances of each particular case." In re Montgomery Ward Holding Corp., 242 B.R. 147, 154 (D. Del. 1999).

I. Debtors Fail To Demonstrate That The Proposed KERP Is Needed.

29. In evaluating KERP programs, courts have emphasized that the debtor must demonstrate a substantial risk that key employees will leave the debtor, thus hampering the debtor's ability to successfully reorganize. See, e.g., In re Montgomery Ward, 242 B.R. at 149-50. Debtors generally meet this burden by showing a significant increase in the loss of key employees immediately prior to or after the bankruptcy filing. Id. Alternately, a debtor may show that a significant number of its key employees have threatened to leave or have been approached by rival companies. Id.

30. Debtors attempt to meet this burden by presenting statistics regarding turnover, but Debtors' statistical evidence does not establish any real need for the KERP. First, the KERP as proposed will cover three employee groups: approximately 36 officers, approximately 200 directors, and approximately 7,319 other "management employees" who are eligible to participate in the plan. KERP Motion, Ex. A; Farkas Aff. ¶¶ 5, 10; Friske Aff., ¶ 11. Yet, Debtors only provide turnover statistics for their officers and directors. Thus, for the largest group of employees potentially covered under the program, Debtors have not provided, and apparently cannot provide, any turnover statistics

at all. See Answers To Interrogatories, at 7. Debtors failure to obtain information regarding turnover among the largest group of employees included in the KERP indicates a lack of business judgment. Moreover, it would not be fair and reasonable to provide KERP bonuses to employees who have not been shown to be in danger of leaving their employment with the company.

31. Second, Debtors' assertions regarding director turnover are not supported by the record in this case. AFA is unable to determine the basis for Debtors' claim that "[t]raditionally, the rate of Director turnover has been less than 10% per year." KERP Motion, ¶ 41. Through discovery, AFA requested information on the voluntary turnover rate for directors from 1996 through 2002. Debtors responded that they only had data for the two years preceding 2002. The turnover rate in 2000 was 11.7% and 15.5% in 2001. Thus, to the extent that the Debtors can legitimately lay claim to a tradition, that experience yields an average rate of 13.7%. The average, contrary to the Debtors' assertion, is higher than the rate United experienced in the year preceding the bankruptcy.

32. For officers, the Debtors' evidence is, to say the least, underwhelming. The rate of voluntary turnover has been 2.5% in 2000, 2.4% in 2001, and 9.8% in 2002. Debtors were unable to provide turnover rates for prior years, and so it may be that the recent rate of 9.8% is not particularly high for Debtors. Also given the small number of Debtors' officers (approximately 36) the loss of even one or two persons can cause a statistical "spike" relied upon by the Debtors.

33. Debtors also assert that "[a] large number of individuals critical to UAL's continuing business have been actively recruited," but fail to offer any specifics, either statistical or anecdotal, regarding recruitment. Farkas Aff., ¶ 2.

34. Given the current economic downturn, it is questionable whether employment with a Chapter 11 debtor is as unpalatable to management employees as might be true in a period of economic prosperity. This would seem to be especially true of management employees with expertise in the airline industry, whose prospects of employment at other carriers would appear to be dim. In sum, the Debtors have failed to demonstrate that the proposed KERP is necessary. Their evidence for managers is non-existent, for directors it is misleading, and for officers it is statistically insignificant.

II. Debtors' Failure To Consult With Organized Labor Regarding The KERP Motion, Or Even Address The Impact Of The Motion On Labor, Demonstrates A Lack Of Business Judgment.

35. Debtors have asserted that their ability to successfully reorganize hinges largely on their ability to cut labor costs. Debtors maintain that "continued cooperation from the Company's unions will be critical" to their effort to achieve the labor savings that they seek. Informational Brief, at 46. Indeed, on-going negotiations with labor regarding pay-cuts and work rule changes are currently at a critical juncture.

36. Despite Debtors awareness that the cooperation of labor is crucial to their reorganization and the critical status of on-going negotiations, Debtors never consulted with organized labor regarding their motion to implement the proposed KERP. Nor does it appear that Debtors have even considered the impact of the proposed KERP on labor relations generally and on-going negotiations specifically.

37. This failure to consult with labor, or otherwise address the potential concerns of labor, indicates that Debtors have not exercised sound business judgment with respect to the KERP Motion. In In re Geneva Steel Co., 236 B.R. 770 (Bankr. D. Utah 1999), a Chapter 11 case, the

bankruptcy court found that the failure of the debtor to consult with its labor union regarding a proposed key employee retention program warranted denial of the motion to adopt the program. The court found that:

> to propose this retention program without first having discussed its provisions with the [union] is not an example of sound business judgment. This is particularly true in light of the circumstances faced by [the debtor] today. Management may appropriately reserve decisions on executive benefits to itself and its directors when all is well, but when the continued existence of the business is in question and the executive benefits are subject to court approval, the dynamics of the decision making process must change.

Id. at 773 (emphasis added). The court found that it faced a "significant dilemma" between the desire of management to retain key employees and the potential that "granting the Motion as prayed may jeopardize the continuing support of [labor] in [debtor's] reorganization process." Id. Thus, the court denied the motion and offered suggestions for a renewed compromise motion that would better address the interests of both parties.

38. As in Geneva Steel, Debtors' KERP Motion risks alienating labor groups whose continued support is critical to the reorganization process. Simply stated, the timing of this motion could not be worse from a labor-relations standpoint. Just as management is demanding deep pay-cuts from labor under the threat that Debtors will otherwise not meet the terms of their DIP financing arrangements, Debtors are also proposing costly payments to management employees. Apparently, Debtors fail to appreciate the demoralizing effect on its front-line employees of handsome bonus payments to management, made "regardless of the outcome" of these proceedings. Friske Aff., ¶ 11. In fact, the concessions Debtors seek from their flights attendants will, to a large degree be consumed by the estimated cost of the KERP. The inequity of financing enriched severance and retention bonuses on the backs of flight attendants whose average annual income, pre-concession, is less than

$35,000 appears to have escaped the Debtors. Debtors' failure to address the labor-relations implications of their motion displays a troubling lack of business judgment.

III. Several Aspects The Retention Plan Are Not Fair Or Reasonable, Indicating A Lack Of Proper Business Judgment.

A. The Proposed Retention Plan Allows For An Inordinate Amount Of Management Discretion In The Implementation Of The Plan.

39. As compared to KERP proposals approved by other bankruptcy courts, the Debtors' proposed KERP allows for an extraordinary level of management discretion in its implementation. In fact, under the terms of the plan, "The Company reserves the right, in its sole discretion, to amend or terminate this Plan at any time." KERP Motion, Ex. A at 3. Such unfettered discretion is inappropriate in the bankruptcy context. Moreover, it undermines the purported rationale for the plan, i.e. to make management employees feel more secure.

40. The proposed Retention Plan also fails to specify who are the "key employees" that the Debtors should retain. Instead, the plan simply states that "Participation in this Plan is limited to active, regular full-time and part-time "management employees" of the Company who are formally selected by the Company and the Chief Executive Officer of UAL to be included in the Plan." KERP Motion, Ex. A at 1. In other bankruptcy decisions concerning proposed KERPs, courts have closely analyzed whether the debtor has appropriately determined which employees are key. See, e.g., In re Aerovox, 269 B.R. at 81-82 (debtors specifically identified key employees and "established that [they] perform numerous critical functions in this Chapter 11 case"); In re Montgomery Ward, 242 B.R. at 150 (approving plan where "Debtors comprised a list of 'absolutely essential' employees" and "[f]rom this list, [] went through a 'sifting process'"); In re Interco, 128 B.R. at 230 (approving plan where debtor specifically identified critical executives). Because Debtors fail to identify their key

employees, this court cannot determine whether the KERP as proposed is fair and reasonable under the circumstances facing these Debtors.

41. Not only does the KERP provide management with unfettered discretion to decide who is included in the plan, it also provides unfettered discretion to determine the amounts granted to management employees under the Retention Plan. This is particularly troubling because such discretion makes it impossible to predict what the actual cost of the Retention Plan would be. See In re Interco, 128 B.R. at 232 (approving KERP where the "costs of the Retention Plan are predictable, which should alleviate creditor concerns with respect to cost forecasting"). Initially, Debtors estimated the cost of the Retention Plan at $34 Million. They now estimate it at $20 million. The key point, however, is that the cost of the plan could be almost any number given the broad, and unacceptable, discretion afforded to management under the plan.

B. Bonuses Under The Retention Plan Are Not Tied To Performance.

42. Another key flaw in the Retention Plan is that bonuses are not tied to specific performance goals. Frequently, bankruptcy debtors tie KERP bonuses to performance benchmarks. For example, in In re Interco, 128 B.R. at 231, KERP bonus payments were keyed to the achievement of set financial targets, with increased bonus payments for performance exceeding certain threshold amounts. Id.; see also In re Kmart, Case No. 02 B 02474 (Bankr. N.D. Ill. Jan. 22, 2002) (KERP program incorporating corporate annual performance plan, with increased bonuses for performance above threshold targets). Such an approach seems eminently sensible. Indeed, there is no benefit to be gained by retaining supposedly key employees through the bankruptcy proceedings if their performance does not benefit the Debtors.

43. In contrast, Debtors proposed Retention Plan is not tied to any performance benchmarks. According to the affidavit of Debtors' expert, the Retention Plan was "devised to retain key staff throughout the reorganization process, regardless of the outcome."[3] Friske Aff., at ¶ 11 (emphasis added). In fact, in a footnote to the KERP Motion, Debtors reserve the right to return to this Court at a later date to request authority to implement a "success plan". KERP Motion, at 12 n.3. This makes no sense. If the KERP were tied to performance, Debtors could maximize their use of the estate's assets, and obviate the need for another expensive "success plan" down the line.

C. The Timing Of Bonus Payments Under The Retention Plan Is Unreasonable.

44. The Retention Plan provides that bonus payments will be made in two installments for management employees assigned to Tiers I - III, with 50% payable within ten months of the effective date of the plan, and 50% payable upon the effective date of a confirmed plan of reorganization. KERP Motion, Ex. A at 2. Tier IV employees are to be paid in a single installment within ten months of the effective date of the plan. Id. Thus, under the terms of the plan, the first bonus installment could be paid almost immediately, which would significantly undermine the incentive value of the payment. In addition, under the terms of the plan, participating employees who are terminated are still entitled to receive the next installment due under the plan. KERP Motion, Ex. A at 3. Therefore, an employee who is terminated more than ten months into the

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[3] Since Debtors have devised their plan to retain key employees "regardless of the outcome" of these proceedings, the provision in the plan providing for bonus payments to be made "upon the effectiveness of a proposed plan of reorganization" presumably would include a Chapter 11 liquidation plan. KERP Motion, Ex. A at 2. At least one bankruptcy court has found that a KERP plan allowing for bonuses upon confirmation of a liquidation plan is impermissible. In re Geneva Steel Co., 236 B.R. 770, 774 (D. Utah 1999)

bankruptcy could receive the second "retention" bonus payment that is due upon confirmation, an event that Debtors estimate will not take place for 18 months.

45. Moreover, it is common for KERP plans to weight bonus payments toward the end of the time period covered by the program. See, e.g. In re Interco, 128 B.R. at 231-32. Such a weighted schedule of bonuses maximizes the incentive value of the plan. In contrast, Debtors plan calls for two equal installments. This too is unreasonable.[4]

IV. Several Aspects Of The Severance Plan Are Not Fair Or Reasonable, Indicating A Lack Of Proper Business Judgment.

A. Debtors' Inability To Provide A Reasonably Accurate Estimate Of The Proposed Severance Plan Indicates A Lack Of Business Judgment.

46. Towers, Perrin originally calculated the cost of the Severance Plan at $65.4 million. United's Board of Directors subsequently finalized the Executive Severance Policy portion of the Severance Plan, which provided benefit levels above those assumed in the Towers, Perrin estimate. Apparently, the Board approved these benefit increases without any calculation of the cost of the increased benefit levels, because no such calculations were provided to AFA in discovery. Answers To Interrogatories, at 5-6. After the finalization of the Executive Severance Policy, Debtors revised their estimate to $75 million purportedly to take into account both the finalized policy and staff and pay reductions subsequent to the original estimate. Id. at 6. This revised estimate, however, was not supported by any calculations whatsoever, and therefore the basis for the revised estimate remains

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[4] Several courts have found that in exchange for special KERP benefits post-petition, it is fair and reasonable that those executives with employment agreements waive any claims against the estate associated with those agreements. In re Aerovox, 269 B.R. at 77, 81 (approval of KERP based in part of waiver provision); In re Interco, 128 B.R. at 233 (same). To the extent that any executives covered by the proposed KERP have individual employment agreements, the KERP should similarly provide for such a waiver in order to maximize the value of the plan to the estate.

unknown. Id. Most troubling, it does not appear that the Debtors have ever done calculations reflecting the non-salary portions of the Executive Severance Policy, such as bonus payments, healthcare benefits, and discretionary pension credits. The Debtors must provide appropriate cost estimates of these benefits in order to establish the reasonableness of the Severance Plan. On the eve of the deadline for this objection, Debtors informed AFA that they have prepared or are preparing a revised estimate for the Severance Plan, but as yet Debtors have not provided that estimate.

47. Clearly as of the filing of their motion and even at present, Debtors were and are unable to provide a reasonably accurate estimate of the cost of the Severance Plan. This inability demonstrates that Debtors have not properly exercised their business judgment in proposing their Severance Plan. Whether or not the Severance Plan is fair and reasonable can only be determined if its approximate costs are known.

B. The Severance Plan Fails To Require Mitigation, And Thus Will Potentially Confer A Windfall On Furloughed Management Employees.

48. The Severance Plan also fails the test of fairness and reasonableness insofar as it does not require mitigation. Courts have made clear that severance plans adopted as part of a KERP should contain a mitigation provision that reduces the amount payable by earnings from other employment during the applicable severance period. In re Geneva Steel, 236 B.R. at 773-74 ("To be acceptable to this court, the severance plan must contain a mitigation provision that reduces the amount payable in the event the executive obtains other employment during the six or nine month reimbursement period."); In re Aerovox, 269 B.R. at 77 (approving KERP severance plan with mitigation provision). To do otherwise is simply to provide senior executives "with a windfall," which is particularly inappropriate in the bankruptcy setting. In re Geneva Steel, 236 B.R. at 773.

Debtors' KERP does not contain a mitigation provision. This is not fair and reasonable, and should preclude granting the KERP in its present form.

C. The Enhanced Executive Severance Policy Proposed By Debtors Is Excessive.

49. The enhanced severance benefits available to executives under the Executive Severance Policy are not fair and reasonable. Under the policy, Executive Vice Presidents and Senior Vice Presidents receive two years of severance, and Vice Presidents can receive a maximum of fifteen months. Section 502(b)(7) of the Bankruptcy Code, however, caps pre-petition employment claims at one year of compensation. 11 U.S.C. § 502(b)(7). This one-year limit should also provide a benchmark for what is fair and reasonable compensation in the post-petition setting, and Debtors' proposal greatly exceeds that limit.

50. Because of the unreasonably long severance periods proposed under the policy, some executives would receive excessive severance payments under the proposed KERP. For example, Debtors estimate that a single Executive Vice President could receive $848,000 in severance pay under the policy. Answers To Interrogatories, at 6. That figure does not include the other payments and benefits available under the policy, such as bonuses, healthcare benefits, and possible pension benefits. Id. at 5. Such a payment far exceeds the purported rationale of the severance policy, i.e. to give executives a sense of security to enable them to focus on the reorganization efforts of Debtors. Such an excessive payment is simply an unjustified windfall to an executive whom Debtors have decided not to retain.

51. Moreover, the length of severance benefits for Executive Vice Presidents and Senior Vice Presidents are not tied to tenure. Therefore, under the proposed plan, an executive who has

been with the company for only a year or two is entitled to larger benefits than non-executive employees who have given the company many years of service. This too is inequitable.

52. Perhaps the most objectionable feature of the Executive Severance Policy is the provision for payment of "bonus[es] that would have been earned for the severance period." KERP Motion, Ex. B (emphasis added). Unless the bonus is earned through performance, the estate derives no benefit from such a payment. A severance payment for a bonus that "would have been earned" is simply an unreasonable windfall for executive employees. This is particularly true in this case where a terminated executive will receive the next scheduled payment provided for in the Retention Plan.

CONCLUSION

For all the foregoing reasons, AFA respectfully requests that this Court deny Debtors' motion to implement the proposed key employee retention program.

Respectfully submitted,

Robert S. Clayman*
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Counsel for Association of Flight Attendants

Dated: January 10, 2003

* Mr. Clayman and Mr. Bartos are admitted pro hac vice.

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of January, 2003, true copies of the foregoing Association Of Flight Attendants' Objection To Debtors' Motion For Entry Of An Order Pursuant To 11 U.S.C. §§ 105(a), 363(b) And 365 Of The Bankruptcy Code Authorizing Debtors To Continue Their Key Employee Retention Program In The Ordinary Course Of Business were served via overnight delivery on the attached Core Group Service List and via facsimile on the attached 2002 Service List.

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Robert S. Clayman

Core Group

<table>
<tr>
<td>Debtors:
United Air Lines, Inc.
WHQLD
1200 East Algonquin Road
Elk Grove Village, IL 60007
Attn: John Lakosil
Phone: 847-700-4462
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<td>Counsel to Debtors and Debtors in Possession:
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Marc Kieselstein
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<td>United States Trustee:
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Chicago, IL 60606
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Fax: 312-886-5794</td>
<td>Counsel to the Debtors' Debtor in Possession Lender
(Bank One):
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233 South Wacker Drive
Suite 5800
Chicago, IL 60606
Attn: David Heller
Timothy Barnes
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<td>Counsel to the Debtors' Debtor in Possession Lender
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(Citibank and JP Morgan):
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Attn: Richard S. Toder
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Fax: 212-309-6001</td>
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(Citibank and JP Morgan):
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<td>Debtors' Private Copy Service:
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150 South Wacker Drive, 4th Floor
Chicago, IL 60606
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Fax: 312-454-8564</td>
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<table>
<tr>
<td>Official Notice and Claims Agent:
Poorman-Douglas Corporation
10300 S.W. Allen Boulevard
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Attn: Rhonda G. McNally
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<td>Counsel to Committee:
Sonnenschein Nath & Rosenthal
1221 Avenue of the Americas
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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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

DEBTORS' OBJECTIONS AND RESPONSES TO ASSOCIATION OF FLIGHT ATTENDANTS' REQUEST FOR ANSWERS TO INTERROGATORIES REGARDING DEBTORS' MOTION FOR THE ENTRY OF AN ORDER PURSUANT TO SECTIONS 105(a), 363(b) AND 365 OF THE BANKRUPTCY CODE AUTHORIZING THE DEBTORS TO CONTINUE THEIR KEY EMPLOYEE PROGRAM IN THE ORDINARY COURSE OF BUSINESS

Debtors hereby respond, subject to the below General Objections and the specific objections listed below each interrogatory, to the Association of Flight Attendants ("AFA") Interrogatories regarding Debtors' Motion for Entry of an Order Authorizing the Debtors to Continue their Key Employee Program in the Ordinary Course of Business.

GENERAL OBJECTIONS

1. Debtors assert their General Objections with respect to each and every Interrogatory.

2. Debtors objects to AFA's Interrogatories to the extent that the information requested is protected by the attorney-client privilege, work-product doctrine, or other applicable privileges.

3. Debtors object generally to Defendants' Interrogatories, Definitions and General Provisions to the extent that they are over broad, unduly burdensome, vague, ambiguous, irrelevant, and not reasonably calculated to lead to the discovery of admissible

evidence. Debtors are responding to AFA's Interrogatories based upon their interpretation and understanding of each Interrogatory, and based on information currently available to Debtors. Should AFA assert a different interpretation of any Interrogatory, or should more accurate information become available, then Debtors reserve the right to add to, supplement, or modify its response and/or objection to such Interrogatory.

4. Debtors object to AFA's Interrogatories to the extent that they seek information that is equally available to AFA as it is to Debtors.

INTERROGATORIES

1. Identify the current number of Debtor's active, regular full-time and part-time management employees.

Response: As of December 14, 2002, the current number of Debtors' active, regular full-time and part-time management employees was 7,555.

2. Identify the key employee retention plans reviewed by Douglas J. Friske and/or Towers, Perrin, Forster & Crosby, Inc. that are not included in the Summary of Chapter 11 Retention and Severance Plans attached to the Affidavit of Douglas J. Friske filed December 9, 2002. For each plan so identified, indicate the name of the debtor(s), the court in which the bankruptcy petition was filed, and the case number(s) of the bankruptcy proceedings.

Response: Subject to the above General Objections, Debtors state that the following key employee retention plans were reviewed by Douglas J. Friske during the development of the UAL KERP, but were not included in the Summary attached to Mr. Friske's affidavit:

Case	Filing Date	State	Number
America West	8/26/94	USBC Arizona	91-07505
APS Holding Corporation	2/28/98	USBC Delaware	98-00197
Edison Brothers Stores	3/9/99	USBC Delaware	99-00529
Harvard Industries	5/8/97	USBC Delaware	97-00954
Humphreys	5/1/01	USBC N.D. Illinois	01-13742
Interco	6/6/91	USBC Missouri	91-40442
Kmart Corporation	1/22/02	USBC N.D. Illinois	02-02474
Montgomery Ward	11/24/99	USBC Delaware	97-1409

Payless Cashways	7/21/97	USBC Missouri	97-50543
TWA	1/10/01	USBC Delaware	01-00056
Washington Group International	5/25/01	USBC Nevada	01-31627

3. The Summary of Chapter 11 Retention and Severance Plans attached to the Affidavit of Douglas J. Friske, filed December 9, 2002, states: "Note: analysis based on Motions in cases where final Orders were unavailable." Identify which of the descriptions of retention and severance plans contained in the Summary of Chapter 11 Retention and Severance Plans were based on motions and state the reason why a final order was unavailable.

Response: Debtors state that they believe that the final retention and severance plan order in the Worldcom bankruptcy was not available at the time that the Summary of Chapter 11 Retention and Severance Plans attached to the Affidavit of Douglas J. Friske was created. Debtors otherwise object to this interrogatory because it seeks irrelevant information which is equally available to AFA as it is to debtors, and because it cannot locate the information necessary to provide a precise answer.

4. Identify which of the Chapter 11 proceedings listed in the Summary of Chapter 11 Retention and Severance Plans attached to the Affidavit of Douglas J. Friske, filed December 9, 2002, have been converted into Chapter 7 liquidation proceedings.

Response: Debtors do not know which of the Chapter 11 proceedings listed in the summary have been converted to Chapter 7 liquidation proceedings. AFA can perform the research necessary to answer this query just as easily as the Debtors.

5. State whether or not the Retention Plan was submitted/presented to Debtors' Board(s) of Directors or any committee(s) thereof, and, if it was, explain what action, if any, was taken by Debtors' Board(s) of Directors or any committee(s) thereof with respect to the Retention Plan.

Response: Debtors state that the Key Employee Retention Plan ("KERP") was submitted to Debtors' Compensation Committee and to Debtors' Board of Directors. The KERP was presented in general form to Debtors' Compensation Committee in October 2002. On December 2, 2002, the Compensation Committee recommended and the Board of Directors

approved the KERP. On December 7, 2002, the Compensation Committee recommended several changes to the KERP, and the Board approved the revisions.

6. Explain fully the basis for Debtors' estimates that the costs of the Retention Plan will be approximately $32 million or $34 million, including, but not limited to, any assumptions used by the Debtors to arrive at the estimates of $32 million or $34 million.

Response: Subject to the above General Objections, Debtors state as follows: Towers Perrin estimates were calculated based on management pay scale as of September 2002. The number of recipients by level were assumed based on scenarios developed with UAL, subject to change upon implementation of the plan. The calculation is explained by the below chart:

		Retention Plan			
	Average Salary	Receiving %	Receiving #	Payout %	Total Cost
Officer Total	$287,198	100%	42	100%	$12,062,308
Directors	$140,540	60%	71	50%	$4,989,157
"Staff"					
Section Managers	$94,967	100%	490	30%	$13,960,109
Other Managers	$82,004	0%	0	30%	$0
Manager Total	$90,888		490	30%	$13,960,109
Professional	$62,768	0%	0	30%	$0
Supervisor	$66,401	0%	0	30%	$0
Non-Management	$30,929	0%	0	30%	$0
Total "Staff"	$55,727	5%	490	30%	$13,960,109
Total Officer Director/Staff			603		$31,011,574

These estimates were intended to be used to determined "not to exceed" limits, and were therefore rounded up to $32 million. The $2 million discretionary retention fund provided for by the plan brings the total to $34 million.

7. Explain fully Debtors' practices relating to severance for officers and directors prior to the adoption of the Severance Plan.

Response: Subject to the General Objections listed above, Debtors state as follows: prior to adoption of the Severance Plan, severance for officers and directors was handled on a case-by-case basis dependent on a multitude of factors. Generally, however, individuals with titles at the Senior Vice President level and above received severance packages valued at three times their base salaries and projected (as opposed to actual) bonuses. Directors and corporate Vice Presidents received severance packages valued at two times their base salaries and projected (as opposed to actual) bonuses. On virtually all occasions, severance packages given officers prior to adoption of the Severance Plan exceeded packages which will be available under the Severance Plan.

8. Explain fully the basis for Debtors' determination that the costs of the Severance Plan could be as great as $75 million, including, but not limited to, any assumptions used by the Debtors to arrive at the estimate of $75 million.

Response: Subject to the above General Objections, Debtors state as follows: Towers Perrin estimates were based upon the same actual pay assumptions as shown in the response to Interrogatory #6. The amount of severance available to officers and directors under the plan was assumed to be as follows:

- Severance equal to 2 years of pay for Executive Vice Presidents, 1.5 years of pay for Senior Vice Presidents, and 1 year of pay for Vice Presidents
- Severance equal to 2 weeks of pay for every year of service for employees below the officer level
- Severance pay calculated on base salary only, excluding bonus (actual or projected)

These assumptions, along with the counts of possible covered employees and average salaries (based on numbers in place when the estimate was determined), created the below calculation:

	Current Payroll		Severance				
			Receiving		Tenure	Weeks	Total
	Total Salary	#	%	#	Avg Yrs	of Sev	Cost
Officers							
EVP	$2,120,000	4	20%	1	NA	104	$848,000
SVP	$3,692,500	11	20%	2	NA	78	$1,107,750
VP	$6,249,808	27	20%	5	NA	52	$1,249,962
Officer Total	$12,062,308	42	20%	8			$3,205,712
Directors	$19,956,627	142	20%	28	18	36	$2,763,225
"Staff"							
Section Managers	$46,533,696	490	20%	98	17	34	$6,085,176
Other Managers	$18,450,926	225	20%	45	20	40	$2,838,604
Manager Total	$64,984,622	715		143			$8,923,780
Professional	$278,377,846	4,435	20%	887	13	26	$27,837,785
Supervisor	$130,211,516	1,961	20%	392	16	32	$16,026,033
Non-Management	$96,404,981	3,117	20%	623	9	18	$6,674,191
Total "Staff"	$569,978,965	10,228	20%	2,045	17	34	$59,461,789
Total Officer Director/Staff	$601,997,900	10,412		2,081			$65,430,726

The final estimate was increased from $65.4 million to $75 million to take into consideration the following developments that occurred after the completion of the original estimate:

- Finalization of the officer severance plan provisions
- Pay and staff reductions

Debtors will supplement their response to this interrogatory when more information becomes available.

9. For each year from 1996 through 2002, identify the rate of voluntary turnover (i.e. resignation) for Debtors' officers.

Response: Debtors object to this interrogatory as overbroad and unduly burdensome; debtors lack accurate, available data for voluntary turnover between 1996 and 1999. Subject to their General Objections and this specific objection, Debtors state that the rate of voluntary turnover for officers was 2.5% in 2000, 2.4% in 2001, and 9.8% in 2002.

10. For each year from 1996 through 2002, identify the rate of voluntary turnover (i.e. resignation) for Debtors' directors.

Response: Debtors object to this interrogatory as overbroad and unduly burdensome; debtors lack accurate, available data for voluntary turnover between 1996 and 1999. Subject to their General Objections and this specific objection, Debtors state that the rate of voluntary turnover for directors was 11.7% in 2000, 15.5% in 2001, and 10.8% in 2002.

11. For each year from 1996 through 2002, identify the rate of voluntary turnover (i.e. resignation) for Debtors' management employees, excluding Debtors' officers and directors.

Response: Debtors object to this interrogatory because it is vague and ambiguous and because Debtors lack accurate, available data to answer this interrogatory.

12. Identify the total "Annual Base Pay," as the term "Annual Base Pay" is defined in the Retention Plan, currently paid to Debtors' officers.

Response: Debtors state as follows: "Annual Base Pay," as defined in the Retention Plan, equals the monthly rate of pay in effect as of December 1, 2002, adjusted to reflect management pay reductions and subsequent pay increases due to promotion, multiplied by 12. The total annual base pay used in determining the cost estimates cited in Interrogatories #6 and #8 for officers was $12,062,308. The current total is less than that amount due to subsequent staff and salary cuts.

13. Identify the total "Annual Base Pay," as the term "Annual Base Pay" is defined in the Retention Plan, currently paid to Debtors' directors.

Response: Debtors state as follows: "Annual Base Pay," as defined in the Retention Plan, equals the monthly rate of pay in effect as of December 1, 2002, adjusted to reflect management pay reductions and subsequent pay increases due to promotion, multiplied by 12. The total annual base pay used in determining the cost estimates cited in Interrogatories #6 and

#8 for directors was $19,956,627. The current total is less than that amount due to subsequent staff and salary cuts.

14. Identify the total "Annual Base Pay," as the term "Annual Base Pay" is defined in the Retention Plan, currently paid to Debtors' management employees, excluding Debtors' officers and directors.

Response: Debtors state as follows: "Annual Base Pay," as defined in the Retention Plan, equals the monthly rate of pay in effect as of December 1, 2002, adjusted to reflect management pay reductions and subsequent pay increases due to promotion, multiplied by 12. The total annual base pay used in determining the cost estimates cited in Interrogatories #6 and #8 for management employees (excluding officers and directors) was $569,978,965. The current total is less than that amount due to subsequent staff and salary cuts.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DEBTORS' OBJECTIONS AND RESPONSES TO ASSOCIATION OF FLIGHT ATTENDANTS' REQUEST FOR ANSWERS TO INTERROGATORIES REGARDING DEBTORS' MOTION FOR THE ENTRY OF AN ORDER PURSUANT TO SECTIONS 105(a), 363(b) AND 365 OF THE BANKRUPTCY CODE AUTHORIZING THE DEBTORS TO CONTINUE THEIR KEY EMPLOYEE PROGRAM IN THE ORDINARY COURSE OF BUSINESS** was served by facsimile and federal express on December 31, 2002 upon:

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