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: July 18,2003

ASSOCIATION OF FLIGHT ATTENDANTS' OBJECTION TO DEBTORS' MOTION FOR ENTRY OF AN ORDER PURSUANT TO 11 U.S.C. §§ 105(a) AND 363(b)(1) OF THE BANKRUPTCY CODE AUTHORIZING DEBTORS TO IMPLEMENT A KEY EMPLOYEE RETENTION PROGRAM FOR SELECT PROFESSIONAL AND TECHNICAL EMPLOYEES

The Association of Flight Attendants ("AFA"), a creditor of the above-captioned debtors and debtors in possession ("Debtors" or "United") and the collective bargaining representative for United Airline's 22,000 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) and 363(b)(1) for select professional and technical employees ("KERP Motion").

The proposed KERP is not a valid exercise of Debtors' business judgment, nor are its terms fair and reasonable. First, Debtor’s motion seeks to destroy the balance of equities that was established only two months ago when United obtained $2.53 billion in annual labor concessions from its employees. Under its Restructuring Agreement with AFA, the flight attendants agreed to pay $302 million annually for the next six years. At

that time, United repeatedly represented to the Court, AFA and other parties that the core construct of these concessions was that both the sacrifices made and the rewards received would be allocated equally among all groups of workers. Indeed, United created incentive payment and profit sharing programs that covered both union and non-union employees. It was the formulae contained within these plans that were intended to ensure that the benefits resulting from these massive labor savings would be equitably distributed.

Now, by its motion, United would jettison that carefully calibrated allocation in favor of guaranteeing a select group of employees a twenty percent increase in pay. There should be no doubt that the flight attendants represented by AFA would not have ratified life-altering concessions had they known that United intended to renege on its promise of fair and equitable treatment. Scrapping the fundamental principle that underpins a reorganization is not, under any circumstances, a reasonable exercise of a company's business judgment.

Second, United has failed to present any evidence supporting its claim that a KERP for 600 professional and technical employees is necessary. It relies upon only conclusory statements, proffers no affidavits, and does not adequately quantify the scope of the purported attrition of these employees. Finally, the reasons alleged by United for the professional and technical employees leaving the airline are no longer valid based upon United's improving financial condition and its recently

stated intention to emerge from bankruptcy as early as the end of this year.

STATEMENT OF FACTS

A. The KERP Motions

1. On December 9, 2003, the Petition Date, the Debotors filed the Motion for Entry of an Order Pursuant to Sections 105(a), 365(b) and 365 of the Bankruptcy Code Authorizing the Debotors to Continue their Key Employee Program in the Ordinary Course of Business [Docket No. 24] (the "First KERP Motion").

2. In the First KERP Motion United sought to implement a plan that would apply to 600 employees at a cost of $34 million. Following negotiations with the official committee of unsecured creditors (the "Creditors' Committee"), United agreed to reduce the cost of its proposed KERP to approximately $20.7 million and to limit its coverage to 317 specifically identified employees. Debtors' Response to AFA' Objection to First KERP Motion at 3,5-7. United, however, was given the right to increase the number of beneficiaries to 350. Id. at 6-7. The KERP also included the creation of a $2 million discretionary fund that United's Chief Executive Officer could distribute to employees as retention or recognition bonuses. First KERP Motion at 17. On February 6, 2003, the Court approved the First KERP Motion as modified in accordance with its agreement with the Creditors' Committee.

3. The key employee retention program for which United now seeks approval (the "Technical Employee KERP") is intended to cover professional and technical employees selected from

Debtors' Information Services Division ("ISD") and various other divisions of the Debtors (the "Professional and Technical Employees"). KERP Motion at 6.

4. The Technical Employee KERP would provide a retention award for 600 employees at a cost of $9.5 million (the "Retention Award"). The amount of an individual retention award will equal "20% of the employee's Annual Base Pay, which is defined as the amount equal to twelve (12) times the employee's monthly base rate in effect on June 1, 2003." Id. at 2 Exhibit A.

5. The average salary of KERP Professional and Technical Employees is currently $79,166.[1]

6. One-half of the Retention Award will be paid upon the effective date of a confirmed plan of reorganization, and the other half will be paid on the date that is six (6) months following the effective date of a confirmed plan of reorganization.

7. 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 Retention Award payment. Id. at 8. No Retention Award is paid to an employee who prior to the date the award is payable voluntarily terminates, voluntarily transfers to a non-eligible

[1] The stated cost of providing a 20% increase to 600 Professional and Technical Employees is $9.5 million. Based upon that amount, the total salary for these individuals equals $47.5 million. Their average salary can then be determined by dividing $47.5 million by 600.

job classification, is terminated for cause or is on personal or educational leave. Id.

8. In contrast to its First KERP Motion, the Debtors statistics regarding turnover of the employees at issue are not supported by an affidavit or other evidence. United claims that the attrition rate for employees in ISD is "traditionally" 6.3% per year. For the period of January 2003 to June 2003 that rate is purportedly 16% and falls to 12% if retirements are not included. Id. at 4.

9. Debtors compare the turnover for ISD employees with "technical, professional and management employees." Debtors, however, do not provide the "traditional" attrition rate for these employees. As alleged in the Motion, for the first half of this year, this group had a turnover rate of 11% and a 7% rate if retirements are not considered. Id.

B. The Restructuring Agreements

10. Beginning on the first day of these proceedings, the Debtors asserted that the reduction of labor costs was a key element of their plan for a successful reorganization. Informational Brief, at 2-3, 11-16, 49-59. Throughout the negotiations with AFA and in its Section 1113 motion to reject AFA's collective bargaining agreement, United stated that the amount sought from the flight attendants was fair and equitable in relationship to the sums sought from the other employee groups.

11. On April 4, 2003, following three months of negotiations and on the eve of a Section 1113 hearing, the parties entered into a Restructuring Agreement that provided the company with $302 million in annual concessions including a 9% cut in wages, substantial reductions in pensions and medical benefits, and major changes to work rules. As was the case for all other employees, the Restructuring Agreement also established both an incentive payment and a profit sharing plan which would enable workers to participate in whatever success United may enjoy following its emergence from bankruptcy. On April 29, 2003 the flight attendants ratified the Restructuring Agreement.

12. Also in April 2003, United, either through agreements with its other unions or by a unilateral decision regarding its unrepresented employees, obtained concessions in amounts that were consistent with the allocations it had presented to AFA.

13. In its motion to approve the changes to its collective bargaining agreements between United and each of its unions, United stated that, "The modifications equitably address the financial, transformational, and labor relations imperatives presently facing United in a cooperative manner that will best serve the interests of the estate." United also recognized that "The unions' leadership and members deserve credit for taking on a fair share of the sacrifice that everyone working to transform United agrees is necessary to build a more competitive, profitable enterprise for the long term." (emphasis added)

Debtors' Agreed-to Motion to Approve the Modifications to Their Collective Bargaining Agreements at 5-6.

14. On April 30 the Court approved the modifications to the labor contracts. Including the concessions provided by the salaried and management employees, United will realize annual savings of $2.53 billion for a period of six years.

ARGUMENT

15. 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.

16. 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

[2] Debtors also caption their motion as arising under Section 105(a) of the Bankruptcy Code, but do not specifically argue in their motion that they are entitled to relief under this code provision. Accordingly, AFA does not address the applicability of Section 105(a).

and circumstances of each particular case." In re Montgomery Ward Holding Corp., 242 B.R. 147, 154 (D. Del. 1999).

I. BASED UPON THE FACTS AND CIRCUMSTANCES OF THIS CASE, THE TECHNICAL KERP IS NEITHER FAIR NOR REASONABLE.

17. In this case where labor concessions are the linchpin of a successful reorganization, the terms "fair and reasonable" are tied to and defined by the manner in which these savings are allocated among all of United's employees. Indeed, only because of United's commitment to equitably apportion concessions was it able to reach consensual agreements with AFA and the other unions.

18. Moreover, another integral part of the pact reached with its unions was the assurance that their members would share equally in United's post-bankruptcy success. Accordingly, all employees, represented and unrepresented, are participants in both an incentive payment and a profit sharing plan. Any action that upsets the balance of equities established by these arrangements cannot be considered fair or reasonable.

19. The Technical Employee KERP, however, destroys that equilibrium. It bestows upon a select group of employees 20% pay increases while the flight attendants and all other workers would continue to labor under substantial wage cuts. For example, while flight attendants will lose 9% or over $3000 of their average $35,000 income over the next year, the Professional and Technical Employees will see their average salary of nearly $80,000 increase by approximately $16,000. In its rawest terms,

it will take the wage concessions of more than five flight attendants to fund the Retention Award of one Professional and Technical Employee.

20. In addition, the fairness of this KERP should be judged by the effects it would have had on the ratification process the unions undertook two and one-half months ago. It is inconceivable that the flight attendants or any other unionized workforce would have ratified agreements that were intended to achieve an equitable allocation of concessions if United had disclosed then its plan to implement the Technical Employee KERP. One only has to consider the debacle caused by American Airlines' belated disclosure of an enriched executive benefit plan while its represented employees were considering substantial concessionary packages, to understand the disruption that would have ensued had United revealed this KERP in April 2003.

II. DEBTORS FAIL TO DEMONSTRATE THAT THE PROPOSED KERP IS NEEDED.

21. 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.

22. Debtors have provided no substantiated facts to demonstrate that the proposed KERP is necessary. Moreover, the statistics it offers regarding rates of attrition, even if verified, are insufficient and flawed.

23. First, the Debtors' statistics do not relate to the Professional and Technical Employees as United has defined that group. Rather it offers attrition rates only for those employees who work in ISD even though the covered employees include individuals who work in "various other divisions of the Debtors." KERP Motion at 6.

24. Second, Debtors compare the attrition rate for the first half of this year with the rate it has "traditionally" experienced. Debtors, however, fail to define what period of time is encompassed by the term, "traditionally". This is of particular concern in light of the fact that in its First KERP Motion United conceded that it did not know the rate of voluntary turnover for management employees for the years 1996 through 2002. AFA's Objection to First KERP Motion, Exhibit 1 at 7.

25. Third, Debtors present statistics for one six month period without taking into account that United's condition has markedly changed during that time. In the first four months of this year United had to contend with the effects of a recent bankruptcy filing, the uncertainty of its efforts to achieve substantial labor cost-savings, and the impact of both SARS and

the Iraqi War. In a recent article, a United representative, in effect, conceded that the airline's statistical claims are primarily based upon the turnover rate for the first quarter of this year. Exhibit 1.[3]

26. During the past two months, United's labor issues were resolved and the effects of SARS and the Iraqi War on United's traffic largely subsided. As a result of these and other factors, United has regained enough of its financial footing to be able to announce its intention to file a reorganization plan by the end of October and to emerge from bankruptcy as much as six months earlier than it had originally planned. Exhibit 2,[4] Exhibit 3,[5] Exhibit 4.[6] In light of these developments, one can reasonably assume that the rate of attrition is steadily abating. Accordingly, United should have proffered statistics that indicate its turnover experience in each of the last two months.

27. Fourth, Debtors rely upon "exit survey data" to determine the reasons Professional and Technical Employees leave the airline. Because United has inexplicably failed to submit this data, one cannot determine the number of employees who participated in the survey or when these particular individuals

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[3] Washington Post, July 8, 2003, *available at* http://washingtonpost.com/ac2/wp-dyn/A23995-2003Jul7.

[4] United Airlines Press Release, June 27, 2003, *available at* http://64.95.88.8/press/detail/0,1442,51120,00.html.

[5] New York Times, July 4, 2003, *available at* http://www.nytimes.com/2003/07/04/business/04AIR.html.

[6] Reuters, June 9, 2003, *available at* http://reuters.com/newsArticle.jhtml?type=topNews&StoryID=290023).

ended their employment. Moreover, unlike the First KERP Motion, here there is no analysis or affidavit from Towers Perrin, the consultants who apparently advised United about the Professional and Technical KERP. KERP Motion at 3.

28. Fifth, United, again without any evidentiary support, claims that six hundred Professional and Technical Employees are vital to its reorganization. In fact, not only does United fail to identify which individuals are eligible for this KERP but it does not adequately describe the departments in which these employees work. The Court is left to speculate as to what are the "various other divisions of the Debtors" and how many of the 600 targeted employees work in areas other than ISD. Id. at 6. All United offers is a description of six positions in which an undisclosed number of the Professional and Technical employees work. Id. at 4-5.

29. 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). Here, United has offered no evidence and only a

blanket, unsubstantiated claim that 600 Professional and Technical Employees are vital to its operations and irreplaceable.

III. THE REASONS PROFESSIONAL AND TECHNICAL EMPLOYEES HAVE ALLEGEDLY LEFT UNITED ARE NO LONGER VALID IN LIGHT OF UNITED'S SUBSTANTIALLY CHANGED CIRCUMSTANCES.

30. United contends that based upon its exit survey the key reasons the Professional and Technical Employees have ended their employment with the company are (1) financial stability, (2) potential future pay cuts, and (3) limited career development. Id. at 5. First, as described above, United's financial condition has greatly improved. As recently as April, when United was dealing with a multitude of crises, no one would have thought it would be in a position to file a plan of reorganization as early as this fall. Second, since May 1, when all employee concessions were implemented, United has not threatened nor mentioned a plan to cut anyone's wages and nothing prevents it from advising the Professional and Technical Employees that it has no intention to do so. Finally, to the extent a company's financial status effects an employee's career advancement, United's improved condition should enhance the opportunities available to the Professional and Technical Employees.

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*
Guerrieri, Edmond & Clayman, P.C.
1625 Massachusetts Avenue, N.W.
Washington, DC 20036
(202) 624-7400

Barbara Hillman
Cornfield & Feldman
25 East Washington Street
Chicago, IL 60602
(312) 236-7800

Dated: July 10, 2003

Counsel for AFA

* Mr. Clayman is admitted *pro hac vice*.

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of July, 2003, I caused to be served 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) And 363(b)(1) Of The Bankruptcy Code Authorizing Debtors To Implement A Key Employee Retention Program For Select Professional And Technical Employees, on the following:

The Debtors and the Core Group, by facsimile; and

All parties listed on the current 2002 list for Service, by e-mail, or by facsimile if they have not provided an e-mail address, or by overnight delivery, if they have provided neither e-mail address nor a facsimile number.

Robert S. Clayman

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