BEFORE THE
APFA-AA SYSTEM BOARD OF ADJUSTMENT

In the Matter of the Arbitration between:	)	
Association of Professional Flight Attendants	)	Base Case No. SS-32-2014-APFA-2
and	)	
American Airlines, Inc.	)	

APFA'S POST-HEARING BRIEF

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TABLE OF CONTENTS

	Page
ISSUE…………………………………………………………………………	1
INTRODUCTION………………………………………………………..........	1
FACTUAL BACKGROUND…………………………………………………	2
I. American's Retiree Health Prefunding Program and Events Leading to APFA's 2001 Agreement to Participate……………….	2
II. American's Bankruptcy and Changes to the Retiree Health Benefits for Current Flight Attendants Under Section 1113………	6
III. APFA and US Airways Negotiate a Conditional Labor Agreement...	15
IV. American's Adversary Proceeding, Service of a Section 1114 Proposal, and Ultimate Decision Not to Seek Section 1114 Relief..	16
ARGUMENT..	27
I. American's Failure to File a Section 1114 Application Excuses the Nonoccurrence of the Condition to Fulfillment of the Promise to Pay Flight Attendants the Company's Matching Prefunding Contributions…………………………………………	27
II. To the Extent That This Dispute Hinges on Whether There Has Been a "Successful Resolution," the Contract Language Is Ambiguous and Should Be Construed Against the Company As the Drafter to Find That There Has Been a Successful Resolution..	36
III. It Is Inequitable for American to Withhold Its Employer Match Contributions from Current Flight Attendants...............................	41
REMEDY…………………………………………...………...………....	44

ISSUE

Did the Company violate the current agreements between APFA and American Airlines including, specifically, paragraph 6 of the MOU dated December 31, 2012; the "Retiree Health" provisions of the Conditional Labor Agreement ("CLA"); Article 35.C and the side letter agreement to Article 35 of the Collective Bargaining Agreement ("CBA") dated September 12, 2012 and any related Articles of the CBA; and Attachment G to the Last Best Final Offer ("LBFO") dated July 19, 2012?

INTRODUCTION

From its origins as a strike issue in 1994 to APFA's reluctant acceptance of the program in 2001, American's Retiree Health Prefunding Program has been a source of controversy and discontent among Flight Attendants. Even following the program's demise as part of a package of sweeping concessions obtained under Section 1113 of the Bankruptcy Code, the dissatisfaction lingers. American now claims that the final distribution of funds it contributed to the program on behalf of current Flight Attendants must await the outcome of litigation that the Company initiated against retirees during bankruptcy, but has failed to prosecute for well over a year.

American's current position that the prefunding matter may dwell in limbo indefinitely is simply contrary to the agreement it reached with APFA during bankruptcy. That agreement was entered into based on American's representations that it would seek relief from its retiree benefit obligations for current retirees in bankruptcy under Section 1114 of the Code. Accordingly, the agreement provided that the employer match funds would be distributed to current Flight Attendants "[c]ontingent upon the successful resolution of the Section 1114 process." American, for reasons of its own, ultimately chose not to exhaust the Section 1114 process. Under these circumstances, basic principles of

contract law dictate that the nonoccurrence of the condition is excused and American is obligated to perform as provided under the agreement.

Having failed to do what it originally indicated that it would do, American argues that there has been no "successful resolution" of the Section 1114 process. The Company now claims that the term "successful resolution" was intended to mean only one result, the complete elimination of its retiree benefit obligations. But the contract language itself does not yield such a narrow meaning, and American has failed to show that it made clear its intent in this regard during bargaining. Under the circumstances, the ambiguous phrase "successful resolution" should be resolved against American as the sole drafter of the language. Accordingly, the Board should adopt APFA's interpretation of the phrase "successful resolution" which encompasses the settlement American reached with its retirees as part of its plan of reorganization in order to successfully exit bankruptcy and consummate the merger with US Airways. American's consensual settlement of Section 1114 constitutes a successful resolution and triggers the Company's obligation to pay current Flight Attendants the employer match money contributed on their behalf.

FACTUAL BACKGROUND

I. American's Retiree Health Prefunding Program and Events Leading to APFA's 2001 Agreement to Participate

As of the early 1970's, and likely well before, American provided for retiree health care coverage at no cost to Flight Attendants. Tr. 216:15-21. Toward the end of the 1980's, American became increasingly concerned about the rising cost of retiree coverage for all employees, including Flight Attendants, particularly in light of the introduction of

Financial Accounting Standard ("FAS") 106 requiring American to record the present value of unfunded future retiree health benefits as a liability on its financial statements. UX 17, at 156-57. In 1989, American first implemented retiree health prefunding pursuant to an agreement with the Transport Workers Union of America ("TWU"), as well as introducing the program for all non-union employees. JX 73; UX 17, at 158. Under the program, participating employees would contribute money to a Company-sponsored trust fund to be used to defray the cost of health care coverage upon retirement. UX 17, at 158. In 1992, American revised the program with TWU to include dollar-for-dollar employer matching contributions, also to be held in the prefunding trust. JX 73. The matching contributions were intended to incentivize other employee groups to agree to participate in the prefunding program.[1] Tr. 210:11-16; UX 18, at 131.

In 1991, American and APFA commenced a new bargaining round and the Company proposed that the Union agree to prefunding. After two years of unsuccessful negotiations, in fall of 1993, APFA and American were released from mediation and, following the statutory cooling-off period, free to engage in self-help. Tr. 212:19-213:22. The Company imposed terms on its Flight Attendants, including the imposition of the prefunding program. *Id.* Subsequently, APFA struck for five days, until President Bill

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[1] In the early 1990's, American proposed prefunding to its pilots in bargaining, including a dollar-for-dollar employer match. Tr. 207:9-208:11. The pilots ultimately arbitrated their collective bargaining dispute in 1991, and the union resisted the Company's proposal for prefunding. UX 16, at 70-71. The arbitrator rejected the Company's prefunding proposal, declining to impose such a "significant conceptual change" although urging the parties to continue to study the issue. *Id.* at 71-72. American's pilots never participated in prefunding. Tr. 633:1-8.

Clinton intervened to bring the parties back to the bargaining table. *Id.* In the wake of the strike, the parties reached tentative agreement on as many issues as possible and then submitted the remaining issues to final and binding interest arbitration. Tr. 214:1-215:8. American's proposal for retiree health prefunding was one of the open issues that was arbitrated. *Id.* The arbitration panel rejected the proposal since similar prefunding programs were not found elsewhere in the airline industry. UX 19, at 64-65.

In the next round of bargaining commencing in 1998, American again proposed prefunding to APFA. Tr. 218:1-219:4. By this point, several large companies had eliminated retiree health care coverage entirely so APFA was more receptive to prefunding as a means to preserve retiree benefits. *Id.* The membership, however, overwhelmingly voted down the first tentative agreement that was reached, in part because the Union had acquiesced on prefunding which was viewed as a strike issue. Tr. 219:8-220:18. Still, APFA reached a second tentative agreement which also contained prefunding. In convincing the membership to accept the program, the Union emphasized the employer match feature and that both employee and employer contributions would be held in trust. During negotiations, American had also assured APFA that if the Company were to terminate the program Flight Attendants would still retain their own contributions and the employer match money. Tr. 228:8-229:5; *see also* UX 16, at 34. APFA conveyed these assurances to Flight Attendants. Tr. 229:6-11; UX 20, at 2; *see also* Tr. 123:20-124:6. The membership ratified the second tentative agreement. Tr. 224:20-22.

Over the years, American issued a number of policy documents and Q&As explaining to employees how the prefunding program worked. American consistently

emphasized that each participant had an individual prefunding account, consisting of both the employee's contributions and American's matching contribution. UX 1, at Q5 (1994) ("Your contributions and American's matching contributions will be assigned specifically to your Prefunding account."); UX 17, at 161 (1995) ("Your contributions, together with the Company's matching contributions, are recorded in an individual account as part of a trust."); UX 2, at 6 (2001) (referring to "your prefunding account"); UX 3, at 9 (2004) (same); UX 4, at 168 (2010) ("Your contributions, together with the Company's matching contributions, are recorded in an individual account as part of a trust."); and UX 5, at 166 (2011) (same). American also explained that each employee's individual account was drawn down over a ten year period following his or her retirement to defray the cost of retiree coverage. *See, e.g.*, UX 5, at 162. The Company made clear, however, that it only expected the prefunding monies to cover a relatively small portion of the total cost of providing retiree medical coverage, and that American would bear the cost of coverage over-and-above the prefunded amount for each Flight Attendant. UX 1, at A22; UX 2, at 5; UX 17, at 160-61. The prefunding monies, both employee and employer contributions, were held in a trust formed as a Voluntary Employee Benefit Association ("VEBA") pursuant to Section 501(c)(9) of the Internal Revenue Code. JX 43, at 1 (Trust Agreement for APFA VEBA).

The Company incentivized Flight Attendants to participate in the prefunding program when first eligible by imposing significantly higher contribution rates on those who delayed participation. Tr. 124:7-22. It was also cumbersome to opt-out of the

program. Tr. 125:1-14; UX 2, at 4. As a result, Flight Attendant participation in prefunding was nearly universal. Tr. 125:15-22.

Following the 2001 Agreement, American and APFA entered into the Restructuring Participation Agreement ("RPA") in 2003 in order to prevent the Company from filing for bankruptcy relief. Tr. 224:12-13; 231:5-15. The RPA contained substantial concessions equivalent to a third of the value of the Flight Attendant contract. Tr. 244:16-232:3. Despite the magnitude of the cuts sought by management, APFA had determined that it would not even discuss the possibility of cuts to retiree benefits. Tr. 232:12-233:6. Accordingly, the RPA made no changes to the prefunding program. Tr. 232:9-11. The RPA became amendable in 2008 and the parties commenced bargaining which dragged on for four and a half years. Tr. 234:19-235:19. In that time, there was almost no discussion of retiree health care at the bargaining table. Tr. 236:18-237:12.

II. American's Bankruptcy and Changes to the Retiree Health Benefits for Current Flight Attendants Under Section 1113

While Section 6 negotiations were still on-going, on November 29, 2011, American filed for Chapter 11 bankruptcy. Tr. 237:13-19. Shortly thereafter, APFA obtained a seat on the Unsecured Creditors Committee ("UCC"), as did the Allied Pilots Association ("APA") and TWU. Tr. 237:22-238:15. However, the unions were walled off entirely from the UCC's determinations with respect to labor issues, including retiree health care, which were handled through a designated labor subcommittee. Tr. 238:16-240:9.

Section 1113 of the Bankruptcy Code provides a process through which a debtor can reject a collective bargaining agreement unless the company and union reach

agreement on modifications. JX 46 (11 U.S.C. § 1113). Basically, the process is initiated when the company makes a proposal to the union for contract modifications. *Id.* § 1113(b)(1)(A). The proposal must satisfy certain statutory standards, including that the modifications must be (1) necessary for a successful reorganization and (2) insure fair and equitable treatment for all bankruptcy stakeholders. *Id.* The fair and equitable standard is basically a codification of the concept of shared sacrifice and is intended to insure that stakeholders are not asked to contribute disproportionately to the entity's reorganization. *See, e.g.*, *In re Century Brass Prods., Inc.*, 795 F.2d 265, 273 (2d Cir. 1986) (purpose of § 1113(b)(1) is to "spread the burdens of saving the company to every constituency while ensuring that all sacrifice to a similar degree"); Tr. 655:12-19.

Having made a Section 1113 proposal, the company must provide information as necessary to evaluate the proposal and bargain in good faith over the proposal. JX 46, § 1113(b)(1)(B) & (b)(2). The company must satisfy these prerequisites before it can file an application for rejection in the bankruptcy court, in the event that negotiations do not produce agreement. *Id.* § 1113(c). Once an application is filed, the Code requires that the bankruptcy court hold a hearing within 21 days and issue a decision within 30 days of the commencement of the hearing, unless the parties agree to an extension. *Id.* § 1113(d). Under Second Circuit precedent applicable to the American bankruptcy, Section 1113 rejection abrogates the CBA in its entirety and permit imposition of the employer's proposed terms. *See In re Northwest Airlines Corp.*, 483 F.3d 160, 170-72 (2d Cir. 2007).

On February 1, 2012, American made Section 1113 proposals to all its unions. Tr. 240:10-241:1. The Company maintained that it needed $990 million in annual labor cost

savings from unionized employees, with $230 million annually to come from its Flight Attendants. Tr. 241:2-12; UX 23, at 41 n.21. In conjunction with its Section 1113 proposals, the Company presented its new business plan to employees, known as the "Plan for Success," which set forth the steps it viewed as necessary to successfully exit bankruptcy. Tr. 241:13-243:9; UX 21; *see also* Tr. 322:3-13. The labor cost savings sought from union employees were part of the business plan. Tr. 243:10-13; Tr. 323:14-325:7. American also stated that "[t]erminating . . . retiree medical obligations" was a "critical" component of its business plan, including benefits for then-current retirees. Tr. 243:22-244:1; UX 21, at 47, 49; *see also* Tr. 326:14-327:19.

In order to obtain $230 million in annual Flight Attendant labor savings, American proposed sweeping contract concessions, including termination of the defined benefit pension plan, drastic cuts in medical coverage for active employees, loss of sick leave benefits and vacation pay, and changes in scheduling and work rules which would lead to the loss of 2,300 Flight Attendant jobs. JX 8; Tr. 245:3-247:18. The Company also proposed elimination of the contractual requirement to provide medical coverage to future Flight Attendant retirees. JX 8 at 13. Instead, the Company would provide access to a retiree medical plan for early retirees ages 55-64 at 100% of the cost, and the ability to purchase a Medicare supplement plan for retirees age 65 and over, although these benefits too could be eliminated at any time in the Company's sole discretion. *Id.* The Company proposed "refund[ing] the employee's prefunding account (which reflects investment experience)." *Id.* The proposal did not address the employer matching contributions. *Id.* American's Section 1113 proposal was limited to future retirees since benefits for current

Flight Attendant retirees were covered under Section 1114 of the Bankruptcy Code (which will be addressed in greater detail below). Tr. 261:5-9. American justified its retiree health proposal by claiming that it was at a cost disadvantage vis-à-vis other legacy airlines who had shed these obligations in bankruptcy. Tr. 301:10-302:10; UX 27, at 17-18.

APFA and American began negotiations over the Section 1113 proposal. The Company negotiating team was the same group as had been involved in negotiations with APFA since 2008: Taylor Vaughn, Cathy Scheu, Vince Heyer, and Kris Venable. Tr. 248:6-11. APFA understood that, if an agreement were not reached, American would file a Section 1113 application with the court, and that courts had generally ruled in favor of such motions in the past. Tr. 248:15-20, 256:6-21; Andrew B. Dawson, *Collective Bargaining Agreements in Corporate Reorganizations*, 84 Am. Bankr. L.J. 103 (2010) (study of large Chapter 11 bankruptcies from 2001 to 2007 finding that courts granted Section 1113 relief in every case where sought). APFA also understood that it would not be able to strike in response to the rejection of its CBA. Tr. 249:18-21; *see also In re Northwest Airlines Corp.*, 483 F.3d at 175-77.

Believing that American's Section 1113 proposal "was completely unattainable," APFA presented a counter-proposal on March 26, 2012 designed to meet the Company's immediate needs while preserving key features of the Flight Attendant agreement. Tr. 245:7-13; JX 73, at 1; JX 14. APFA's counter included a proposal regarding retiree medical benefits. JX 73, at 1; JX 9. APFA proposed that the monies in the current Flight Attendant VEBA, both employee and employer contributions, be transferred to a replacement VEBA to which active employees would contribute $30 per month and

American would contribute $50 per month with those contributions subsequently adjusted for inflation. *Id.* APFA retained Segal Company, an actuarial and benefits consulting firm, to design the replacement VEBA. Tr. 304:14-20; JX 10. APFA's proposal was intended to retain some form of subsidized medical coverage for future retirees employing the existing VEBA monies (both employee and employer), while at the same time eliminating American's open-ended obligation for retiree medical. Tr. 304:7-13. American's actuaries, Towers Watson, reviewed APFA's VEBA proposal. JX 15. Towers Watson's primary objection was that the VEBA would not have sufficient assets to be viable beyond 2020 if Flight Attendants were offered an early-out package, which APFA was also seeking in negotiations. *Id.*

The next day after the Union served its comprehensive counter-proposal, American filed its Section 1113 motion against APFA, as well as APA and TWU. JX 73, at 1. The Section 1113 trial began on April 23, 2012, and those proceedings were not concluded until May 25, 2012. JX 73, at 1-2. In its Section 1113 filings with the court, including sworn declarations, American repeatedly stated that medical benefits for then-current retirees would be addressed in a separate motion filed under Section 1114 of the Bankruptcy Code. UX 22, at 38 n.20 (". . . in a separate motion under Section 1114 of the Code, American will ask the court for permission to eliminate company-paid retiree medical benefits for former employees who retired prior to the Petition Date."); UX 23, at 41 n.21 (same); UX 24, at 14 n.14 (same). These statements were consistent with American's oral representations to APFA: "the Company said many times they were going to file an 1114 because it had been the usual practice in other bankruptcies." Tr. 264:2-5.

While the Section 1113 trial process was on-going, TWU announced that it would send American's final offer out to be voted upon by the union's seven different crafts. On May 15, 2012, it was announced that five of the seven groups had ratified their agreements. In these ratified agreements, TWU agreed to the elimination of subsidized medical benefits for future retirees. UX 25, Ex. A at 96-101. The agreements provided that TWU employees prefunding contributions would be refunded to them. *Id.* at 103. The agreements also provided:

> In addition, the parties agreed that contingent on the successful resolution of the Section 1114 process, as soon as practicable after termination of the Trust Agreement for the Group Life and Health Benefits Plan for Employees of Participating AMR Corporation Subsidiaries (Union Employees), the Company prefunding contributions for each participating active employee, and investment earnings attributable thereto, will be distributed to the employee (subject to applicable tax withholdings and/or excise tax), excluding employees who have already received refunds of their employee prefunding accounts.

Id.

During the Section 1113 trial, APFA and American did not engage in any substantive bargaining. Tr. 306:13-20. Following the conclusion of the Section 1113 trial on May 25, 2012, Bankruptcy Judge Sean H. Lane urged the parties to return to the negotiating table rather than have him decide the Section 1113 motions still pending. Tr. 255:20-256:5. Initially, the parties engaged in mediation overseen by Bankruptcy Judge James M. Peck. *Id.* Beginning in June 2012, APFA and the Company began negotiations that would ultimately lead to the agreement known as the Last, Best, and Final Offer ("LBFO"). For the most part, the parties reached agreement on the LBFO terms on July 5 with only a few "cleanup" issues remaining. Tr. 258:3-8. However, the Union

purposefully delayed having the APFA Executive Committee vote to send the LBFO out for ratification until July 20, 2012 in order to get American to sign a non-disclosure agreement allowing US Airways access to Company records for the purpose of evaluating a possible merger. Tr. 279:4-17; *see also* UX 28, at 79 (American agreed to enter non-disclosure agreement on July 19, 2012).

When the LBFO negotiations began, the parties' positions on retiree medical benefits remained the same as when American filed its Section 1113 motion. Tr. 306:13-307:2. On July 3, 2012, however, American presented APFA with a comprehensive LBFO proposal, including a revised retiree medical proposal which added for the first time the following language:

> Contingent on the successful resolution of the Section 1114 process, as soon as practicable after termination of the Trust Agreement for the Group Life and Health Benefits Plan for Employees of Participating AMR Corporation Subsidiaries (Union Employees), the Company prefunding contributions for each participating active employee, and investment earnings attributable thereto, will be distributed to the employees (subject to applicable tax withholdings), excluding employees who have already received refunds of their employee prefunding accounts.

JX 16, at 18. This language was lifted essentially verbatim from the agreements ratified by TWU members on May 15, 2012. Tr. 78:10-17, 259:5-11. In fact, during the hearing in this matter, American's Managing Director of Health and Welfare, Mary Anderson, admitted that the above provision contains mistakes as a result of American's failure to adapt the TWU language to the Flight Attendant group. First, the Trust Agreement referred to is the title of the Trust Agreement for TWU employees, not the APFA Trust Agreement which is separate. Tr. 478:2-480:7 ("Q: Okay. So you believe that's a mistake in the

document? A: I do."); *compare* JX 42 *with* JX 43. Second, the phrase "excluding employees who have already received refunds of their employee prefunding accounts" only applied to certain TWU employees, and had no applicability to the Flight Attendant group. Tr. 481:12-482:17.

As American acknowledges, the key phrase in this dispute is "contingent upon the successful resolution of the Section 1114 process." Tr. 78:10-12 (Opening Statement). However, there were no negotiations between APFA and American regarding this language from the time it was first proposed to the Union on July 3, 2012 and the final ratification of the LBFO on August 19, 2012. Tr. 307:16-308:3. Joint Exhibits 21-26 are drafts exchanged between the parties, which show that the key phrase remained unchanged from American's initial proposal on July 3. The only back-and-forth between APFA and American concerned whether the employer prefunding money could be distributed to a tax-advantaged Health Reimbursement Account ("HRA"), which ultimately did not prove feasible. JX 21-26.

During bargaining, American never communicated to APFA that the phrase "Section 1114 process" as it appeared in American's July 3, 2012 proposal was intended to include the adversary proceeding initiated by the Company against its retirees on July 6, 2012. Tr. 308:6-9; JX 73, at 2. In fact, American's then Senior Vice President of People, Denise Lynn, who developed the Company's Section 1113 bargaining strategy (but was not herself at the negotiating table) testified that even she did not understand the details of the Company's legal strategy with regard to the elimination of medical benefits for current retirees. Tr. 628:16-629:4, 651:12-652:7. American also never stated that the proposed

language required the total elimination of its retiree health obligations. Tr. 262:6-10, 308:10-14.

In his opening statement, American's counsel indicated that extensive evidence would be presented regarding what the Company told APFA during bargaining about the meaning of the key phrase at issue in this case. Tr. 54:6-19, 75:13, 93:16-20, 94:3, 95:19. However, the Company actually introduced very little testimony about what was said in negotiations, and the little introduced was exceedingly vague in terms of the timing and context of the statements claimed. Basically, the Company presented only one witness, Mary Anderson, who was actually present during bargaining at any point in time (despite the fact that the Company's primary negotiator in the APFA Section 1113 bargaining, Taylor Vaughn, was present throughout the arbitration hearing). Ms. Anderson testified that at some unidentified point in time she told the "unions" (not specifically APFA) that the Company's "intent" was "to remove [its] retire[e] medical obligation in total" in order to "get them off the books . . . you know, no liability, no cash expense, no accounting expense." Tr. 402:7-20. As far as negotiations with APFA, she testified only that she "usually said the liability has to come off the books before we can start talking about releasing the Company match money" and that these conversations were "late in the game." Tr. 419:12-420:12. Thus, there is no evidence that American specifically explained the meaning of the language at issue here which first appeared in its July 3, 2012 proposal.

Based on the proposal's plain language and the Company's representations in court and during bargaining that it intended to file a motion under Section 1114 as was done in other legacy airline bankruptcy cases, APFA understood the provision at issue to mean that

"the Company had every intention of following an 1114 process. And whether there was a settlement or agreement reached prior or a Judge's decision that gave them what they needed to exit bankruptcy, that would be the conclusion of the 1114 – the successful conclusion of the 1114 process." Tr. 262:11-22; Tr. 263:14-15 ("whatever relief they needed to exit bankruptcy").

Flight Attendants ratified the LBFO on August 19, 2012. JX 73, at 2. In accordance with the agreement, American refunded Flight Attendants' own prefunding contributions on December 12, 2012. *Id.* at 3. The amounts for individual Flight Attendants varied, but most received approximately $2,000, which included the investment earnings on their prefunded amounts. Tr. 174:10-175:18.

III. APFA and US Airways Negotiate a Conditional Labor Agreement

In mid-March 2012, US Airways and APFA began discussions regarding a possible merger with American. Tr. 250:7-19. In negotiations conducted from April 5-12, 2012, APFA and US Airways reached an agreement known as the Conditional Labor Agreement ("CLA"), which would come into effect in the event of a merger. JX 31; JX 73, at 1. US Airways required concessions in the CLA, but less harsh than American's Section 1113 proposal. Tr. 253:10-12. In the CLA, US Airways agreed to APFA's concept of a replacement VEBA to provide medical benefits to future retirees, although without the on-going employer contributions that APFA had sought in its proposal to American. JX 31, at 2; CX 1 and 2. The CLA provided that the replacement VEBA would be "seeded with [the] current balance of FA and AA contributions per Pre-funding provisions of CBA." JX 31, at 2. The CLA did not condition the release of American's employer match money to

the APFA-sponsored replacement VEBA in any way. *Id.* Seeding the replacement VEBA with the Company match money was not treated as cost item to be charged against APFA in valuing the CLA. Tr. 354:16-21.

In December 2012, APFA engaged in further negotiations regarding the CLA with the UCC acting as an intermediary with US Airways. Tr. 270:6-271:2, 272:18-273:3. The purpose of the negotiations was to clarify some aspects of the CLA in light of the ratification of the LBFO in the interim. Tr. 271:16-21. The product of these negotiations is referred to as the "MOU." Tr. 270:18; JX 32. The MOU addressed retiree medical. JX 32, at 2. By this point in time, American had refunded the Flight Attendant prefunding contributions in accordance with the LBFO. Therefore, the MOU provided that the replacement VEBA would not be implemented. *Id.* The MOU further stated: "It is the intent of the parties to maintain the Retiree Medical program provided for in the new CBA," meaning the new access-only plan for future retiree. *Id.*; Tr. 273:4-7. The MOU was silent regarding the disposition of American's prefunding contributions. Tr. 273:16-18.

IV. American's Adversary Proceeding, Service of a Section 1114 Proposal, and Ultimate Decision Not to Seek Section 1114 Relief

Section 1114 is the provision of the Bankruptcy Code that governs the treatment of non-pension retiree benefits during a Chapter 11 case and before a Chapter 11 plan of reorganization can be confirmed. JX 47 (11 U.S.C. § 1114). These non-pension benefits are often referred to as other post-retirement benefits ("OPEB"). Section 1114 provides that a debtor must continue to pay retiree benefits unless either the retiree's "authorized representative" has agreed to or the court has ordered modification of payment. *Id.* §

1114(e). The Code also requires that a Chapter 11 plan provide for the "continuation after its effective date of payment of all retiree benefits, . . . at the level established pursuant" to Section 1114. *Id.* § 1129(a)(13).

A labor organization serves as the "authorized representative" of "those persons receiving any retiree benefits covered by any collective bargaining agreement to which that labor organization is signatory," unless the organization declines to serve as the representative or the court determines that such representation is inappropriate.[2] *Id.* § 1114(c)(1). In addition, the court may appoint a committee of retired employees "if the debtor seeks to modify or not pay the retiree benefits or if the court otherwise determines that it is appropriate." *Id.* § 1114(d). Where there are both union and non-union retirees, the bankruptcy court may choose to appoint a single committee representing all retirees. *See* 5 Norton Bankr. L. & Prac. 3d § 105:8 ("In an effort to keep costs to the estate at a minimum, one committee comprised of a representative selection of nonunionized employees and employees belonging to the various unions should be sufficient.").

Before a debtor-employer can file an "application" to modify benefits, it must first make a proposal to the authorized representative "for those necessary modifications in the retiree benefits that are necessary to permit the reorganization of the debtor." *Id.* § 1114(f).

[2] While American's counsel suggested that APFA service on the Retiree Committee appointed by the bankruptcy court presented a conflict of interest, *see* Tr. 291:8-16, the Code provides that by default unions represent their retirees under Section 1114.

The proposal must be based on the most complete and reliable information available at the time. *Id.* In addition, the debtor must provide all information relevant to evaluating the proposal. *Id*. Between the time of making the proposal and the hearing date, the debtor must meet with the authorized representative in a good faith attempt to reach settlement. *Id*. If settlement is not reached, in the application, the debtor must show that the modification is necessary to permit its reorganization, that all affected parties are treated fairly and equitably under the proposal, and that the balance of the equities favors modification. *Id.* § 1114(g).

A hearing on the application must be scheduled within 21 days after it is filed. *Id.* § 1114(k)(1). The court is then required to rule on the application within 90 days after the commencement of the hearing, and that deadline may only be extended by the agreement of the debtor and the authorized representative. *Id.* § 1114(k)(2). If the court fails to render a decision within the 90-day period, the debtor may implement its proposed modification. *Id.* § 1114(k)(3). Section 1114(k) "assures swift resolution of applications for modification of retiree benefits." 5 Norton Bankr. L. & Prac. 3d § 105:16.

When a Section 1114 application is granted, the difference between the original benefits and the modified payments is treated as a general unsecured claim in bankruptcy. *In re Ionosphere Clubs, Inc.*, 134 B.R. 515, 527 (Bankr. S.D.N.Y. 1991) ("unpaid retiree claims resulting from any modification under § 1114 are general unsecured claims"). In American's bankruptcy, as in most Chapter 11 cases, general unsecured claims were satisfied through the issuance of stock in the reorganized Company. UX 33-35. Therefore,

the recovery rate on claims ultimately depended on the value of the new stock issued at whatever point in time the holder might choose to sell it. *Id.*

Shortly after American filed for bankruptcy, two self-selected potential retiree representatives moved the court to form a retiree committee in anticipation that the Company would file a Section 1114 application. JX 49, at 4; JX 50, at 5. On February 22, 2012, American opposed these motions arguing that they were "premature" since it had "not initiated any proceedings pursuant to section 1114 of the Bankruptcy Code to deal with retiree benefits." JX 51, at 3. The UCC also filed a limited objection, noting that "Debtors reported to the Committee that the retiree benefits at issue are not terminable at will, which suggests that 11 U.S.C. § 1114 is likely to be implicated." JX 52, at 3. The UCC subsequently filed a revised objection stating that it had reviewed documents indicating that at least some of American's retiree benefits may be terminable at will and therefore possibly not subject to the Section 1114 process. JX 53, at 3, 4. Ultimately, all parties reached a stipulation directing appointment of a retiree committee and on May 3, 2012 the United States Trustee approved the appointment of committee representatives, including APFA President Laura Glading on behalf of retired Flight Attendants. JX 54; JX 73, at 2.

On July 6, 2012, American filed an adversary proceeding in bankruptcy court against the retiree committee seeking a declaration that the Company is not legally obligated to continue to provide retiree medical benefits. JX 57. "An 'adversary proceeding,' . . . is a *lawsuit* filed within the bankruptcy case. *See* Fed. R. Bankr.P. 7001; *see also* 10 Collier on Bankruptcy ¶ 7001.01 (Alan N. Resnick & Henry J. Sommer eds.,

16th ed. 2010) ('Adversary proceedings are separate lawsuits within the context of a particular bankruptcy case and have all the attributes of a lawsuit. . . .')." *In re TWL Corp.*, 712 F.3d 886, 892 (5th Cir. 2013). Employers have brought declaratory judgment actions similar to American's outside of bankruptcy either naming as defendant a union or filed as a defendant class action.[3] The UCC filed a motion to intervene in the adversary proceeding and join in American's complaint, stating:

> The Committee wishes to intervene in the Adversary Proceeding because of the gravity of the issues presented. At stake is the OPEB of virtually all of the Debtors' current retirees. If the Debtors prevail, they can terminate the OPEB – which total approximately $1.4 billion as of plan year 2010 (Complaint ¶ 14) – in the exercise of their business judgment. In contrast, if the adversary complaint fails, all stakeholders will face the expense and uncertainty of section 1114 proceedings. Moreover, a judgment that the Debtors' OPEB is unvested would allow the Debtors to terminate those benefits without generating a large unsecured claim, thereby avoiding the dilution of unsecured creditor recoveries.

JX 62, at 6. The UCC remained actively involved in the adversary proceeding, as it was in retiree benefit matters more generally. UX 14 (billing statements of UCC counsel).

Simultaneous with filing the complaint, American sought permission from the court to file for summary judgment immediately, claiming that there was no genuine dispute of material fact because the dispute could be decided based solely upon benefit plan documents. JX 58. The retiree committee responded that the court should allow full discovery before proceeding with summary judgment. JX 59 and 60. In the end, the parties

[3] *See, e.g.*, *Stone & Weber Eng'g Corp. v. Ilsley*, 690 F.2d 323 (2d Cir. 1982); *John Morrell & Co. v. UFCW*, 37 F.3d 1302 (8th Cir. 1994); *Maytag Corp v. UAW*, 687 F.3d 1076 (8th Cir. 2012); *Windstream Corp. v. Da Gragnano*, 757 F.3d 798 (8th Cir. 2014); *Teamsters Local Union No. 340 v. Eaton*, 2015 WL 413864 (D. Me. Jan. 30, 2015).

ultimately agreed to a schedule for discovery and summary judgment briefing with American filing a motion for partial summary judgment on August 15, 2012.[4] Tr. 144:22-145:6; JX 61. In the words of American's counsel, Edward Meehan, "we got bogged down in discovery" and the schedule for oral argument on the summary motion also "kept getting slipped back." Tr. 524:9-10, 525:1-2.

On July 16, 2012, the retiree committee filed its claim for potential damages in the bankruptcy proceeding in the amount of $1,367,332,456. UX 8. The claim reflected the value of benefit payments to current retirees that American would no longer need to make if it was relieved of its retiree obligations. JX 62, at 6; Tr. 328:17-329:1. In other words, the claim was equivalent to the OPEB liability that American carried on its books at the time. JX 62, at 6. The amount of the potential claim was not disputed. *Id.* A potential retiree claim of this magnitude would have a meaningful impact on the recovery of other general unsecured creditors since distribution of the allocated stock in the reorganized company to satisfy a greater claims amount would dilute the claims pool. Tr. 330:7-333:7; UX 29 (explaining the "OPEBonomics" at work in determining creditor recoveries in the American bankruptcy).

On September 12, 2012, American's Denise Lynn sent a letter to employees, including Flight Attendants, outlining benefit changes to be implemented as a result of the

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[4] American designated its motion as one for partial summary judgment since it believed that it would still need to request relief under Section 363 of the Bankruptcy Code in order to terminate the retiree benefits. Tr. 572:9-574:20. Section 363 requires the debtor to seek court approval for actions not in the ordinary course of business. *Id.*

bankruptcy. UX 10; Tr. 170:171:5. Concerning benefit changes for current retirees, the letter stated:

> Retiree medical and life benefits for current retirees (those who retired and enrolled in the retiree medical coverage prior to November 1, 2012) will not change until the 1114 process is resolved. This is the process under Chapter 11 that allows a company to pursue changes to health and welfare benefits for existing retirees. The company has proposed to make the same changes to the benefits in place for existing retirees as it is making for active employees who retire on or after November 1, 2012. However, we won't know the final outcome of the 1114 process for several months.

UX 10, at 4.

While the discovery process in the adversary proceeding was on-going, in October 2012 American also initiated the Section 1114 process by making a proposal to the retiree committee under Section 1114(f)(1)(A) as a precondition to filing an application seeking the modification of retiree benefits. JX 47, § 1114(f)(1); Tr. 148:18-149:1. As required by Section 1114(f)(2), American engaged in negotiations with the retiree committee over its proposal. Tr. 149:2-150:9. During the negotiations, American indicated that, if the parties could not reach agreement, the Company would file a Section 1114 application and was prepared to do so at any moment. Tr. 150:10-151:8. In fact, the billing records for American's counsel show that they were working feverishly on a Section 1114 application throughout the fall of 2012, preparing extensive motion papers including ten separate declarations in support. UX 13. Overall, counsel billed American a total of 993 hours for work on a Section 1114 application (that was never filed), more hours than billed for the adversary proceeding. *Id.*

As American's counsel, Edward Meehan, testified, throughout 2012 American continued to work toward filing a Section 1114 application, "[b]ut towards the end of the year, [counsel] came to understand in communications with the financial advisor that it would be a financial disaster for the Company to file an 1114 application at that point." Tr. 525:4-13. As Mr. Meehan understood it, by the end of 2012, the claims in American's bankruptcy were expected to be "paid out at 100 cents on the dollar" such that, in his view, a Section 1114 motion would only "accelerat[e] any obligation." Tr. 528:8-529:20. Counsel's view was apparently predicated on the belief that the general unsecured claims in the American bankruptcy would be paid in cash. Tr. 590:19-592:3. However, American satisfied its general unsecured claims with stock in the reorganized Company, not cash. UX 33-35. Thus, for claims to pay out at full value meant that it was projected that the value of stock in the new Company (if sold upon emergence) would be equivalent to the value of the holder's bankruptcy claim. American never advised APFA that it had decided not to pursue Section 1114 relief. Tr. 264:2-7; 276:4-7.

American wrapped up summary judgment briefing in the adversary proceeding in early January 2013. JX 61, 63-65. The court held oral argument on January 23, 2013. JX 66. During argument in response to assertions by retiree committee counsel that American would still need to exhaust Section 1114 regardless of the outcome of the adversary proceeding, American's counsel, Edward Meehan, stated:

> 1114, this is not an 1114 proceeding. We have not filed an 1114 proceeding. We are not seeking relief under 1114. The Delphi [] case, Your Honor, we are in the Second Circuit, if the benefits are not vested, it is the company's position as a matter of law, we do not need to go through an 1114 proceeding. We have no desire to create substantial claims for anyone who is not entitled

> as a matter of law to those claims. So this is, has nothing to do with 1114, Your Honor, ... Either [the benefits] are vested in which case we are not free to modify them or they are not vested in which case we are.

JX 66, at 116.[5] At the conclusion of the hearing, the court took American's motion for partial summary judgment under advisement.

During the fall of 2012, US Airways and American also began negotiations regarding a possible merger. UX 28, at 80-82. In November 2012, US Airways made a merger proposal to American providing that American stakeholders would receive 70% of the stock in the new company and US Airways stockholders would receive 30% ("Equity Split"). *Id.* at 81. US Airways, however, made the Equity Split subject to a number of conditions, including "the elimination in the Chapter 11 Cases of AMR's liability for other post-employment benefits ("OPEB")." *Id.* Discussions continued. On January 28, 2013, US Airways advised that it was willing to increase the Equity Split to 72/28, but still with the condition that American extinguish its OPEB liabilities in bankruptcy. *Id.* at 85. On February 5, 2013, US Airways indicated that it would agree to the 72/28 Equity Split without the requiring American to eliminate its OPEB liabilities. *Id.* at 85. This merger

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[5] Counsel for the retiree committee made these assertions relying upon the reasoning of *In re Visteon Corporation*, 612 F.3d 210 (3d Cir. 2010), which held that any termination of retiree benefits in bankruptcy, whether vested or not, must be done pursuant to Section 1114. In contrast, American relied on a decision reaching the opposite conclusion from the same bankruptcy court in which its Chapter 11 was filed. *In re Delphi Corp.*, No. 05-44481(RDD), 2009 WL 637315 (Bankr. S.D.N.Y. Mar. 10, 2009). However, neither decision would have been *stare decisis* for Judge Lane. *In re Jamesway Corp.*, 235 B.R. 329, 336 n.1 (Bankr. S.D.N.Y. 1999). So it is unknown whether American would have been required to file under Section 1114 even if it prevailed in the adversary proceeding. Tr. 569:6-570:8 (conceding that Judge Lane could have followed *In re Visteon*).

proposal was accepted shortly thereafter. *Id.* at 85-86. On May 10, 2013, the bankruptcy court approved the final merger agreement. JX 73, at 3.

Subsequently the merger agreement became part of American's bankruptcy plan of reorganization, which was approved by Judge Lane on October 22, 2013. UX 9, at 17, 20; JX 73, at 3. Section 1129 of the Bankruptcy Code governs plan confirmation and requires, among other things, that the plan address the disposition of retiree benefits under Section 1114. JX 48, § 1129(a)(13). The Company engaged in negotiations with the retiree committee regarding the provisions in the reorganization plan addressing retiree benefits. Tr. 165:15-166:5. As part of the plan, the parties agreed that the reorganized American could continue to prosecute the adversary proceeding and, to the extent that the Company was unsuccessful in whole or in part in obtaining the relief sought, it would continue to pay any remaining vested benefits. UX 9, Ex. A at 84-85. In addition, as agreed upon, the plan foreclosed the possibility of any retiree claim, providing that if any modification of retiree benefits were subsequently deemed to give rise to a claim, American would simply continue those benefits unmodified. UX 9, at 30; *see also* JX 68, at 2. The plan also provided for the retiree committee to continue in existence. UX 9, Ex. A at 98-99. "There was a concern that with the 1114 process now foreclosed, that the 1114 Committee would go away" and defense of the adversary lawsuit would no longer be funded by the bankruptcy estate. Tr. 169:10-19.

American emerged from bankruptcy on December 9, 2013, at which time the merger became effective. JX 73, at 3. At this point, Judge Lane had still not ruled on American's motion for partial summary judgment in the adversary proceeding. On March 18, 2014,

during an omnibus bankruptcy hearing, American's counsel represented to the court that the Company had advised the retiree committee that it "intend[ed] to shift the cost of retiree health and life insurance coverage to the retirees in the next several months." JX 68, Att. at 35. The court responded: "isn't this sub judice in front of me?" *Id.* Counsel responded "notwithstanding the fact that the litigation is before you, [] the debtors do have the right to make these changes" and "even if we don't prevail on summary judgement, we have the right consistent with the plan" to make the changes. *Id.* at 36.

On April 18, 2014, Judge Lane issued a decision denying in part and granting in part the motion for partial summary judgment. JX 70. As to the vast majority of retirees, the court denied the motion. Tr. 155:14-156:5. The court rejected American's argument that the issue of vesting was to be determined solely by benefit plan documents reserving the Company's right to modify or terminate benefits. JX 70. Instead, the court found that a trier of fact could conclude that American's collective bargaining agreements and other documents granted a vested right to benefits. *Id.* On May 28, 2014, Judge Lane issued a final order reflecting his ruling. JX 71. Since that time, American has not taken any action in court to prosecute the adversary proceeding which remains open and pending. JX 72.[6]

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[6] As of the date of this brief, there has still been no activity on the court docket since May 28, 2014.

ARGUMENT

I. American's Failure to File a Section 1114 Application Excuses the Nonoccurrence of the Condition to Fulfillment of the Promise to Pay Flight Attendants the Company's Matching Prefunding Contributions

Basic principles of contract law dictate that when a party fails to take action that is necessary to effect a contractual condition, the occurrence of that condition is excused. The *Restatement (Second) of Contracts* provides:

> Where a duty of one party is subject to the occurrence of a condition, the additional duty of good faith and fair dealing imposed on him under § 205 may require some cooperation on his part, either by refraining from conduct that will prevent or hinder the occurrence of that condition or by taking affirmative steps to cause its occurrence.

Restatement (Second) of Contracts, § 245 (1981). If a party fails to take the affirmative steps necessary to bring about the occurrence of a condition, "it has the further effect of excusing the non-occurrence of the condition itself, so that performance of the duty that was originally subject to its occurrence can become due in spite of its non-occurrence." *Id.* Likewise, *Williston on Contracts* explains:

> If a promisor prevents or hinders the occurrence of fulfillment of a condition to her or his duty of performance, the condition is excused. In other words, "the nonoccurrence or nonperformance of a condition is excused where the failure of the condition is caused by the party against whom the condition operates to impose a duty." Accordingly, the liability of the promisor is fixed regardless of the failure to fulfill the condition.

Williston, § 39.4 (quoting *Rohde v. Mass. Mut. Life Ins. Co.*, 632 F.2d 667, 670 (6th Cir. 1980). The *Restatement* provides the following illustration:

> A contracts to sell and B to buy a house for $50,000, with the provision, "This contract is conditional on approval by X Bank of B's pending mortgage application." B fails to make reasonable efforts to obtain approval and, when the X Bank disapproves the application, refuses to perform when A tenders

> a deed. A has a claim against B for total breach of contract. B's breach of his duty of good faith and fair dealing contributed materially to the non-occurrence of the condition, approval of the application, excusing it.

Restatement (Second) of Contracts, § 245.

These principles are sometimes referred to as the "prevention doctrine." *Moore Bros. Co. v. Brown & Root, Inc.*, 207 F.3d 717, 725 (4th Cir. 2000). The doctrine "'operates as an exception to the general rule that one has no duty to perform under a contract containing a condition precedent until the condition occurs.'" *Johnson v. Coss*, 667 N.W.2d 701, 706 (S.D. 2003) (quoting *Williston*, § 39:4). "[P]revention is similar to the concept of 'waiver by estoppel' in the context of excuses for nonperformance of contractual duties. An individual who prevents the occurrence of a condition may be said to be 'estopped' from benefitting from the fact that the condition precedent to his or her obligation failed to occur." *Williston*, § 39.7. We submit that the prevention doctrine should apply with even greater force in a case such as this where it is the party who insisted upon the contractual condition who fails to take the action necessary for that condition to come about.

The prevention doctrine applies in the labor relations context. In *Zadey Natey, Inc. v. United Food and Commercial Workers Local No. 27*, 826 F. Supp. 142 (D. Md. 1992) the court applied the prevention doctrine to uphold an arbitration award in favor of a union. The collective bargaining agreement included a provision that it would be binding on the parties' "heirs, executors, administrators, successors and assigns," but the employer entered into an asset purchase agreement that required it to terminate all employees. *Id.* at 143. The arbitrator's award found that the purchaser qualified as a successor under the

CBA, and that therefore the employer violated the CBA for failing to obtain the purchaser's agreement to continue the terms of the CBA. In upholding the award, the court found that the employer "breached [the] duty of good faith and fair dealing" by obstructing the successorship condition to the CBA's enforceability. *Id.* at 146-47 (citing *Restatement (Second) of Contracts*, §§ 205, 245). The court stated:

> Zady Natey argues that the principles set forth in the Restatement prohibiting a party from taking steps to render impossible the performance of a provision of a contract into which it has entered should not be incorporated into labor law. It has cited no authority in support of its position, and reason certainly does not substantiate it. Indeed, the interest of preserving stability in labor relations supports rather than undercuts the implication of a duty requiring a party to refrain from acting in bad faith.

Id. at 147 n.7.

In *National Labor Relations Board v. Local 554, Graphic Communications International Union, AFL-CIO*, 991 F.2d 1302 (7th Cir. 1993), the Seventh Circuit enforced an NLRB order requiring that a union sign a collective bargaining agreement it had negotiated with an employer. The contract contained an express condition that the union could not sign the agreement without approval by the international union, but the union failed to submit the contract to the international, and then claimed that the international's lack of approval prevented the local from signing. *Id.* at 1306-07. "The dilatory tactic of the [union] in failing to seek international approval, obtaining the benefit of its bargain, and then asserting the failure of the International to approve the contract as a basis for failing to execute the agreement gives rise to an estoppel situation." *Id.* at 1307. The Seventh Circuit cited *Restatement (Second) of Contracts*, § 245 to hold that the NLRB was justified in finding that "the union failed in its duty to seek the International's signature

and therefore cannot complain for lack of signature." *Id.* at 1308; *see also Locke v. US Airways*, No. 13-2330, 2014 WL 4087497 (1st Cir. Aug. 20, 2014) (applying prevention doctrine in case involving last chance agreement, but finding that employer did not hinder occurrence of condition).

Here, American made the payment of the employer prefunding money to Flight Attendants "[c]ontingent on the successful resolution of the Section 1114 process." Having insisted on this condition, American was obligated to avail itself of the Section 1114 process, or else forfeit the condition. As APFA understood, and we believe the Company understood as well, "the Section 1114 process" referred to the process outlined under Section 1114 of the Bankruptcy Code, *i.e.* a proposal for modification of benefits, negotiations, and, if necessary, application to the court for permission to modify. This is simply the most natural and obvious meaning of the phrase "Section 1114 process." This is the process that had been followed in every other legacy airline bankruptcy, and American had made clear that it was looking to emulate its competitors' restructuring of retiree health obligations. As a result, American's business plan for a successful reorganization as presented to APFA during Section 1113 bargaining required savings from the elimination of retiree benefits, just as it required labor cost savings from current employees. Most significantly, at the time the LBFO language was agreed to, *American had stated unequivocally that it intended to file a Section 1114 motion*, both in court filings and during negotiations.[7] Tr. 264:2-5; UX 22-24. And, in fact, American continued to

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[7] *See also* Tr. 477:6-12 (Anderson testimony):

pursue Section 1114 relief for months after the APFA agreement was ratified, including making a Section 1114 proposal, negotiating over it, and threatening the imminent filing of its Section 1114 application if its proposal was not accepted.[8]

APFA's understanding that American would avail itself of the process set forth in Section 1114 of the Bankruptcy Code was also in informed by the Section 1113 requirement of fair and equitable treatment. Under Section 1113, the sacrifices sought from union employees must be shared by the other stakeholders in the bankruptcy. APFA's ultimate agreement to eliminate future retiree benefits for its active Flight Attendants was

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> Q: But your testimony earlier was that what you told APFA is that, in your view, it was – the Section 1114 process was the means of getting the $1.2 billion [retiree benefit] liability off the books. Is that correct?
>
> A: At the time, yes, that was the path I thought we were going to go.

[8] American introduced three APFA hotline communications to members in an attempt to argue that the Union viewed the Company's adversary proceeding as part of "the Section 1114 process." CX 3-5. We think that read in their entirety these hotlines simply do not support the Company's interpretation. In fact, APFA's initial hotline message following the filing of the adversary proceeding plainly indicates that the Union did not view that litigation as part of the Section 1114 process, stating:

> In the meantime, American Airlines is still providing medical and life insurance benefits to its retirees and has told the Committee through counsel that it will continue to do so until this litigation and the Section 1114 process are resolved. Our expectation is that the Bankruptcy Court will reject American Airlines [*sic*] position and require American Airlines to meet the standards set forth in Section 1114 of the Bankruptcy Code, before modifying any of the benefits provided to retirees.

CX 3. In addition, in its July 26, 2013 hotline specifically addressing the prefunding match money, APFA stated: "Since AA chose to focus on its adversarial motion rather than file a formal 1114 and is unlikely to file prior to our emergence from bankruptcy, it is APFA's position that exiting bankruptcy will successfully conclude the 1114." CX 5.

predicated on the understanding that current retirees could be required to do the same during bankruptcy under Section 1114.

Moreover, as reflected in its proposal for a replacement VEBA, APFA's intent from the outset of the Section 1113 bargaining, in which active employees were being asked to give up so much, was to retain the employer match money originally contributed on behalf of current employees. Viewed in this light, it is untenable to suggest that APFA agreed to make the return of that money contingent upon a condition that the Company could simply choose not to fulfill and thereby retain the funds at issue. Even more untenable is the suggestion that APFA somehow agreed to the current state of affairs in which the Company claims that "the Section 1114 process" remains unresolved *nearly 20 months after American's exit from bankruptcy protection with no apparent prospect for resolution*. Section 1114 is a bankruptcy process, one with tight statutory deadlines that dictate a relatively rapid final resolution. This is the process to which APFA reasonably understood the plain language of the agreement to refer.

American's current attempt to argue that "the Section 1114 process" was actually intended to refer to, or at least include, its adversary proceeding is simply belied by the undisputed facts. At the time when the language in question was first employed in the Company's agreements with TWU, there was no adversary proceeding and no reason for any union to believe that such a proceeding (never before pursued in any airline bankruptcy) would be filed. It strains credulity to the breaking to assert that this language was understood to refer to something unknown at the time. APFA knew that the language in question had come from American's prior agreements with TWU. Therefore, in the

absence of any explicit explanation to the contrary, the Union reasonably expected that the language carried the same meaning as when originally drafted.

American's suggested interpretation of "the Section 1114 process" is also wholly unnatural. Again, absent some explicit explanation (and there was none), no party in the position of APFA could be expected to understand that "the Section 1114 process" was intended to refer to a type of proceeding that had not occurred in any prior airline bankruptcy, as opposed to, or even in addition to, the usual process under Section 1114 of the Bankruptcy Code. It is also not reasonable to suggest that the phrase "Section 1114 process" standing on its own would be understood to refer to litigation that is not unique to bankruptcy. An adversary proceeding is simply a lawsuit that happens to be filed by or against the debtor while bankruptcy is on-going. The process is the same as for any other type of federal civil litigation. It is not specifically a bankruptcy process, as demonstrated by the fact that the litigation continues (albeit in a dormant state) even now that American has exited bankruptcy. American claims that, since it chose for convenience to name the retiree committee as defendant to its adversary proceeding rather than its unions or a class representative, this should somehow have been understood to make the adversary proceeding part of "the Section 1114 process." But this is a strained interpretation, at best, which should not be adopted, especially in the absence of any evidence from the parties' bargaining history to support it.

In fact, American's suggested interpretation is really just an after-the-fact construction as demonstrated by the Company's own statements during the bankruptcy. Denise Lynn's letter to employees dated September 12, 2012 plainly shows that the

Company understood the Section 1114 process to mean the process to modify benefits set forth in Section 1114 of the Bankruptcy Code. UX 10, at 4. In addition, the statement of American's counsel in open court during oral argument on the adversary proceeding could not have been clearer or more unequivocal: "this is not an 1114 proceeding. We have not filed an 1114 proceeding. We are not seeking relief under 1114." JX 66, at 116.

In its Opening Statement, American also argued that, in order to have a successful resolution of "the Section 1114 process," it needed to eliminate retiree benefits in a manner that did not give rise to a bankruptcy claim. Tr. 84:8-21. This too is a nonsensical re-interpretation of the agreement language. The modification of retiree benefits through Section 1114 gives rise to a bankruptcy claim. JX 47, § 1114(i) & (j) (Code references to the creation of a claim); *see also In re Ionosphere Clubs, Inc.*, 134 B.R. 515, 527 (Bankr. S.D.N.Y. 1991). And yet, American is now arguing that when it used the phrase "the Section 1114 process" it actually required a result that is not possible under Section 1114, namely the complete elimination of retiree benefits without giving rise to a large retiree claim.

Even if the phrase "Section 1114 process" could somehow be construed to include the adversary proceeding, this would not relieve American of its obligation under the LBFO language to make an application under Section 1114 of the Code. The prevention doctrine requires "reasonable efforts" to bring about a condition of performance. As American's counsel testified, the adversary proceeding and Section 1114 were not mutually exclusive and American could have pursued both. Tr. 581:11-12 ("We were free to do that. There was no prohibition on that."). In fact, throughout the fall of 2012,

American continued to pursue both tracks, such that over 900 hours were spent preparing a Section 1114 application, which appears to have been ready for filing or very nearly so. In order to make a reasonable effort to fulfill the conditional language in its agreement with APFA, American need only have filed the Section 1114 application it had already prepared.

Unknown to APFA, however, American had concluded at the end of 2012 that it no longer wanted to pursue Section 1114 relief based upon the belief (mistaken in our view) that such a filing would be a financial disaster for the Company.[9] Of course, American was free to make that determination, whether correct or not.[10] But having decided upon

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[9] American also contends that in the same time period it came to believe that it was unlikely to succeed under the Section 1114 standard. Tr. 529:21-533:4. American believed that the improved financial state of the Company, attributable in large measure to the Section 1113 concessions of current employees, would undermine its argument that the total elimination of retiree medical was necessary for a successful reorganization. Tr. 83:6-13. There is, however, no way to know whether American's assessment was correct or not because the Company never filed a Section 1114 application having decided that it no longer wanted to succeed on a Section 1114 application.

[10] Actually, prevailing on a Section 1114 application with claims projected to pay out at or near 100% would arguably have represented a win-win result for American and its retirees. Conversion of the retiree obligation into a bankruptcy claim would have removed the liability from the Company's books, no longer to be a drag on its financial statements as required under FAS 106. In addition, American would be able to satisfy the claim from the pool of stock in the reorganized entity, thus converting a cash expense into one payable through new equity already allocated to satisfy bankruptcy claims. From the retiree perspective, they would essentially be made whole by a claim worth stock valued equal or near to the value of the promised future retiree benefits. In addition, retirees would have money in hand (assuming they liquidated the stock upon emergence) without the risk of American sliding into bankruptcy again and seeking for a second time to shed its retiree obligations. The big loser in this scenario, however, would be other major unsecured creditors as represented by the UCC whose bankruptcy recoveries would be diluted by a large retiree claim. And, of course, the UCC's support was crucial to the proposed merger with US Airways.

that course, American is not free to argue that the condition it placed upon its payment of the employer matching contributions to current Flight Attendants remains unfulfilled.

II. To the Extent That This Dispute Hinges on Whether There Has Been a "Successful Resolution," the Contract Language Is Ambiguous and Should Be Construed Against the Company as the Drafter to Find That There Has Been a Successful Resolution

APFA believes that this case should be resolved under the prevention doctrine as explained in Part I of our Argument. In that regard, we believe that the contract language is clear and presents no ambiguity. Alternatively, however, if this matter were decided on the basis of whether or not there has been a "successful resolution" of the Section 1114 process, the contract language is ambiguous in this respect and should be construed against American as the drafter. As a result, the APFA's interpretation should be adopted to find that there was a "successful resolution" when American reached a settlement with the retiree committee as part of its plan of reorganization in order to exit bankruptcy.

The rule to construe against the drafter is applicable in this case.

> The "contra proferentem" (against the proponent) principle states that "if language supplied by one party is reasonably susceptible to two interpretations . . . the one that is less favorable to the party that supplied the language is preferred." The rule promotes careful drafting of language and accurate disclosure of what the language is intended to mean by penalizing the proponent who is "at fault" for negligently drafting the text. . . .
>
> Because the rule is not dependent on the meaning attached by the parties, it is applied when the intention of the parties cannot be ascertained by use of the primary principles of interpretation, and therefore should not be applied if there is no discovered ambiguity. Moreover, where the final text of a provision differs substantially from the original proposal, and both parties approve the final draft and there is no showing that the other party was misled, the rule will not be applied.

Elkouri & Elkouri, *How Arbitration Works*, at 9-48 - 9-49 (7th ed. 2012).

Here, there can be no doubt that American was the sole drafter of the language at issue. As American acknowledges, the language was lifted nearly verbatim from its prior agreements with TWU (with two mistakes as a result of the Company's failure to adapt the language to the Flight Attendant group). Even if American and TWU bargained over the language, in terms of its negotiations with APFA, American was the proponent of the language at issue. Although there was some exchange between the parties regarding whether the employer match money could be distributed to an HRA, there was no back-and-forth regarding the key language here, *i.e.* the phrase "[c]ontingent upon the successful resolution of the Section 1114 process." Indeed, the key language remained unchanged from American's initial proposal on July 3, 2012. This is unsurprising given the Section 1113 context for the negotiations. Retiree medical was just one among a host of painful concessions sought by the Company, in a negotiations process driven by the compressed time frames of Section 1113 and with the threat of court-ordered contract rejection hanging over the Union's head. These were not tidy negotiations.

As a result, the phrase "successful resolution" was retained in the final agreement despite its inherent ambiguity. *See Git Indus., Inc. v. Rose*, 81 A.D.2d 656, 657, 438 N.Y.S.2d 372, 374 (1981) (finding "inherently ambiguous" contract language requiring "successful completion" without further definition); *In re Fullmer*, 323 B.R. 287, 300 (Bankr. D. Nev. 2005) (contract conditioning payment on construction of "successful subdivision" is ambiguous). American now claims that "successful resolution" meant only one thing – the complete elimination of the Company's retiree medical obligations. Tr. 54:11-16, 95:21-96:5 (Opening Statement). In other words, the Company is saying that

among the whole range of possible consensual or court-approved outcomes of the Section 1114 process, one and only one outcome could be considered a "successful resolution" under the agreement's language.[11] But if American's intent was that "successful resolution" have only one narrow meaning, then it needed to have said so in the language of the agreement, but did not.[12]

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[11] The testimony of Mary Anderson undermines American's claim that "successful resolution" requires the complete elimination of retiree benefits. Ms. Anderson was asked whether "a settlement in which American and the Retiree Committee agreed to eliminate 90 percent of American's future retiree healthcare cost" would constitute a "successful resolution." She responded "I don't know." Tr. 484:16-21. Ms. Anderson was also asked whether American had made a proposal to the retiree committee that provided for some continuation of subsidized medical benefits. She conceded that American had made such a proposal, but she could not say whether or not acceptance of that proposal would have constituted a "successful resolution." Tr. 485:6-20, 487:18-488:5. The fact that Ms. Anderson did not have answers to these questions also demonstrates that the phrase "successful resolution" is ambiguous, and does not clearly require one and only one result.

[12] The position taken by American in its written denial of APFA's grievance is inconsistent with the Company's position during the arbitration hearing that "successful resolution" required the total elimination of its retiree medical obligations. In the grievance denial, American wrote:

> As part of that process, the Company assured you that *it would distribute some or all of the employer-match portion of the prefunding contributions to active flight attendants if and to the extent those funds exceed what is necessary to pay for retiree benefits if the Company prevails in that litigation*. In April 2014, however, the Bankruptcy Court denied the Company's summary judgment motion in the adversary proceeding with respect to most groups of retirees, including retired flight attendants, and, to date, the Company has not been *successful in eliminating or significantly reducing* its flight attendant retiree medical expenses. That litigation is not yet concluded, and, if no settlement in that case can be reached, the Company will have to decide when and whether to request trial dates from the Bankruptcy Court.

JX 2 (emphasis added).

American claims that, despite the lack of clear contract language, it nevertheless made its intentions known during negotiations. But the evidence presented does not support this claim. APFA witnesses Laura Glading and Randy Trautman (who was a constant participant in negotiations) testified that American never stated in bargaining that the proposed language required the total elimination of its retiree health obligations. Tr. 262:6-10, 308:10-14. The Company's witness, Mary Anderson, the only witness actually present at the table at any point, agreed that she never used those words to describe American's intent. Tr. 418:17-419:11 ("I don't recall using those exact words."). Instead, she testified only that she "usually said the liability has to come off the books before we can start talking about releasing the Company match money." Tr. 419:13-15. This is not a sufficiently clear and unequivocal communication to resolve the ambiguity in the phrase "successful resolution."

Moreover, if "successful resolution" meant only the total elimination of retiree benefits, then according to the testimony of Denise Lynn this language in the agreement was unnecessary. Ms. Lynn testified that the monies in the trust fund could only be used for the benefit of participants. Tr. 649:6-9. She further testified that, even absent the contingency language at issue, upon the elimination of all further retiree health obligations, American would have been required as a matter of law to distribute its employer match money to participants. Tr. 658:15-660:7. It is well-settled, however, that any reading of contract language that renders an agreement provision meaningless or nugatory is to be avoided. *See* Elkouri & Elkouri, at 9-41 – 9-43 (collecting decisions). For this reason as

well, American's claim that "successful resolution" meant only the complete elimination of retiree benefits should be rejected.

Absent any clear explanation from the Company and under the circumstances of the Section 1113 negotiations, APFA reasonably understood the language at issue to mean that "the Company had every intention of following an 1114 process. And whether there was a settlement or agreement reached prior or a Judge's decision that gave them what they needed to exit bankruptcy, that would be the conclusion of the 1114 – the successful conclusion of the 1114 process." Tr. 262:11-22; Tr. 263:14-15 ("whatever relief they needed to exit bankruptcy"). Just as the Section 1113 process was focused upon the relief that American needed to exit bankruptcy, APFA reasonably concluded that success in Section 1114 meant that American would get whatever relief from retirees that it needed to exit bankruptcy. APFA certainly believed that a settlement with the retiree committee, upon whatever terms, would constitute a successful resolution of the Section 1114 process. In fact, in all other legacy airline bankruptcy cases, Section 1114 had been resolved through settlement, and generally on terms less than the total elimination of retiree benefit obligations. UX 15; UX 27, at 18; JX, at 12; Tr. 632:11-18. These were the competitors to whom American was comparing itself.

Ultimately, as part of the Company's plan of reorganization, American did reach a settlement with the retiree committee resolving Section 1114. Section 1129 of the Bankruptcy Code requires that a debtor address Section 1114 in its plan of reorganization. In order to fulfill this requirement and exit bankruptcy, American negotiated terms with the retiree committee. The Company agreed that Section 1114 relief would be foreclosed.

It also foreclosed the possibility of a retiree claim, promising not to modify benefits in the future if such modification were ultimately deemed to give rise to a claim. In addition, the parties agreed that the reorganized American could continue to prosecute the adversary proceeding and, if unsuccessful in obtaining the relief sought, would continue to pay any benefits found to be vested. In order to accomplish this, they also agreed that the retiree committee would continue in existence despite American's bankruptcy exit. Presumably, American would not have entered into this consensual resolution of Section 1114 unless it believed that the settlement served its interests, particularly in terms of its need to exit bankruptcy in order to effectuate its merger with US Airways. Therefore, American's settlement with the retiree committee should be considered a "successful resolution" of the Section 1114 process since it gave the Company the terms it needed in order to successfully reorganize.

III. It Is Inequitable for American to Withhold Its Employer Match Contributions from Current Flight Attendants

Several equitable considerations weigh against American's position in this matter. First, American is claiming an unjustified windfall. Under the structure of the prefunding program, the employee's contributions and the employer match made on her or his behalf were to be drawn down in equal increments over a ten-year period commencing upon the individual Flight Attendant's retirement. UX 7, Auditor's Report, at 7. Thus, American only anticipated having a certain amount of prefunding money available to defray the benefit costs of each retiree, and expected to pay from general funds the cost of coverage over-and-above the employee's individual prefunding account. Now, by claiming that the

Section 1114 process remains unresolved, American will have far more prefunding money available on a per retiree basis than originally contemplated under the structure of the trust. Presumably American is able to amend the trust's draw-down mechanism to employ the additional funds now available to it, but even so the reallocation of the match money represents a considerable windfall for the Company compared to its expectations when setting up the prefunding program.

Second, American's position is inequitable from the perspective of the individual Flight Attendant. Ever since American first imposed prefunding on its Flight Attendants in 1994, the Company pointedly and gratuitously told Flight Attendants that the prefunding monies – both employee and employer contributions – were held in a separate individual account for them. *See, e.g.*, UX 1, at Q5 ("Your contributions and American's matching contributions will be assigned specifically to your Prefunding account."). Now, American claims that these individual accounts merely a recordkeeping mechanism and not an actual account, and points to the fact that the employer match money could be forfeited in certain circumstances under the program. Nevertheless, it is clear that the Company gave Flight Attendants the impression over the years that employer prefunding match was specifically allocated to them. It is little wonder that they now find it difficult to understand how the Company can be allowed to keep "my money."

Third, at one point, US Airways management, which is now the current management of American, was in a position to insist upon the elimination of retiree benefits as a merger condition, but dropped this demand. As set forth in the Company's own SEC filing, at the outset of the merger negotiations, US Airways conditioned its Equity Split offer on

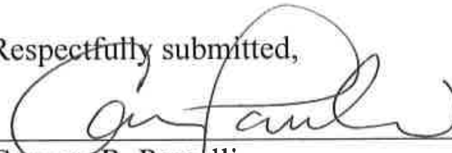
American's elimination of retiree benefits during bankruptcy. UX 28, at 80-87. US Airways continued to insist upon this condition until the very final stage of the merger negotiations, and its compromise on this point appears to have paved the way for a final merger agreement. *Id.* Having made the decision to drop this demand in order to obtain the greater benefits of the merger, current management should be estopped from claiming that the non-fulfillment of a condition that they were in a position to insist upon excuses their performance under the agreement with APFA.

Lastly, as set forth in the CLA reached with US Airways, current management was also willing to give current Flight Attendants both their own contributions and the employer match money attributable to them to be used to seed a replacement VEBA. Management did not condition the release of the employer match money in any way, and instead agreed to place the money into the new APFA-sponsored VEBA without regard to whether its obligations to current retirees continued. However, after the Flight Attendants' own prefunding contributions were refunded to them by American in December 2012, APFA and US Airways agreed that the replacement VEBA was no longer possible since roughly half of the seed money had been disbursed. APFA and US Airways did not specifically address the employer match money at that point in time, and instead simply agreed that the LBFO provisions regarding the access-only retiree medical plan would remain in place. Even though the replacement VEBA provision in the CLA never became operative, current management still should not now be heard to claim (as it has Tr. 78:18-79:5(Opening Statement)) that it always insisted upon the elimination of retiree benefits as a precondition to giving current Flight Attendants the employer match money. That is simply not the case.

REMEDY

"Contingent upon the successful resolution of the Section 1114 process," American is obligated to distribute the prefunding employer match funds to current Flight Attendants who prefunded. As set forth above, this condition to American's performance under the agreement should either be deemed excused or, alternatively, found to have been fulfilled. Accordingly, as a remedy, American should be required to distribute the prefunding match money, including all investment earnings, in the appropriate individual amounts to current Flight Attendants who prefunded as soon as practicable following issuance of an award. If there is some legal or practical impediment to the distribution of the employer prefunding money from the trust, then Flight Attendants should be made whole through money damages in an amount equivalent to the prefunding match money held in the trust on their behalf. Alternatively, as relief, affected Flight Attendants should be put in the position they occupied *status quo ante* to the agreement at issue with regard to the employer match money, such that the funds will continue to be held in trust and be used to defray the retiree health costs for these Flight Attendants when they retire.

Respectfully submitted,



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