# Employee Sacrifices and Collaboration at American Airlines:

# A Profit-Enhancing Business Model in Jeopardy?

**Association of Professional Flight Attendants**
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## I. AMR AT THE BRINK – EMPLOYEES PLEDGE $1.6 BILLION IN ANNUAL CONCESSIONS TO AVOID BANKRUPCTY IN 2003

In the spring of 2003, as airlines tried to weather the unprecedented financial hardship caused by the catastrophic downturn in travel demand resulting from the terrorist attacks on 9/11, American Airlines employees were asked to take drastic steps to lower costs with the aim of keeping their company from being forced to seek bankruptcy protection. The company restructured its operations and costs largely through the voluntary concessions made by its flight attendants and other employees. As a result the company avoided having to file for bankruptcy protection, which would have completely eliminated shareholder value.

The catastrophic events of September 11, 2001, hit US airlines harder than any other industry and forced the sector into an unprecedented financial tailspin. By mid-2002, airlines that had recently reported billions in profits were suddenly faced with overwhelming losses as 20% of their passengers had simply quit flying. In 2002, US Airways and United were forced to seek bankruptcy protection, with several other carriers soon to follow. Facing the same severely deteriorating marketplace and staggering losses, American Airlines employees were asked to voluntarily agree to massive cuts in wages, benefits, and work rules, in the hope of keeping their company out of bankruptcy.

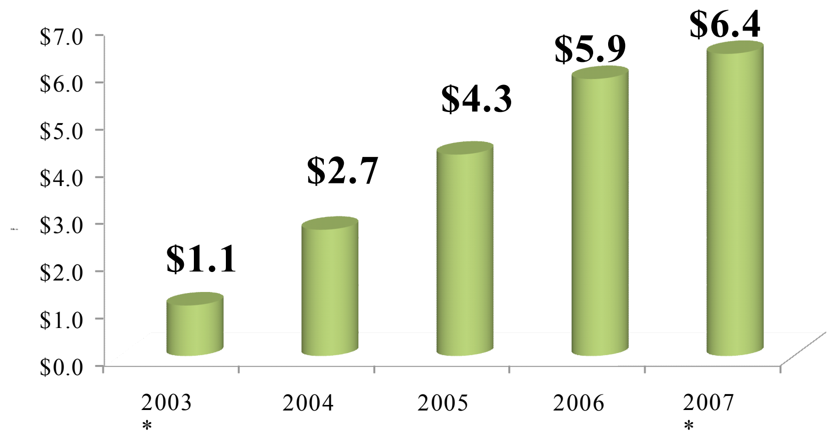
In 2003, the majority of more than 80,000 frontline (non-management) independent and unionized employees of American agreed to provide $1.6 billion in annual cost savings. While management wages were cut between 4% and 15%, pilot and flight attendant wage scales were slashed by as much as 23% and 15.6%, respectively. In addition, employee benefits were reduced, vacation and sick accruals severely curtailed, and 25% of frontline jobs were eliminated. Of those frontline employees who remained on the payroll, work hours were dramatically increased as work rules were eliminated. This voluntary restructuring ensured that American Airlines remained the only traditional network carrier to have never sought bankruptcy protection.

## II. EMPLOYEE SACRIFICES ARE STAGGERING; $ 6.4 BILLION AND COUNTING

The flight attendants surrendered over $ 340 million per year since 2003. These loyal employees were hit especially hard as, in addition to wage and benefit cuts, their rest periods were cut back to the bare minimum and their time away from home was greatly extended. Life for an American Airlines flight attendant is very difficult these days.

Since 2003, American Airlines' employees provided lift to their company's fortunes through their ongoing multi-billion concessionary sacrifices and good will. The cumulative value of the employee concessions is staggering.

Cumulative AA Frontline Employee Concession Value




Source: AMR valuation of non management employee Restructuring Participation Agreements (RPA) .
Note: 2003 is partial year after the RPA was effective on May 1, 2007 is through April only.

As the chart above indicates, over the past four years, frontline employee sacrifices at American Airlines have provided $6.4 billion in relief and have helped turn the company around.[1] The ultimate beneficiary of the employee sacrifices were AMR shareholders, whose investments would have been completely eliminated in the event of a bankruptcy. Instead of being worthless, AMR share values have increased nearly 2000% since the stock bottomed out just prior to the concessionary agreements.[2]

## III. THE FLIGHT ATTENDANTS' UNION ENTERS INTO A UNIQUE COLLABORATIVE BUSINESS MODEL - STOCK PRICES AND PROFITS SOAR BACK

The 2003 concessions were adopted under the premise that management and frontline employees would share sacrifices and rewards as a team. The concept of "pulling together and winning together" was introduced as the cornerstone of a changing corporate culture at American. Under a new business model, labor leaders were to be treated as business partners by management. Labor and management's vision were that both sides would equally bear the burden of sacrifice. This was certainly a far different approach than had traditionally been the case at American, and was touted as a different path. This set American apart from than other network airlines which were facing bankruptcy.

APFA, American Airlines and the other unions boldly set out in 2003 to reengineer the corporate culture at American. Their efforts were focused on building back trust among the frontline employees whose cooperation was viewed as a critical component of any recovery plan. This new approach of collaboration between workers and management was part of the adoption of a long-term strategic recovery plan for AMR,

[1] $1.6 billion per year from May 2003 through April 2007 in cumulative non-management labor savings.
[2] Based on March 2003 AMR stock price of $1.58 and recent (3/2007) prices in the $33.00 range.

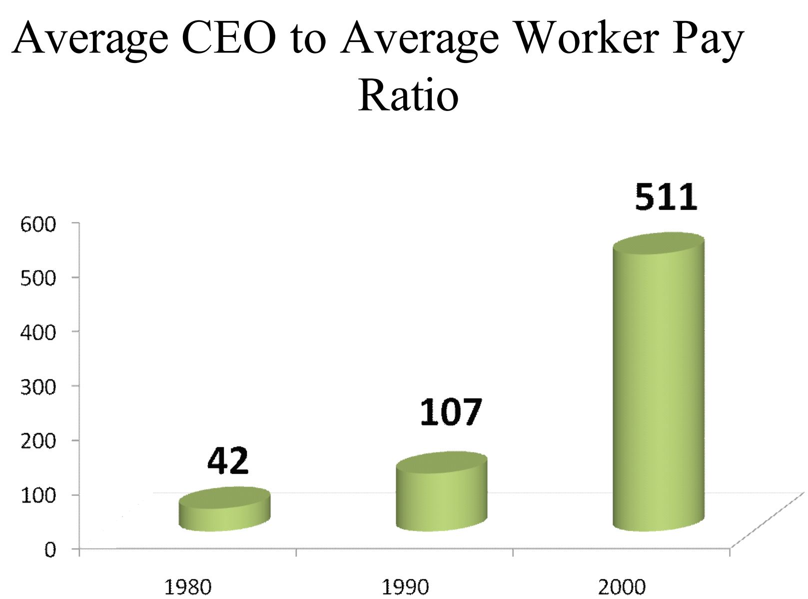
called the “Turnaround Plan”. This was an attempt to reestablish employee trust and to simultaneously provide the best business model for return to prosperity for American Airlines, its employees and investors.

The joint labor management collaborative strategy produced substantial benefit to American Airlines’ financial status. The carrier has returned to profitability. Loads and yields are up. The airline now has over $5.5 billion in cash on hand. Much debt has been reduced. Stock value has risen sharply. The financial picture has dramatically changed.

## IV. EXECUTIVES TAKE MILLIONS WHILE EMPLOYEES SEE NO REWARD FOR THEIR SACRIFICES

Under a management-only stock-based performance incentive program a small group of AMR executives reaped nearly $100 million in stock grants and cash in April 2006, and are scheduled to make a total of about $200 million in stock awards in April 2007. These bonuses are being parceled out to fewer than 1,000 executives, while all of the other 80,000 American Airlines’ employees receive little, if anything, for their sacrifice in returning their company to profitability.

In his January 2007 “State of the Economy” address President George W. Bush, stated to an audience on Wall Street, “The fact is that income inequality is real. It has been rising for more than 25 years.” “The earnings gap is now twice as wide as it was in 1980.” The president continued, “America’s corporate boardrooms must step up to their responsibilities. You need to pay attention to the executive compensation packages that you approve. You need to show the world that America’s businesses are a model of transparency and good corporate governance.”[3]




Source: Institute for Policy Studies, 2004.

Indeed, the President’s remarks reflect a growing concern, even among business leaders, that the growth in executive compensation in America is out of control. Several

[3] MSNBC News Services January 31, 2007

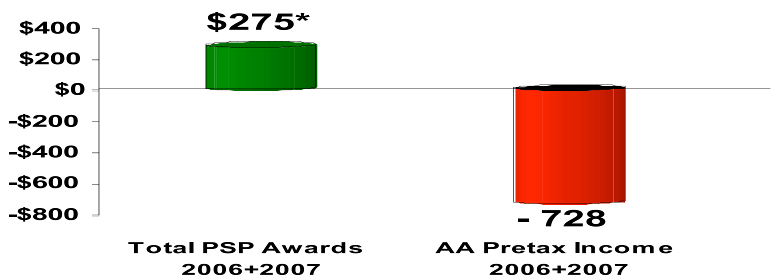
recent academic studies concur that in the past decade executive compensation packages at large U.S. corporations have increased by over 250%.[4] More importantly the astronomical growth in the gap between executive pay and pay of the average American worker is also well established in economic literature.

A 2004 study found that the ratio of executive pay to average worker pay had tripled between 1970 and 2000, from just over 20 times more than the average worker to more than 90 times in 2000.[5] Other studies, focused on CEO total compensation, found that the gap has grown even wider. In 1980 average total pay for an S&P 500 CEO was measured at 42 times greater than average pay for their frontline employees. By 1990, this ratio more than doubled to CEO pay being 107 times the average line worker pay. Over the next 10 years it grew by five-fold, so that by the year 2000 the average pay for an S&P CEO was more than 500 times the pay of the average line worker.

The American Airlines employee share of prospective gains was nothing like that offered to management. In 2003, as part of the concessionary agreements, management provided three variable compensation incentive plans for frontline employees; 1) an Employee Stock Option Plan (ESOP), 2) a revamped profit sharing plan and 3) a new relative performance-based plan called AIP. The profit sharing plan only pays out if American earns more than $500 million in pretax profits. These three plans were to be the basis of "rewards" and the incentive for frontline workers to continue to "pull together" with management to fix American. Payment under this formula has provided very little to each dedicated employee.

The rewards for top management were however not entirely based on these three programs, but instead included plans that were wholly separate from worker incentive plans and based on completely different metrics. Management incentive programs were known collectively as Long Term Incentive Plans (LTIP) and were designed to reward top managers and key employees with cash and stock awards based primarily on the relative performance of AMR stock.

PUP/PSP Awards and AA Pre-tax Profits




Source: AA 10K/A 2006.

*Note: Exact PSP payout is not known until it is issued on April 18, based on AMR stock price.

The Performance Unit Plan (PUP), later amended and renamed the Performance Share Plan (PSP)) is an incentive program that was set up to reward a select group of 800 to 1000 top AMR managers based on the relative performance of AMR stock compared to selected competitors over rolling three year periods . Due to the escalation of AMR stock since the 2003 concessions became effective, the PUP/PSP plan paid out

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[4] The Growth of Executive Pay, Bebchuck and Grinstein, Oxford Review of Economic Policy, Vol. 21, No. 2 ,2005.

[5] Managerial Capital and the Market for CEOs, Murphy and Zabojnik,, Marshal School of Business, University of Southern California, September 2004.

approximately $100 million in cash and stock to approximately 800 top managers in April 2006. This was paid out despite the fact that American Airlines had lost money in every year since 2003, and posted a pretax loss of $892 million in 2005.[6] At the same time, not a dime of profit sharing was awarded to the more than 80,000 frontline employees. As this disparity became more patent, so did the challenge to American Airlines leaders to prove to its employees that collaboration was a worthy path. Regrettably this would not happen.

## V. A CORPORATE MISCALCULATION – AMERICAN REJECTS THE PROFIT MAKING MODEL OF A NEW CULTURE

The company's frontline employees are now forced to reconsider the validity of their partnership as a result of the inequity in the distribution of rewards resulting from their shared sacrifice. Any partnership that delivers huge rewards to only a few select partners has the very real potential to threaten the health of the business over the long-term. Several recent studies have shown that employee satisfaction is closely tied to customer happiness and profitability[7]. This is an obvious reality.

In April 2007 the PSP program is poised to pay out nearly double the value to the same group of top executives as in 2006. The total value of the 2007 PSP award is expected to be between $175 and $200 million in AMR equity. The value of this payout is larger than American Airlines' net profit for the entire year 2006 of $164 million.[8] For the top five executives at American, the 2007 PSP payouts are seven times the annual salary paid to officers in those positions in 2002.

Frontline employee salary remains well below the 2002 pay levels. Certainly returning to profitability should lead to rewards for all frontline workers who remain burdened by their sacrifice in 2003.

No matter how many corporate attempts are made to justify the rewards, leaving out the frontline workers from the benefits of their sacrifice has probably eliminated any possible last chance that AMR management had to keep employees "pulling together." Clearly the flight attendants are not "winning together."

If employees are forced to back away from this unique partnership, American Airlines will have turned away from a very profitable business model. The current protest by American Airlines employees is not about the level of executive pay, but more a statement about being betrayed once again by a company whose corporate culture appears to resist all who attempt to change it. American Airlines is squandering an opportunity for a sustained turnaround plan.

[6] American Airlines 2006 10K.
[7] "Examining the Relationship Between Employee Satisfaction and Customer Satisfaction", AlphaMeasure.
[8] American Airlines 2006 10K.