



Allied Pilots Association



Association of Professional Flight Attendants



Transport Workers Union

## **Closure Statement: 2003 – 2005 Performance Share Plan Grievance Arbitration**

At the request of the unions, Mr. Robert O. Harris (the independent arbitrator in the 2003-2005 Performance Share Plan – formerly “PUP” – grievance) reviewed the payout calculations for PUP payments made by the Company in April. His review verified that: 1) the Company’s records reflect payment per the Company’s stated intention (stock and cash, the basis for Mr. Harris’ order in the grievance arbitration), and 2) that the records indicate compliance with the individual cash compensation limit established by the Annual Incentive Program (“AIP”). Mr. Harris conducted his review and distributed confirmation of the Company’s compliance in June.

Based upon Mr. Harris’ review, we estimate that the Company delivered a total value to the PUP participants of approximately \$94 million. Of this total value, about \$66 million was delivered in AMR stock, with the remaining \$28 million delivered in cash.\* By utilizing AMR stock in lieu of cash pursuant to the AIP cash compensation limits, the Company retained cash of \$66 million that it would have otherwise distributed.

As a result of his review, Mr. Harris has terminated the grievance and the related jurisdiction granted him by the parties to this matter.

\* The Company declined to disclose the final number of Performance Share Units forfeited, the number awarded to international employees, and the units for retired/laid-off plan participants; therefore, the final amounts of actual cash paid and total value delivered are estimated.



## Appointment

The parties entered into an agreement to have a single hearing on the grievances which were submitted to American Airlines by the Grievants (hereafter referred to as the unions). Under that agreement, each of the unions named a member to the System Board which was established by the agreement, and the Carrier named three members. The agreement called for Robert O. Harris to be the Chairman and neutral member of the System Board. Hearings were held in Fort Worth, Texas on March 7, 8, 9 and 10, 2006. Briefs were filed by the parties on March 23, 2006.

Because of the time constraints involved in the agreement, the parties originally agreed that the Chairman should render an Award no later than noon on March 28, 2006; however, after email consultations among the Board members it was agreed that the decision should be deferred until after the AMR Board of Directors meeting on March 29, 2006.

The grievances filed by the unions complain that the payout to be given to management employees under the 2003-2005 Performance Unit Plan (PUP) for officers and key employees violates the limitations contained in the Annual Incentive Program (AIP).

The genesis of the AIP is that during 2003, American, like other airlines, was in financial difficulty, and in an attempt to avoid filing for bankruptcy, negotiations were undertaken to modify the collective bargaining agreements with its unions. Modifications of each of the collective bargaining agreements with the unions involved in this case were reached; however, before the Restructuring Agreements were

finalized and signed it was disclosed that a Supplemental Executive Retirement Program (SERP) and Retention Agreements existed. These programs contained substantial payments to many executives at the time when the line employees were being asked to take wage cuts. The reaction by the unions was immediate. They forced the resignation of the chief executive, Donald Carty, and also negotiated the AIP in return for actually signing the previously agreed-upon wage concessions. It should be noted that Mr. Carty was the principal company negotiator involved in the creation of the AIP although the present CEO, Gerard Arpy, attended some of the meetings and the actual drafting of the AIP language was the responsibility of then Vice President of Employees Relations, Jeff Brundage. The result was the following limitation on management incentive programs in the AIP:

Any “cash bonus” compensation plan for management employees shall be based primarily on criteria and thresholds contained in the Annual Incentive Formula. Any cash compensation program for management not based on such criteria and thresholds may pay no more than 20% of the maximum possible cash that was or could have been earned by the individual management employee under the Annual Incentive Formula. For purposes of this paragraph, the phrase “cash bonus” shall not include any payments in the form of severance, retirement benefits or deferred payments of base compensation or eligible cash bonuses from prior years.

Any future stock equity or stock option-based program developed for the benefit of management and key employees will be determined by the Compensation Committee of the Board based on market practices.

The question presented by the grievances in this case is whether the PUP is a “stock equity or stock option-based program.” As originally drafted, each of the PUP programs provided for a cash payout based upon total shareholder return during the specified time period (3 years) multiplied by the percentage of the target which is based

upon AMR's stock price in relation to a comparator group of airlines.

The AMR Board of Directors met on March 29, 2006. Thereafter, on March 31, 2006, American moved to reopen the record. On the same day, American and the unions agreed upon a stipulation to reopen the record to receive the following documents: 1) The Company's uncontested Motion to Reopen the Record; and 2) The Declaration of Gary Kennedy, Esq. and the AMR Corporation Board of Directors' Resolutions related to the 2003/2005 and 2004/2006 Performance Unit Plans annexed thereto.

Mr. Kennedy's Declaration reads as follows:

1. I am the Senior Vice President, General Counsel, and Chief Compliance Officer of AMR Corporation. I am fully familiar with the matters set forth herein.
2. Annexed hereto as Exhibit 1 are a true and correct copy of Resolutions adopted by the AMR Corporation Board of Directors on March 29, 2006, related to the 2003/2005 Performance Unit Plan.
3. Annexed hereto as Exhibit 2 are a true and correct copy of Resolutions adopted by the AMR Corporation Board of Directors on March 29, 2006, related to the 2004/2006 Performance Unit Plan.
4. In accordance with the Resolutions annexed hereto as Exhibit 1, the AMR Corporation Board of Directors has determined that what had been the 2003/2005 Performance Unit Plan and now is denominated as the 2003/2005 Performance Share Plan will be settled in a combination of stock and cash. The cash portion of the distributions will not exceed the limitation for those cash compensation programs for management not based primarily on criteria and thresholds contained in the Annual Incentive Formula as described in the Annual Incentive Program ("AIP") that is Joint Exhibit 4 in this proceeding.
5. The following two examples are illustrative of the calculation that will be used to determine the cash and stock distributions under the 2003/2005 Performance Share Plan (based on the closing stock price of \$27.10 on March 29, 2006):

	Base Salary	Multiplier	20% Limitation 40% of Salary	<u>Earned</u>	<u>Award</u>	<u>Distribution</u>			<u>Portion</u> Value
				Unit Award at 175%	Total Award Value	Cash Portion	Cash as a % of Salary	<u>Stock</u> No. of Shares	
Example 1 (based on median)	\$75,000	200%		2,100	\$56,910	\$22,358	30%	1,275	\$34,553
Example 2 (Based on Darrah Example)	\$250,000	200%		26,250	\$711,375	\$74,525	30%	23,500	\$636,850

6. The AMR Corporation Board of Directors has made a similar modification to the 2004/2006 Performance Unit Plan, as described in the Resolutions annexed hereto as Exhibit 2. Therefore, an allocation of cash (consistent with the AIP) and stock, similar to that described above, will be used to satisfy those obligations.
7. At present, AMR Corporation has not determined the manner of distribution for the 2005/2007 Performance Unit Plan. The 2005/2007 Performance Unit Plan will not become final until 2008 and it is uncertain if there will be sufficient stock available to fulfill the 2005/2007 Performance Unit Plan.
8. The objective of the AMR Corporation Board of Directors is to support management and the unions in their efforts to work collaboratively to restore the company to financial health and to avoid the confrontational path taken by other airlines. To this end and in an effort to resolve the grievances pending before the System Board of Adjustment, the AMR Corporation Board of Directors has adopted Resolutions modifying the 2003/2005 Performance Unit Plan and the 2004/2006 Performance Unit Plan as described above.

The first of these (Exhibit 1 to the Kennedy Declaration) reads as follows:

2003/2005 Performance Unit Plan

RESOLVED, that the Corporation be, and it hereby is, authorized to amend and restate the 2003-2005 Performance Unit Plan for Officers and Key Employees (the "2003-2005 Plan") and those agreements ancillary thereto (including, for example, the 2003-2005 Performance Unit Agreements) (the "2003-2005 Restatement"). The 2003-2005 Plan after such amendment and restatement will be referred to as the "Restated 2003-2005 Plan";

RESOLVED, that the 2003-2005 Restatement will include the ability to make distributions in cash, or the Corporation's common stock, \$1 par value (the "Common Stock") or other marketable property of the Corporation, in each instance to satisfy the Corporation's obligations under the Restated 2003-2005 Plan;

RESOLVED, that to the extent necessary to comply with existing regulations and accounting policies, the officers of the Corporation and its Subsidiaries may be granted such shares of Common Stock as may be necessary to effectuate the purpose of the 2003-2005 Restatement;

RESOLVED, that the officers of the Corporation (each, an "Authorized Officer") be, and each hereby is, authorized to take the necessary actions, to execute those documents and instruments and to file those documents and instruments, in each instance as such Authorized Officer deems necessary or appropriate to give effect to the foregoing resolutions; the taking of such actions, the execution of such documents and instruments and the filing of such instruments and documents, to be conclusive evidence of such Authorized Officer's authorization and authority.

An identical resolution (Exhibit 2 to the Kennedy Declaration) regarding the 2004/2006 Performance Unit Plan was also adopted.

Under the circumstances, the actions taken by the AMR Board of Directors eliminate the possible violation of the AIP which was alleged in the unions' grievances. Accordingly, the grievances are moot and are dismissed.

#### Order

The grievances are, under the circumstances as set forth above, moot and shall be dismissed. The Board will retain jurisdiction for sixty (60) days from the date of this

decision to resolve any disputes which may arise regarding this Order.

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Robert O. Harris  
Chairman

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Edwin White, Jr. for APA

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Mark L. Burdette for American Airlines

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Beth M. Young for TWU

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Ralph L. Richardi for American Airlines

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Anne Loew for APFA.

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Carol E. Wright for American Airlines

Chevy Chase MD, April 3, 2006