Airlines in the Wake of Deregulation: Bankruptcy as an Alternative to Economic Reregulation

JEFFREY S. HEUER*
MUSETTE H. VOGEL**

TABLE OF CONTENTS

I. INTRODUCTION 248
II. BACKGROUND 250
A. *OVERVIEW OF AIRLINE REGULATION* 250
B. *HEALTH OF THE AIRLINE INDUSTRY* 254
III. ANALYSIS 257
A. *INTRODUCTION TO BANKRUPTCY ISSUES* 257
B. *THE USAGE AND POTENTIAL USAGE OF CHAPTERS 7 AND 11 IN THE AIRLINE INDUSTRY* 260
C. *THE RESULTS OF AIRLINES IN BANKRUPTCY* 278
IV. IMPACT OF BANKRUPTCY AND CONCLUSIONS 283

* Associate, Grossman, Mitzenmacher and Schechter, Chicago, Illinois; B.A., University of Iowa; J.D., DePaul University College of Law.

** Fellow, International Institute of Higher Studies in Criminal Sciences, Siracusa, Italy; B.A., University of Illinois; J.D., DePaul University College of Law.

The authors wish to acknowledge the assistance and thank Mr. Joel A. Schechter, Bankruptcy Panel Trustee for the Northern District of Illinois and Mr. Ronald F. Grossman, both of the law firm of Grossman, Mitzenmacher and Schechter. The authors would also like to thank Mr. Kevin J. Connor, attorney for the Resolution Trust Corporation, Federal Deposit Insurance Corporation, and Professor Paul S. Dempsey, Professor of Transportation Law and Director of the Transportation Law Program, University of Denver College of Law.

I. INTRODUCTION

In 1975, an economist wrote this about the status of the airline industry:

> A heated debate surrounds the issue of governmental regulation of transportation. Nowhere is the debate more intense than in air transport where the ten U.S. Domestic carriers have reported aggregate losses of $52.5 million for the first half of 1975. Regulators maintain that, while regulation has not been entirely successful, a reevaluation of the existing regulatory framework is all that is necessary. Opponents, on the other hand, argue that deregulation is the only course that can restore the industry's lost profitability.[1]

The airline regulation debate continues, except now, the regulators are calling for an overhaul and intensification of the regulatory scheme and the deregulators claim reevaluation of the present program would solve a majority of the airline industry's problems.[2]

Critics of the current deregulated state of the airline industry cite a laundry list of airline afflictions that warrants a more paternalistic handling of the industry's affairs. Among these problems are monopolistic air fare rates in some markets, loss of small community service, lowered safety standards, predatory mergers and an overabundance of bankruptcy filings.[3] To help resolve these perceived problems, specific regulatory bids are being made by a host of regulation advocates to provide for stricter policies having to do with service,[4] safety,[5] pricing,[6] and market concentration.[7] One regulator even calls for the implementation of regulations vis à vis a new federal transportation commission independent of the executive branch.[8]

Deregulators repeatedly insisted at the onset of deregulation in the late 1970's that deregulation was only intended for economic concerns—

---

1. Gritta, *Profitability and Risk in Air Transport: A Case for Deregulation*, 7 TRANS. L.J. 197 (1975) [hereinafter *Profitability and Risk*].

2. *Aviation Regulatory Reform: Hearings before the House of Representatives Subcommitte on Aviation*, 94th Cong., 1st Sess. 62, 74 (1977) [hereinafter *1977 Aviation Subcommittee Hearings*].

3. *Who Wins the Air Wars? Wall Street Loves the Airlines, but You Might Not*, NEWSWEEK, Sept. 18, 1989, at 41.

4. DEMPSEY, The Social and Economic Consequences of Deregulation, 240 (1989) [hereinafter *Consequences*] (strict entry and exit regulation to ensure service to small towns).

5. *Id.* at 240-241 (Increase air traffic control standards, input congressional resources in the construction of new airports, direct regulation of landing and takeoff through tariffing airlines flying at peak periods, regulation of carrier maintenance, regulation of pilot qualifications and overall stronger enforcement of current and any new promulgated regulations).

6. *Id.* at 239 (Amend Robinson-Patman Act to add services to price discrimination prohibition on goods and creation of "mileage-based formula to assess reasonable rates").

7. *Id.* at 240 (Forced sale of single airline controlled airport hubs to new entrants, taxation of frequent flyer programs to discourage loyalty to particular airlines).

8. *Id.* at 242-244 (Independent regulatory agency that self-selects its own officers to avoid political bias of president in power).

essentially that laissez-faire policy should only dictate in competitive markets[9] and artificial government supports should be removed to allow efficient and competitive companies to survive and weak ones to fail. Deregulation was never intended to be the basis for abandoning safety, air traffic control, or for failing to implement the antitrust[10] and consumer protection laws. In fact, when Congress deregulated the industry, it essentially lifted only the restraints on entry into the market, price and route structure. Deregulation firmly stood and still stands for the proposition that the governmental mechanisms in place have the potential to sufficiently handle the deregulator's public interest concerns, while the market can adequately provide the most reasonable price to the consumer.

One of the mechanisms in place is bankruptcy. It will be argued in this article that bankruptcy, which functions at a microeconomic level, more adequately serves the entire airline industry than direct government economic regulation for three reasons. First, the bankruptcy courts are without power to affect those airlines which have succeeded in the deregulated era. Second, the courts have greater power and more flexibility to especially rehabilitate a failing airline. Third, bankruptcy courts, as courts of general equity, will more adequately balance the interests of the debtor-airline, creditors, employees, government, airline industry and the public.

The article is divided into three parts. The first part briefly overviews airline regulation and deregulation and summarizes the opposing views on the health of the airline industry. The second part details the delicate balance of powers allocated to the debtor and other parties in interest as provided for in the Bankruptcy Code and analyzes the fate of airlines that have entered bankruptcy in the deregulated era. Specifically, the Conti-

9. "In testifying in favor of a statutory change mandating gradual and progressive movement toward essential reliance on competitive market forces in the long run, the Board [Civil Aeronautics Board] is not advocating a statutory deregulation of domestic air transportation - that is, Congress' removal of all regulatory controls. We do not think that we nor anyone else knows enough at this time to prescribe that in the law or precisely set forth the ultimate regime. Our recommendation for increasing reliance on competitive market was stated as being part of an integrated program which included adequate safeguards and retention of sufficient regulatory authority to step in when and if serious injury to the public interest appeared likely to result." *1977 Aviation Subcommittee Hearings*, *supra* note 2 (statement of Hon. John E. Robson, Chairman of the Civil Aeronautics Board).

10. Had the Department of Transportation heeded the warnings of the Department of Justice, the premier antitrust agency, a series of significant mergers, *e.g.*, United and Pan American's trans-Pacific assets, Northwest and Republic, Delta and Western, TWA and Ozark, would not have taken place and market concentration would not be of concern. *See generally*, Kahn, *Deregulatory Schizophrenia*, 75 CALIF. L. REV. 1059, 1064-65 (1986) (Kahn also questions the Department of Transportation's approval of Texas Air's acquisition of People's Express when Texas Air already owned New York Air, Continental and Eastern and had cornered 57 percent of the Newark and LaGuardia departure market).

nental, Braniff, Eastern, Airlift and Global International bankruptcies are examined in their relevant part. The third and final section sets forth the authors' opinion that bankruptcy has and will continue to serve its varied purposes. Attempts to neutralize the delicate balance will result in a less effective bankruptcy system which will inevitably culminate in a weakened airline industry.

II. BACKGROUND

A. *OVERVIEW OF AIRLINE REGULATION*

The airline industry was highly regulated at its inception because Congress feared it would fall into the same disastrous economic hole as the railroads and motor carriers had in the 19th and early 20th century. Congress was forced to step in and save those troubled industries as the competitors practiced policies developed under a pre-Depression government which condoned market domination of every industry aspect.[11] Rivals had predatorily priced each other out of business and each industry suffered enormous economic losses that required liquidation and eventual dissolution of the majority of the competitors. After the destructive competition dust settled, what remained was a railroad monopoly/oligopoly extracting unreasonably high prices[12] and a very unhealthy and chaotic motor carrier industry essentially threatening the same result.[13] To avoid similar results in the airline industry, Congress enacted

11. Congress passed the Act to Regulate Commerce, which called for the creation of the Interstate Commerce Commission (ICC) and a strict regulatory scheme to control interstate railroads. The Judiciary adhered to a strict view of limited federal power over commerce and struck down the powers granted the ICC. However, Congress responded by enacting further legislation expanding the ICC's power. *Consequences* at 14 and nn. 41 & 42. Congress also promulgated special provisions in the bankruptcy code for railroad reorganization. *See* 11 U.S.C. §§ 1162 *et. seq.* and *infra* at nn. 247-252 and accompanying text for a discussion of Chapter 11 reorganization for railroads. Note that one of the restraints on railroads is the inability to abandon the railroad line without strict adherence to provisions concerning replacement lines and ICC approval of abandonment. NORTON'S BANKR. LAW. ED. § 44:48 (Supp. 1989). Also note that "cashlessness" does not allow a railroad to extinguish its obligation as a common carrier, nor does it provide sufficient reason to justify abandonment, although it might make it difficult to provide service. Gibbons v. United States, 660 F.2d 1227 (7th Cir. 1981).

12. *Consequences, supra* note 4, at 12.

13. The motor carrier industry had an additional element that evoked public interest and Congressional attention that was absent in the railroad dilemma. The Depression created an oversupply of trucks and truckers because entry into the field was relatively easy, all that was required was a license and a truck. As each trucker went bankrupt or went out of business due to the intensive competition of shippers only meeting their short term marginal costs, the trucks were sold to other truckers and the whole process recycled again. Since the Depression had motivated Congress to erect regulatory schemes to protect against troublesome wages, working conditions and general instability, the fact that the effect on the truckers was highly visible was enough to regulate for economic and safety reasons. *Consequences, supra* note 4, at 15-18.

the Civil Aeronautics Act of 1938[14] and the Civil Aeronautics Authority (later the Civil Aeronautics Board),[15] to control the growth of the industry.

The goal of regulating the airline industry was analogous to that of the railroad and motor carrier legislation: to achieve stability in the industry.[16] The regulatory scheme called for regulation of three economic areas: 1) airline entry/exit of the market, inclusive of the power to grant certification to enter the market, approval, allocation and assignment of routes, and service to certain communities;[17] 2) rates and air fares;[18] and 3) antitrust.[19] The Civil Aeronautics Board (CAB) was granted the power to interpret the regulations in light of the Congressional purposes for promulgating the statute.[20]

The next forty years of regulation led to such stability that the market became stagnant, concentrated and began to lose profitability.[21] Among the problems complained of were constraints on the innovation of service

14. In 1958, the name of the act was changed to Federal Aviation Act. The Federal Aviation Act, which was amended by the Airline Deregulation Act in 1978, is codified at 49 U.S.C. §§ 1301 *et.seq.* (Supp. 1989).

15. In 1939, the Civil Aeronautics Authority name was changed to the Civil Aeronautics Board. Dempsey, *Rise and Fall of the Civil Aeronautics Board - Opening Wide the Floodgates of Entry*, 11 TRANS. L.J. 91, 93, note 2 (1979) [hereinafter *Rise and Fall*].

16. Dempsey, *Transportation Deregulation - On a Collision Course*, 13 TRANS. L.J., 329, 335 (1984) [hereinafter *Collision Course*]; *Consequences, supra* note 4, at 19; *Rise and Fall supra* note 15, at 107 and note 45.

17. 49 U.S.C. § 1371.

18. *Id.* at § 1374.

19. *Id.* at § 1384.

20. The Congressional policy statement for the Civil Aeronautics Board is as follows:

> In the exercise and performance of its power and duties under this chapter, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:
>
> (a) The encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the United States Postal Service, and of the national defense;
>
> (b) The regulation of air transportation in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, and to improve the relations between, and coordinate transportation by, air carriers;
>
> (c) The promotion of adequate, economical, and efficient service by air carriers at reasonable charges, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices;
>
> (d) Competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the United States Postal Service, and of the national defense;
>
> (e) The promotion of safety in air commerce; and
>
> (f) The promotion, encouragement, and development of civil aeronautics.

49 U.S.C. § 1302.

21. To reemphasize, the airline industry lost $52.5 million in the first half of 1975. *See supra* note 1.

alternatives, restricted market entry and lack of competitive pricing.[22] Many rationales were cited for the problems plaguing the industry. One of the strongest was that CAB regulation in the mid-70's governed a different economic environment than existed when regulation was instituted. Regulation of the airline industry was desirable when the economic environment after the Depression was favorable and technology was rapidly changing. Forty years later, deregulation became favorable because the economic environment caused sluggish productivity, moderate traffic growth and rising costs.[23] Another reason given for the slow market was that the CAB maintained a *de jure* policy of denying certification requests. In 1938, 21 main route carriers served the then 48 states. In 1976, only 10 were left. Of the mid-size carriers, only 7 survived of the 17 carriers originally certified and in the local service market, only 8 carriers remained of the 32 certified.[24]

The chairman of the CAB testified to the Aviation Subcommittee of the House of Representatives that regulation resulted in greater inefficiency because it,

> [I]nduced costly inefficiencies through overscheduling, overcapacity, competition in frills and equipment races . . . . It has not provided the environment or the incentives for the basic price competition. Because of these inefficiencies, and the regulatory system's insulation of labor-management bargaining, neither the airline investor nor the consumer has fully reaped the potential benefits of the industry's enormous past productivity gains and growth. Nor has regulation produced a financially strong airline industry.[25]

In fact, several published studies examined deregulated intrastate markets, and maintained that CAB regulation brought about the inefficiency and effectuated higher fares than would have resulted had the CAB not controlled the industry.[26] In 1975, the CAB took up the matter and considered the effect of the proposals for deregulation and determined that the "airline industry 'is naturally competitive, not monopolistic,' and that regulation caused higher-than-necessary costs and prices, weakened the

---

22. Kelleher, *Deregulation and the Troglodytes - How the Airlines Met Adam Smith*, J. OF AIR L. & COMM. 299 (1985) [hereinafter *Deregulation and the Troglodytes*].

23. *1977 Aviation Subcommittee Hearings, supra* note 2, at 70.

24. *Id.* at 73 (". . . despite the tremendous growth of commercial aviation, the existing system of regulation has certainly not expanded the number of significant participants or reduced concentration.") (remarks of CAB Chairman Robson).

25. *Id.* at 70 (remarks of CAB Chairman Robson).

26. *Profitability and Risk, supra* note 1, at 197-98, n. 2 (citing W.A. JORDON, AIRLINE REGULATION IN AMERICA: EFFECTS AND IMPERFECTION, 226 (1970) (deregulated intrastate California carrier study that showed rates were 47% lower than they would have been under the CAB) and G.W. DOUGLAS and J.C. MILLER III, ECONOMIC REGULATION OF DOMESTIC AIR TRANSPORT; THEORY AND POLICY, (1975) (study reached similar result that deregulated Texas intrastate market had lower fares)); *Deregulation and the Troglodytes*, *supra* note 22, at 299, n. 8 (citing in addition to Gritta's sources, Keeler, *Airline Regulation and Market Performance*, BELL J. ECON. & MGMT. SCI. 399 (1972); R. CAVES, AIR TRANSPORT AND ITS REGULATORS: AN INDUSTRY STUDY (1962).

ability of carriers to respond to market demands and narrowed the range of price/quality choices available to the consumer."[27] The CAB report concluded that the regulations treating the industry as a public utility should be abandoned in the three to five year time span.[28]

In 1978, federal legislation was passed which reflected the CAB's view of regulation and the findings of the Congressional hearings[29] which examined the pros and cons of deregulation. To date, the Air Deregulation Act of 1978,[30] which amended the Federal Aviation Act, comprises the deregulated provisions. The relevant parts of the Act required the following:

> (1) Federal subsidization for air carriers in small communities with a prohibition against discontinuing essential service until the CAB can find a satisfactory replacement.[31]
>
> (2) Fares falling within a "zone of reasonableness" are not suspendable or subject to the jurisdiction of the CAB or the Department of Transportation upon the dissolution of the CAB.[32]
>
> (3) Two or more carriers may not merge if unlawful according to the consolidation and merger guidelines in the Act.[33]

The intended consequences of airline deregulation all fell under the umbrella of shifting the focus of regulation from ensuring the "well-being of the aviation industry, to making service economically available to more of the American public."[34] Deregulating pricing, market entry and routes would allow competition in these areas, instead of granting automatic profit to the airlines at the consumers' and investors' expense. Deregulation promised:

> Wide-open competition, with the free entry of new firms 'policing' the market, and assuring adequate reasonably-priced service; substantial fare reductions; deregulation would provide the public with new price/service options, such as lower-fare, no-frills service; benefits of deregulation would be equitably distributed and markets that lacked their own direct competition would benefit from the constant threat of competition from new entrants, and by providing freedom to compete in pricing, deregulation would obviate the pre-

---

27. *Deregulation and the Troglodytes*, *supra* note 22, at 301, n. 11 (quoting Executive Summary of Report of the CAB Special Staff on Regulatory Reform at 1 (1975)).

28. *Id.*

29. *See generally, 1977 Aviation Subcommittee Hearings supra* note 2; Senate Subcomm. on Administrative Practice and Procedure, 94th Cong. 1st Sess., Airline Regulation of the Civil Aeronautics Board (Comm. Print 1975) [hereinafter *1975*].

30. Airline Deregulation Act, Pub. L. No. 95-504, 92 Stat. 1705 (1978) (codified as amended at 49 U.S.C. §§ 1301 *et. seq.* (Supp. 1989)).

31. *Id.* at § 1389.

32. *Id.* at § 1482.

33. *Id.* at § 1378. Section 1551(a)(7) of the Transportation Federal Law transferred the authority over antitrust from the Secretary of Transportation to the Department of Justice as of January 1, 1989.

34. *1975 Airline Regulation Hearings, supra* note 29.

vious need to compete in service, and would particularly eliminate scheduling pressure and resulting excess capacity.[35]

The deregulators were not without warning in their pursuit of limiting the government's role in the industry. Critics of deregulation cautioned that reform would not bring the results that deregulation advocates hoped for. Specifically, the predicted effects were abandoned service, capital starvation, possible carrier failure, employee hardship, excessive industry concentration and destruction of the U.S. air system.[36] Whether or not these predictions came to life, suggesting that the industry cannot survive in a deregulated state, is discussed below.

B. HEALTH OF THE AIRLINE INDUSTRY

Just how healthy the airline industry is depends on whether a follower of John Maynard Keynes or Adam Smith is conducting the examination. A determination of whether the airline industry has fared well under deregulation also depends on at what stage the inquiry is taking place.

Immediately after the Deregulation Act was signed into law, the industry appeared to flourish with the entry of new carriers into new routes. The incumbent carriers experienced major increases in loads.[37] The industry was profitable and consumers felt the results of deregulation in lower fares.

However, as early as 1979, the airline industry took a public relations nose-dive. Reports of industry-wide problems began to appear. Losses for late 1979 and early 1980 totaled $500 million.[38] Service was discontinued in 49 cities.[39] Many of the airlines experienced large Federal Aviation Administration maintenance fines.[40] Airlines attempted to recover their operating losses by increasing fares in the monopoly markets.[41]

There are a number of rationales for the appearance of early failure on the part of deregulation. In early 1979 and 1980, fuel prices doubled due to the OPEC oil embargo and in response, the CAB allowed the air-

35. Brenner, *Airline Deregulation - A Case Study in Public Policy Failure*, 16 TRANS. L.J. 179, 182 (1988).

36. *1977 Aviation Subcommittee Hearings, supra* note 2, at 70.

37. *Deregulation and the Troglodytes, supra* note 22, at 303.

38. *Consequences, supra* note 4, at 31 (citing, Evans, *Deregulation of Airlines Was Hailed as Blessing, Later Cursed as Harmful*, Denver Post, June 22, 1980, at 41, col. 1. Another source cites operating losses at $480 million in 1981 and in 1982, aggregate losses were $650 million. *Deregulation and the Troglodytes, supra* note 22, at 304 (citing, Civil Aeronautics Board Report to Congress, Implementation of the Provisions of the Airline Deregulation Act of 1978, Appendix D (1984)).

39. *Consequences, supra* note 4, at 29.

40. *Id.* at 31, citing Gonzales, *Airline Safety, a Special Report*, PLAYBOY, July, 1980, at 140, 209 (the fines assessed against the airlines were $1,500,000 against Braniff; $385,000, PSA; $166,000, Prinair; $500,000, American; and $100,000 Continental).

41. CONSEQUENCES, *supra* note 4, at 37.

lines to raise fares 31 percent to compensate.[42] The economy was in a recession, interests rates were extraordinarily high and the PATCO strike handicapped the industry.

The industry's immediate plunge after passage of the Deregulation Act was viewed as the fault of deregulation by the deregulation critics. The criticism was that without regulation, entrants were allowed to freely enter the market, destructive competition followed and the losses piled up without any controls. Nearly $2 billion in overall losses were suffered from 1979 to 1983.[43] The fact that Air New England, Braniff, Continental, El Al, Laker, and 16 other air carriers entered various stages of bankruptcy after the promulgation of the Airline Deregulation Act of 1978[44] was enough to show that the market virtually chewed up and spit out the airlines daring enough to enter the market. The theory of contestability heralded by the deregulators, that the threat of new entrants into the market will keep the market competitive and fares reasonable, was also being chewed up and spit out as each new entrant either merged into another line or totally stopped operating.[45]

Today, regulation proponents fault deregulation for an unacceptable, oligopolistic industry that has cut costs and safety standards to increase profits. Regulators are concerned that the industry is too highly concentrated without rate regulation to control the monopoly markets. Regulators find no solace in the market's current profitability and they claim that any success enjoyed by the incumbent airlines are the result of monopoly extracted profits, reduction in service and diminished labor costs.[46]

---

42. E. BAILEY, D. GRAHAM & D. KAPLAN, DEREGULATING THE AIRLINES-AN ECONOMIC ANALYSIS 121 (1983).

43. CONSEQUENCES, *supra* note 4, at 39.

44. *Id.*

45. Kahn, the main proponent of deregulation, has repeatedly stated that the principal basis for deregulation, the theory of contestability, does not apply to markets that have only one competitor. He cites to a series of studies that demonstrate market concentration ratios make a significant difference in fares. Kahn, *Deregulatory Schitzophrenia*, 75 CALIF. L. REV. 1059, 1062, note 9 (citing E. BAILEY, D. GRAHAM & D. KAPLAN, DEREGULATING THE AIRLINES (1985); CALL & KEELER, *Airline Deregulation, Fares, and Market Behavior: Some Empirical Evidence*, in ANALYTICAL STUDIES IN TRANSPORT ECONOMICS (A. Daughty ed. 1985); Graham, Kaplan & Sibley, *Efficiency and Competition in the Airline Industry*, 14 BELL J. ECON. 118 (1983); Moore, *U.S. Airline Deregulation: Its Effects on Passengers, Capital, and Labor*, 29 J.L. & ECON. 1 (1986); Morrison & Winston, *Empirical Implications and Tests of the Contestability Hypothesis*, 30 J.L. & ECON. 53 (1987); D. Strassman, Contestable Markets and Dynamic Limit Pricing in the Deregulated Airline Industry (1986) (on file with the *California Law Review*)).

46. In support of their view of the industry, those in favor of stricter regulation of the industry can cite to overall industry losses of $6.7 billion in the first eight years of deregulation versus the $2.2 billion profit realized in the eight years preceding passage of the Act. M. Brenner, *Airline Deregulation-A Case Study in Public Policy Failure*, 16 TRANSP. L.J. 179, 224 (1988). The optimistic studies that claim deregulation has actually increased profitability by $2.5 billion are neutralized by the charge that the recession and high fuel prices were not factors by 1986 and the

Finally, the regulators, who lack an understanding of the function of bankruptcy, assert that deregulation is a failure because of the 150 bankruptcies that have been filed over the history of deregulation. Supposedly this number evidences a plagued industry with a doubtful recovery because few are willing to enter a market where so many companies have gone belly up.

On the other hand, deregulators claim that the industry was only able to recover from the dismal state in the early 1980's because deregulation allowed the airlines the ingenuity to create alternatives for survival.[47] The former CEO of Southwest Airlines claimed that the problems in the industry were not created by the deregulation of fares and route structures, but by other factors that were unforeseeable by Congress, such as the high interest rates, high fuel prices and highly leveraged carriers facing unexpected increases in cost.[48]

Deregulators are quick to refute complaints of high concentration in the market with a reminder that the CAB, or later, the Department of Transportation, approved all the mergers that were proposed and that because of this, antitrust jurisdiction was transferred to the Department of Justice. Deregulators also argue that markets with only one carrier should be regulated, that monopoly pricing should not be allowed to occur because the fare does not reflect the market forces. Deregulators are quick to point out that promoting regulation based on the fact that deregulation allows the market to extract monopoly pricing is unfounded. If stronger antitrust enforcement is desired, then enforce the antitrust laws and remove or amend the antitrust exemption for airlines[49] from the federal transportation laws.

In fact, proponents urge that deregulation has allowed the industry to produce "societal benefits." Lower fares reflect market forces at a cost savings of $11 billion a year[50] and as another example, approximately 90 percent of all passengers traveled in 1986 on fares that were 61 percent

---

industry's net did not yet exceed its interest payments even after those external problems had ceased. The Brookings study published in 1986, made such a claim and also asserted that deregulation aided the public by $6 billion a year. *See* S. MORRISON & C. WINSTON, THE ECONOMIC EFFECTS OF AIRLINE DEREGULATION (1986); *But c.f.*, M. Brenner, *A Case Study in Public Policy Failure* 16 TRANSP. L.J. at 224 (which asserts that the profit margin was negative 0.7% in 1986 versus the 2.7% that it had been prior to the Deregulation Act).

47. *Deregulation and the Troglodytes, supra* note 22, at 304.

48. *Id.* at 303-304; R. Gritta, *Bankruptcy Risks Facing the Major U.S. Airlines*, 48 J. OF AIR L. & COM. 90 (1982) (prediction that conservatively financed airlines through the issuance of stocks, were able to survive and liberally-financed companies that acquired capital through assumption of debt, would fail).

49. 49 U.S.C. § 1384.

50. Kahn, *Airline Deregulation-A Mixed Bag, But a Clear Success Nevertheless*, 16 TRANSP. L.J. 229, 236 (1988).

below the coach fare.[51]

The bottom line of the deregulation argument is that while the industry has experienced a large number of bankruptcies in the past eleven years, this is not a sign of a weakened industry necessarily failing. Bankruptcy, discussed at length below, is the proper forum to handle rapid growth and an equally rapid attrition of the many new entrants into the airline industry.

III. ANALYSIS

A. INTRODUCTION TO BANKRUPTCY USES

The United States Bankruptcy Code (Code), enacted in 1978, was a Congressional attempt to conform the bankruptcy laws to prevailing business realities.[52] A cornerstone of the Code is Chapter 11, Reorganization.[53] Chapter 11 has multiple purposes: to relieve the debtor from immediate payment of pre-petition debt;[54] to reorganize the debtor's finances;[55] to return the debtor to the marketplace as a viable enterprise;[56]

---

51. *Id.* at 237.

52. 11 U.S.C. §§ 101 *et seq.*

53. *Id.* at §§ 1101-1174. While Chapter 11 will be the primary focus of this article, Chapter 7 will also be explored in part. The focus of Chapter 7 is more limited and concerns the liquidation of the corporate debtor's assets and distribution of those funds in accordance with the priority scheme as enumerated in the Bankruptcy Code. R.E. GINSBERG, 1 BANKRUPTCY: TEXT, STATUTES, RULES 1031 (2nd ed. 1989) [hereinafter *Ginsberg*].

54. 11 U.S.C. § 362. § 362 creates an automatic stay as to all legal actions affecting the bankruptcy estate. § 362 applies to the following proceedings:

> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
>
> (2) the enforcement, against the debtor or against property of the estate, of a judgement obtained before the commencement of the case under this title;
>
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
>
> (4) any act to create, perfect, or enforce any lien against property of the estate;
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of a case under this title;
>
> (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
>
> (8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

11 U.S.C. § 362(a)(1)-(8).

55. Gerstell, Hoff-Patrinos and Morgan, *Alternatives to Chapter 11 and Contingency Planning for a Chapter 11 Filing in Aviation Indrustry Bankruptcy Issues*, 43 COM. L. & PRAC. 391 (1986) [hereinafter *Alternatives to Chapter 11*].

to reform or rescind burdensome contracts;[57] to provide continued employment to the debtor's workforce;[58] to treat creditors in an even-handed manner;[59] to further the public interest;[60] to attempt to ensure the stockholders a fair return on their investment;[61] and to consolidate in as great a manner as possible all of the debtor's widespread interests. Companies seek the bankruptcy court's protection for reasons that include cash flow problems, generally inclement economic conditions, ineffective labor and contract situations and to stay litigation.[62]

In order to balance these varied and conflicting purposes and reasons for bankruptcy, the bankruptcy courts have been given wide powers to decide all "core proceedings" concerning the debtor's estate.[63] The bankruptcy courts are courts of equity and may issue any order, process

---

56. Kaplan, *Bankruptcy as a Corporate Management Tool*, A.B.A.J., Jan. 1987, at 66 [hereinafter *Corporate Management Tool*].

57. 11 U.S.C. § 365 allows the trustee or debtor in possession to assume or reject executory contracts or unexpired leases. An executory contract is intended "to mean a contract on which performance remains due to some extent on both sides." *NLRB v. Bildisco*, 465 U.S. 513, 522 n.6 (1984), *quoting*, H.R. REP. NO. 9595, 95th Cong., 1st Sess. 347 (1977). § 365 is explained more fully *infra* at note 103. Labor contracts are specifically covered under 11 U.S.C. § 1113 of the Code and are discussed *infra* at nn. 174-184 and accompanying text.

58. *In re* Certified Corp., 51 Bankr. 768, 770-71 (Bankr. D. Haw. 1985).

59. *Alternatives to Chapter 11, supra* note 55, at 44.

60. *In re* Professional Sales Corp., 48 Bankr. 651, 661 (Bankr. N.D. Ill. 1985).

61. *Corporate Management Tool, supra* note 56, at 64.

62. *Id.*

63. 28 U.S.C. § 157 includes a list of possible core proceedings. Core proceedings include, but are not limited to:

> (A) matters concerning the administration of the estate;
> (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
> (C) counterclaims by the estate against persons filing claims against the estate;
> (D) orders in respect to obtaining credit;
> (E) orders to turn over property of the estate;
> (F) proceedings to determine, avoid, or recover preferences;
> (G) motions to terminate, annul, or modify the automatic stay;
> (H) proceedings to determine, avoid, or recover fraudulent conveyances;
> (I) determinations as to the dischargeability of particular debts;
> (J) objections to discharges;
> (K) determinations of the validity, extent, or priority of liens;
> (L) confirmations of plans;
> (M) orders approving the use or lease of property, including the use of cash collateral;
> (N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; and
> (O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims.

28 U.S.C. § 157(b)(2)(A-O). The estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1).

or judgement to carry out the Code.[64] In Chapter 11, the management remains firmly in place and is called the debtor-in-possession (DIP).[65] The DIP is given a wide range of rights and powers in order to reorganize.[66] Wary that the management may have been partially or fully to blame for the debtor's necessity in seeking relief in bankruptcy, the Code has provided creditors and parties-in-interest a wide variety of countervailing rights.[67]

64. 11 U.S.C. § 105.

65. *Id.* at § 1101

66. The debtor-in-prossession is granted substantial rights and powers in accordance with § 1107 of the Code. These include the protection of the automatic stay, the right to reject or assume executory contracts, the right to reject collective bargaining agreements, the right to use, sell or lease property, the right to obtain credit and the right to exercise avoidance powers. 11 U.S.C. §§ 362-365, 1113, 544, 545, 547 and 548. The debtor-in-possession is entrusted with all the rights, powers, duties, and limitations of a bankruptcy trustee, save for the right to receive statutory compensation under § 330. *Id.* at § 1107. The debtor-in-possession is authorized to operate the debtor's business. *Id.* at § 1108.

67. 11 U.S.C. § 1109 allows certain parties in interest to be heard on any issue in a Chapter 11 proceeding. These parties include the Securities and Exchange Commission, the creditors' committee, equity security holder's committee, creditors, equity security holders, the debtor and the trustee (if one is appointed). 11 U.S.C. § 1109(a) and (b). While "parties in interest" includes the debtor and debtor-in-possession, the term as used in this article will exclude those parties. This is done as a matter of style rather than to recite all possible parties in interest or by referring only to a term such as "creditors" which may be underinclusive. This power to be heard is a strong counter balance to the notion that a debtor-in-possession has virtually unlimited powers to further its own agenda in disregard of other interests. Additionally, individual sections of the Bankruptcy Code provide that notice be given and an opportunity to be heard to parties affected outside of those who have an automatic right to be heard. Parties in interest are given two types of rights: procedural and substantive.

Procedural rights can be referred to as the rights to notice and hearing. These rights are important as they give parties in interest the right to information about actions the debtor-in-possession must necessarily bring forth for court approval. Further, the procedural rights to notice and hearing are often the springboard to the substantive rights discussed below.

By requiring notice and hearing, the debtor-in-possession is on alert that parties in interest will know about its actions and will be able to object or negotiate the terms of the action. Notice and hearing is necessary for the debtor-in-possession to use, sell or lease property outside the ordinary course of business, 11 U.S.C. § 363(b), to obtain credit and incur debt outside the ordinary course of business, *Id.* at § 364(b), the allowance of an administrative expense, *Id.* at § 503(b), actions under the avoidance powers, *Id.* at §§ 544, 545, 547-50, and the abandonment of property, *Id.* at § 554.

While the procedural rights are undoubtedly important, the substantive guarantees of the Code allow parties in interest to defend their rights and interests and effect the general direction of a Chapter 11 proceeding in both its pre- and post confirmation stages. Under Chapter 11, the greatest source of rights for secured creditors derives from the theory of "adequate protection," *Id.* at § 361, while the greatest source of power for unsecured creditors is the ability to form a creditor's committee with its attendant rights to information and investigation. *Id.* at §§ 1102 and 1103. Finally, the secured and unsecured creditors have a right to examine the reorganization plan and vote on the plan. *Id.* at §§ 1125(b) and 1128.

Some commentators have suggested that the powers given to parties in interest are insufficient "for them to exercise meaningful control or to make their participation profitable." LoPucki, *The Debtor in Full Control-Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AMER.

To determine the relative benefits of bankruptcy to the airline industry, it is necessary to study how various airlines and parties in interest have fared in bankruptcy in the deregulated era. This first part of the section will analyze the actual and potential uses of the bankruptcy courts by various parties. The second section will detail the results of airlines in bankruptcy. It is hoped that after a thorough analysis of the activities of airlines in Chapters 7 and 11, one is left with the firm conviction that the bankruptcy courts are less intrusive, more flexible, more equitable and are quicker to respond than an administrative agency. Consequently, the public is served by lower fares and better service; management is spurred by competition to think aggressively and innovatively; labor is encouraged to take a more active role in corporate well-being through an increase in efficiency and participation; creditors are served by a single forum in which to recoup their debt and, finally, government energy is better channeled into enforcing antitrust and consumer protection laws.

B. The Usage and Potential Usage of Chapter 7 and 11 in the Airline Industry

1. Filing a Bankruptcy Petition in "Bad Faith"

The initial question parties in interest may seek to determine is whether a case was filed in bad faith. If it is filed in bad faith,[68] the proceeding must be dismissed. The bankruptcy court was faced with this question in Continental's bankruptcy proceeding.[69] In *Continental*, the Airline Pilot's Association (ALPA), the Union of Flight Attendants (UFA), and the International Association of Machinist and Aerospace Workers (IAM) challenged the good faith bankruptcy filing of the airline.[70] After a long set of hearings, the court found that Continental did not file bankruptcy solely or primarily to modify its collective bargaining agreement.[71]

BANKR. L.J. 99, 248 (1983). A non-use of powers granted such as the right to bring an involuntary petition, to form creditor's committees, to use the creditor's committees' powers and to propose plans of reorganization has resulted in the debtor remaining in full control. *Id.* at 247-48. This may be the case in certain reorganization plans where there is little hope of reorganization or of recovering the debt owed. (Essentially, why throw good money after bad?) However, the rights are very real and powerful, and exercised when necessary.

68. 11 U.S.C. § 1129(a) sets forth the requirements that must be met before a Chapter 11 reorganization plan may be approved. § 1129(a)(3) requires that the plan be proposed in good faith.

69. *In re* Continental Airlines Corp. 38 Bankr. 67 (Bankr. S.D. Tex. 1984).

70. *Id.* at 69. The debtors and unsecured trade creditors opposed the petitioner's motion. The action by the petitioners was apparently taken in response to new wage rates and rules unilaterally implemented by Continental. Unilateral changes were allowable in pre § 1113 proceedings.

71. *Id.* at 71. The court heard testimony on the issue of good faith for 11 days and reviewed extensive briefs. *See infra* nn. 174-184 and accompanying text for further explanation of collective bargaining agreements [hereinafter *CBA*] in the bankruptcy context.

Rather, the court found that Continental had not paid $42 million in trade debt on time, "was in violation of its liquidity provisions with secured lenders," would run out of cash within one week and had no credit.[72]

Given the difficulty in proving "bad faith" and the burdensome debt and dire straits that Continental faced, bankruptcy was its only option.[73] Continental's objectives in filing the petition, to reduce mounting debt, to gain adequate credit, to preserve jobs, and to restore consumer confidence, were "consistent with the purposes, spirit and intent of that statute."[74] Therefore, while it is in bad faith to file a bankruptcy petition solely for the purpose of modifying or rejecting a collective bargaining agreement, it is perfectly within the debtor's right to file a petition even if one of its intentions, *inter alia*, would be to reject a collective bargaining agreement in furtherance of other legitimate bankruptcy objectives.[75]

2. PROPERTY OF THE ESTATE

Another initial question is what constitutes property of the estate under § 541. An estate is created at the commencement of a bankruptcy petition and the property of the estate consists of "all legal or equitable interests" of the debtor.[76] An issue that arose in the first Braniff bankruptcy was whether "slots" are property of the estate.[77] Slots are the landing and take-off rights granted to an airline.[78] The court ruled against Braniff and determined that slots were not property of the estate.[79] Rather, the court found that the Special Federal Aviation Regulation established slots as "rules" of the Federal Aviation Administration.[80] "Slots are actually restrictions on the use of property-airplanes; not property in themselves."[81]

This case does not seem to comport with bankruptcy analysis on at

72. *Id.* at 70. "This court would reject any argument that a financially troubled company, which is losing money and is insolvent . . . is unable to pay it debts as they mature, has no credit and no free assets, and is about to run out of cash; nevertheless, cannot file a Chapter 11 proceeding if rejection of its collective bargaining agreements is a planned element in the reorganization of its business."

73. *Id.* at 71. The unsecured trade creditors testified that if the case were dismissed, they would have filed an involuntary bankruptcy petition under 11 U.S.C. § 303.

74. *In re* Continental Airlines Corp., 38 Bankr. at 71.

75. *Id.* at 71.

76. 11 U.S.C. § 541(a)(1).

77. *In re* Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983).

78. Simon, *Airline Operations in Chapter 11*, in AVIATION INDUSTRY BANKRUPTCY ISSUES, 8 PRACT. L. INST. 517, 520 (commercial Law and Practice Handbook No. 391, 1986) [hereinafter *Airline Operations*].

79. *Braniff, supra* note 77, at 942.

80. *Id.* at 942 (noting Northwest Airlines, Inc. v. Goldschmidt, 645 F.2d 1309 (8th Cir. 1960)).

81. *Braniff, supra* note 77, at 942.

least two levels. The Fifth Circuit admitted that the slots may "rise to some limited proprietary interest."[82] The court then stated that because licensing and certification remain subject to the "jurisdiction and approval of the applicable agency,"[83] jurisdiction vested outside the bankruptcy court. If the estate retains an interest in the property, jurisdiction should co-exist with the bankruptcy court and the administrative agency because the concept of property of the estate is very broad. The DOT should, therefore, seek the modification of the automatic stay because its actions would affect the rest of the estate or object to the sale of the slots and gates.[84]

Another basis for questioning the continuing validity of this holding is the fact that the Department of Transportation currently allows the sale and purchase of slots.[85] At least one recent instance was the purchase of eight gates by Midway Airlines from Eastern in Philadelphia.[86] Further, the bankruptcy court in the Eastern proceeding approved the sale of Eastern's Latin American routes, slots and miscellaneous equipment to American Airlines for $349 million.[87] Because the DOT now recognizes the sale of slots, gates and routes and because it seems apparent that the debtor-in-possession retains at least a limited propriety interest in slots, routes, and gates, the continuing validity of *Braniff* must be questioned.

3. § 362: THE AUTOMATIC STAY

Most judicial and administrative actions taken against the debtor are stayed pursuant to 11 U.S.C. § 362.[88] But the police and regulatory ex-

82. *Id.*

83. *Id.*

84. § 362(a) and *see infra* at nn. 88-101 and accompanying text. Section 363(b)(2)(A) requires the DIP to give notice when selling property. See *infra* n.121.

85. *Airline Operations, supra* note 78, at 522.

86. Chicago Tribune, Nov. 16, 1989, § 2, at 1, col. 2.

87. Chicago Tribune, Mar. 30, 1990, § 3, at 3, col. 1.

88. 11 U.S.C. § 362 automatically stays a wide array of actions that could be taken against a debtor but for the filing of a bankruptcy petition. The automatic stay takes effect immediately upon the filing of a bankruptcy petition, § 362(a). These actions include commencing or continuation of judicial or administrative proceedings, the enforcement of judgments, the attempt to gain possession of property and to create or perfect liens. 11 U.S.C. § 362(a)(1). For a full listing, *see supra* note 63. This section affords the debtor a "breathing spell" from the payment of prepetition debt. H. Rep. No. 95-595, 174; H & H Beverage Distributors v. Dep't of Revenue, 850 F.2d 165 (3rd Cir. 1988). It also affords the debtor the right to consolidate many claims into the bankruptcy proceeding rather than defend itself in multiple forums subject to conflicting decrees. Kommanditselskab Supertraus v. O.C.C. Shipping, Inc., 79 Bankr. 534 (Bankr. D.C.N.Y. 1987).

For a party to proceed in an action against the debtor outside the bankruptcy forum, the debtor must modify the automatic stay or be specifically excepted. The exceptions are reviewed *infra* at note 89. A creditor must prove that it is not adequately protected or the debtor retains no equity in the property and the property is not necessary to an effective reorganization. Typically, this provision is enforced upon motion of a secured creditor seeking the return of their collateral.

ception to the stay exempts most governmental actions that protect health, safety, welfare and morals.[89] It is generally recognized that the National Labor Relations Board is exempt from the automatic stay.[90] By analogy, the Railway Labor Relations Board should be similarly exempt.

In the Continental bankruptcy, the National Mediation Board (NMB) was not automatically excepted from the stay.[91] The NMB contended that the election was not a proceeding against the debtor and that it was governed by the police power exception.[92] The bankruptcy court found both arguments unpersuasive, holding that the election proceedings were clearly between the International Brotherhood of Teamsters and the airline.[93] Further, the court found that the NMB "investigates . . . conducts elections and it certifies in representation disputes. It has no enforcement authority."[94]

Id. at § 362(d). For an explanation of "adequate protection," "not necessary," and "no equity," *see*, *Alternative to Chapter 11*, *supra* note 55, at 311-326.

89. The automatic stay is a fundamental right of the debtor-in-possession halting many actions against it. 11 U.S.C. § 362. However, the automatic stay is not an ironclad rule.

One exception is the "police and regulatory power" exeception. *Id.* at § 362(b)(4). An exemption is given:

> "where a governmental unit issuing a debtor to prevent or stop a violation of fraud, environmental protection, consumer protection, safety or similar policy or regulatory law, or attempting to fix damages for violation of such a law."

S. Rep. No. 989, 95th Cong., 2d Sess., at 2 (1978).

This exception has been held to apply to state law "affecting health, welfare, morals and safety, but not regulatory laws that directly conflict with the control of res or property by the bankruptcy court." Missouri v. U.S. Bankruptcy Court, 647 F.2d 768, 776 (8th Cir. 1981), *cert. denied*, 454 U.S. 1162 (1987). The breadth of this exception has been heatedly debated by the courts. *See generally*, *Id.*; *In re* Cash Currency Exchange, Inc., 762 F.2d 542 (7th Cir. 1985); PennTerra Ltd v. Dep't of Environmental Resources, 733 F.2d 267 (3rd Cir. 1984). While this exception allows enforcement by government actors, money judgments will often interfere with the property of the estate and the realignment of the order of the creditors, and, therefore, the government's actions may be stayed. *In re* Sampson, 17 Bankr. 528 (Bankr. Conn. 1982).

90. *In re* Shippers Interstate Service Inc., 618 F.2d 9 (7th Cir. 1980); NLRB v. Evans Plumbing Co., 639 F.2d 291 (5th Cir. 1981).

91. *In re* Continental Airlines, Corp., 40 Bankr. 299 (Bankr. S.D. Tex. 1984). The NMB's function is to assist in dispute resolution as a mediator under the Railway Labor Act. Comment, *Deregulation in the Airline Industry: Toward a New Judicial Interpretation of the Railway Labor Act*, 80 NW. U.L. REV. 1003, 1006 (1986) [hereinafter *Deregulation in the Airline Industry*]. In the present case, the International Brotherhood of Teamsters, Airline Division (IBT), sought certification of Continental's Fleet Service and Passenger Service employees prior to the filing of a bankruptcy petition. However the elections were to be held subsequent to what proved to be the date of Continental's bankruptcy petition. Upon filing their bankruptcy petition, Continental sought to prevent the NMB from violating the stay by proceeding with elections. The NMB disregarded this action and proceeded with the representation election. *In re* Continental Airlines, Corp., 40 Bankr. at 301-302.

92. *Id.* at 304.

93. *Id.* at 306. "To accept the argument that the positions of IBT and Continental are not one against the other would be a sham."

94. *Id.* at 305. True enforcement powers are necessary for this exception to apply.

Continental also faced problems from the Airline Pilots Association (ALPA).[95] The ALPA scheduled 317 pilots of Continental to attend disciplinary hearings at the same date and time.[96] The court found this action would result in irreparable harm to the airline by forcing Continental to cancel flights for three days, would damage Continental's reputation and goodwill and thus constituted interference with the debtors assets and operations.[97] The court also found that the hearings constituted an "unreasonable harassment" of Continental.[98]

Both Continental decisions make perfect sense in a bankruptcy setting. The police power exception to the stay is narrow.[99] It is important to remember that the stay may be lifted in the proper circumstances. That is essentially what Continental requested in the NMB case.[100] The court also proceeded, quite equitably, to hold that while the ALPA's actions violated the stay, the actions could be undertaken over a longer period, so as not to disrupt the airline's operations. Therefore, a corporation in bankruptcy is protected form unwarranted harassment, including harassment by employees.[101]

4. *THE INTERRELATIONSHIP BETWEEN 11 U.S.C. §§ 1110, 365 AND 547.*

The recovery of airline equipment is not affected by the automatic stay.[102] Section 1110's scope has come into conflict with other provisions of the Code. The specific conflict in the bankruptcy of Airlift International was the relationship between § 365 and § 1110, and the estate's

95. *In re* Continental Airline Corp., 43 Bankr. 127 (Bankr. S.D. Tex. 1984).

96. *Id.* at 127

97. *Id.* at 128. Action that interferes with the debtor's estate violates the automatic stay.

98. *Id.* at 129. The court explained that the debtor's interest would be far more damaged than the union's interest as the union "would be required to merely reschedule the hearings" over a longer period.

99. *See supra* note 89.

100. *In re* Continental Airlines, Corp., 40 Bankr. at 301.

101. *In re* Continental Airlines, Corp., 43 Bankr. at 127. The court conceivably could have assessed actual and punitive damages against the ALPA for willful violation of the stay. 11 U.S.C. § 362(h).

102. 11 U.S.C. § 1110(a). The Code makes special provisions for the secured creditors of aircraft equipment. Section 1110 is a limited exception to the automatic stay for the secured creditors of "aircraft, aircraft engines, propellers, appliances or spare parts." The purpose of section 1110 is to "encourage new financing in the transportation industry and to promote industry modernization by protecting equipment financiers." *Alternatives to Chapter 11, supra* note 55, at 312. The creditor may repossess aircraft equipment without seeking the lifting of the automatic stay. 11 U.S.C. § 1110(a). The debtor-in-possession may prevent the repossession by curing all defaults that occurred within 60 days of filing the bankruptcy petition, perform in accordance with the financing agreement and cure all post-filing defaults "before the later of (i) 30 days after the date of such default; and (ii) the expiration of such 60-day period." *Id.* at § 1110(a)(2)(B).

liability because of its use of an aircraft.[103] The conflict also involved what priority payment the secured lender was entitled to.[104] The appellate court found that the Congressional intent behind § 1110 mandated GATX to receive the full amount of failed payments up to the date of surrender of the airplane and the payments be accorded an administrative expense.[105] The court rejected the bankruptcy court's analogy of § 1110 to § 365.[106] Because the theory of § 1110 was to offer "equipment financiers greater certainty with regard to their ability to protect collateral in bankruptcy," the bankruptcy court's determination wholly under-compensated GATX.[107] Further, the estate is liable for the full contract if it assumes the contract during bankruptcy proceedings.[108] The same is true under § 1110 except the debtor may cut liability by return of the aircraft.[109] Thus, because the aircraft was a necessary component to the bankruptcy proceeding, GATX was entitled to an administrative expense.[110]

Section 1110 was also at the center of controversy in further litigation in the Airlift International bankruptcy.[111] The issue was "whether a stipulation entered pursuant to § 1110 precludes a trustee in bankruptcy from recovering preferential transfer under . . . § 547."[112] The appellate court found § 1110 required all defaults be cured prior to retaining the air-

103. *In re* Airlift International, Inc., 26 Bankr. 61 (Bankr. Fla. 1982); *In re* Aircraft International, Inc., 761 F.2d 1503 (11th Cir. 1985). The debtor-in-possession is given the right to assume or reject executory contracts and unexpired leases under Code section 365. An executory contract is one "in which performance remains due to some extent on both sides." N.L.R.B. v. Bildisco, 465 U.S. 513, 522 n. 6 (quoting H.R. Rep. No. 95-595 at 347 (1977)). This ability to assume or reject commercial contracts remains a strong weapon in the arsenal of the debtor-in-possession to jettison burdensome contracts and retain contracts necessary to a successful reorganization. This right to assume an executory contract is conditioned on the debtor-in-possession curing a default or adequately assuring that a default will be cured and future performance adequately assured. 11 U.S.C. § 365(b). Further, the rejection of an executory contract constitutes a breach of contract to which a creditor is entitled to file a proof-of-claim. 11 U.S.C. § 365(g)(1).

104. *In re* Aircraft Intern., Inc., 761 F.2d 1503 (11th Cir. 1985). The debtor and the secured lender, GATX, entered into a stipulation under § 1110 for the use of an aircraft. Payments were not made for approximately 1½ months that totalled $178,966.59. GATX sought full payment as an administrative expense. The co-trustees argued that payment should be had only for the reasonable value of actual use and should not be entitled to an administrative expense. *Id.* at 1507.

105. *Id.*

106. The bankruptcy court found that § 365 and § 1110 had similar purposes thus GATX was entitled to merely an award of reasonable actual use value, the standard remedy under § 365. *See also, In re* Airlift Intern., Inc., 26 Bankr. 61 (Bankr. Fla. 1982).

107. *In re* Airlift Intern., Inc., 761 F.2d at 1507.

108. *Id.* at 1509.

109. *Id.*

110. *Id.* at 1510-11.

111. Seidle v. GATX Leasing Corp., 778 F.2d 659 (11th Cir. 1985).

112. *Id.* at 662. The trustee sought the return of $326,902.32, that was paid by Airlift to GATX

craft.[113] The trustee, by seeking the return of all pre-petition payments to the estate as a preference, would cause an inequitable result: if the debtor defaulted and then wished to have the airplanes, the default must be cured; if the debtor made payments up to filing, it could retain use of the aircraft and recover the payments as a preference.[114] This would essentially undermine the purpose of § 1110 to either "prompt and certain repossession . . . or . . . satisfaction of all past due amounts and a promise to make future payments."[115] Therefore, the trustee could not recover the pre-petition payments as preferences having entered into a stipulation under § 1110.[116]

In *Global Int'l Airways*, the bankruptcy court was faced with the issue of when to allow a debtor to assume a lease under § 365.[117] The debtor attempted to assume a lease for an airplane from Air Canada.[118] The court must approve the assumption of a lease after the debtor proves that the assumption is a benefit to the estate.[119] The court found that the debtor could not meet this burden because the estate stood to lose at least $1.6 million.[120]

The *Airlift* and *Global* cases illustrate the court's ability to balance equities. Clearly, § 1110 protects airline financiers, and the appellate court correctly granted the financier an administrative expense for the amount of money defaulted upon by the trustee. Further, a preference action would render § 1110 a nullity. The *Global* court correctly examined

---

within 90 days prior to the filing of a bankruptcy petition which seemingly constituted an avoidable preference under § 547.

The trustee's avoiding powers allow the debtor-in-possession to undue certain transactions undertaken prior to or after the filing of the bankruptcy petition. 11 U.S.C. §§ 544-50. The most powerful avoiding power is the ability to recover preferences under § 547. 11 U.S.C. § 547 provides that a preference action may be undertaken to recover a transfer of property of the estate that was for the benefit of a creditor on account of an antecedent debt made while the debtor was insolvent within 90 days of the filing of the bankruptcy petition (or within one year of the transfer if an insider) that enabled the creditor to receive more than it would have received under a liquidation proceeding. 11 U.S.C. § 547(b). This power allows the debtor-in-possession to recover all funds paid out by the debtor prior to the filing of the petition, provided the conditions are met. Essentially it allows the debtor-in-possession to undue unfavorable (to the debtor and to non-preferred creditors) transactions.

113. Seidle v. GATX, 778 F.2d at 662.

114. *Id.*

115. *Id.* at 664.

116. *Id.* at 662. The bankruptcy and district courts essentially agreed with the appellate court's ultimate decision.

117. *In re* Global Int'l Airways, 35 Bankr. 881 (Bankr. W.D. Mo. 1983).

118. *Id.* at 882.

119. *Id.* at 886.

120. *Id.* at 887-88. The debtor proposed to run one charter flight per month for three months. The lease ran for one year and would cost between $1.9 million (debtor's estimate) and $2.9 million (Air Canada's estimate). The debtor claimed it would make between $210,000 and $300,000 per charter flight.

the potentially devastating effect that the assumption of the aircraft lease would have on the reorganization of the estate and possible pay out to all classes of creditors.

5. *11 U.S.C. § 363(*b): THE USE, SALE OR LEASE OF PROPERTY OUTSIDE THE ORDINARY COURSE OF BUSINESS AND ITS EFFECT ON THE REORGANIZATION PLAN

A vigorously litigated area in the airline industry bandruptcy situation is over the use, sale or lease of property outside the ordinary course of business.[121] The court in *Lionel*[122] explained that the debtor must articu-

121. 11 U.S.C. § 363(b), sets forth the instances in which the debtor, in-possession may use, sell or lease property. It conveniently divides into two situations: the use, sale and lease of property in the "ordinary course of business" 11 U.S.C. § 363(c), and outside the ordinary course of business. *Id.* at § 363(b).

The debtor-in-possession may use, sell or lease property of the estate in the ordinary course of business without notice to parties in interest or a hearing before the bankruptcy court. *Id.* at § 363(c). The obvious policy reason is that the debtor-in-possession is, in large part, in control of the ordinary day-to-day activities of the debtor's business. To force the debtor-in-possession to send notice and defend itself in court is neither cost nor time effective. The ordinary course of business is usually limited to those activities frequently and commonly entered into by the debtor prior to the filing of the bankruptcy petition. Hillman and Caras, *When the Bank Wants Its Borrower in Bankruptcy: Benefits of Bankruptcy for Lenders and Lender Liability Defendants*, 40 ME. L. REV. 375, 385-86 (1988) [hereinafter *Benefits of Bankruptcy*]. Included in the list of activities covered by § 363(c)(1) is the ability of a debtor-in-possession to enter into a post-petition collective bargaining agreement. *In re* DeLuca Distributing Co., 38 Bankr. 588 (Bankr. N.D. Ohio 1984); *In re* Sealift Maritime, Inc., 265 NLRB 154 (1982).

The only real restriction on the debtor-in-possession in transacting ordinary business is in the use of "cash collateral." 11 U.S.C. § 363(c)(2). The term "cash collateral" is defined in § 363(a) and provides in pertinent part: "cash collateral means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents." Cash collateral is treated with special care because of the concern that the debtor "will mismanage, transfer, hide or otherwise dissipate collateral . . . because it is highly volatile and subject to rapid dissipation." *Benefits of Bankruptcy*, at 387. To protect the creditor's cash collateral, the debtor-in-possession must receive the consent of the creditor, 11 U.S.C. § 363(2)(A) (1983), or have the court authorize the use of cash collateral after notice and a hearing. *Id.* at § 363(2)(B).

The debtor-in-possession may also use, sell or lease property outside the ordinary course of business. *Id.* at § 363(b). Non-ordinary course of business transactions may only be undertaken after notice and hearing. *Id.* at § 363(b)(1). The most common type of non-ordinary business transaction is the sale of all or part of the debtor's estate. *See generally, In re* Lionel Corp., 722 F.2d 1063 (1983). Courts have had wildly different interpretations concerning § 363(b). *Compare, In re* WHET, 12 Bankr. 743 (Bankr. MA. 1981); and *In re* White Motor Credit Corp., 14 Bankr. 584 (Bankr. N.D. OH. 1981). *WHET* found nothing objectionable to the sale of most or all of the assets outside a plan, while *White* would allow such a sale only under emergency or exceptional cases. *See generally*, Trust, *From Airwaves to Airplanes: A Practical Guide for Chapter 11 Sales Outside the Ordinary Course of Business*, 91 COMM. L.J. 267 (1986) [hereinafter *From Airwaves*].

The fear of allowing the sale of all or a great portion of the property of the estate is that the debtor-in-possession will effect a liquidation of the assets without proposing a Chapter 11 plan which requires the approval of the creditors or without converting the proceedings to a Chapter 7. The requirements for proposing and accepting a reorganization plan are described *infra* at

late a business justification other than "appeasement of major creditors"[123] to use, sell or lease property outside the ordinary course of business. The question specifically facing the appellate court during the Braniff bankruptcy was "when does a transaction go outside the ordinary course of business such that it is also outside the scope of § 363 so as to render a bankruptcy court without power to approve the sale?"[124]

Essentially, when does a transaction effect the basic structure of the reorganization? The *Braniff* court held that the proposed transaction "had the practical effect of dictating some of the terms of any future reorganization plan."[125] The court concluded that the transaction would short circuit the requirements for confirmation of a Chapter 11 plan.[126] The court found the sections of the agreement which forced the secured creditors to vote with a majority of the unsecured creditor's committee, and provided for the release of claims against Braniff, the secured creditors and its officers and directors particularly appalling.[127] Where the effect of a sale would leave little choice for reorganization, the court is without power to approve the transaction.[128]

---

notes 138-142 and accompanying text. The difference between liquidating a Chapter 11 through a plan and converting a proceeding to a Chapter 7 is one of tactics. A liquidation plan under Chapter 11 allows the debtor-in-possession to liquidate itself (believing itself to be more efficient than a Chapter 7 trustee) and saves the added layer of administrative expenses under 11 U.S.C. § 330. The disadvantage is that the plan must be accepted, often an arduous task. The distribution scheme under Chapter 7 or Chapter 11 is identical and can be found in 11 U.S.C. § 507.

In a hearing under § 363(b) the debtor-in-possession must articulate a business reason for its decision and the sale must be in the best interest of the creditors. Neither requirement is explicitly stated in the Code, although both have been implied by the courts. *See, From Airwaves*, at 268. *See generally, Lionel* and *White Motor Credit*. Non-ordinary transactions are further burdened by the requirement that the creditor's security interest be adequately protected against loss. 11 U.S.C. § 363(c). The concept of Adequate protection is delineated in § 361. Adequate protection may be assured by periodic cash payments to the creditor, an additional or replacement lien, or other compensation that will result in the indubitable equivalent of the creditor's interest. § 361(1-3). *See generally*, Baird and Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97 (1984). The debtor-in-possession must also adequately protect the use of cash collateral. *Benefits of Bankruptcy*, at 387.

122. *In re* Lionel Corp., 722 F.2d 1063 (2d Cir. 1983).

123. *Id.* at 1070.

124. *In re* Braniff Airways, Inc., 700 F.2d 935, 939 (5th Cir. 1983).

125. *Id.* at 940. At issue was the "PSA Agreement." The PSA Agreement provided in great part that Braniff would transfer for cash, airplanes, equipment, terminal leases and landing slots in exchange for unsecured notes, travel scrip and profit participation in PSA's proposed operations. The Agreement also called for a restructuring of Braniff's creditors. The action raised "a blizzard of objection to each of these elements." *Id.* at 939.

126. *Id.* at 940. The transaction would establish the "terms of the plan *sub rosa*." *Id.* at 940. The requirements for a confirmation of a Chapter 11 plan are found at 11 U.S.C. § 1129(a) (1983).

127. *Id.*

128. *Id.*

A similar situation faced the appellate court in the *Continental* proceeding.[129] Judge Gee succinctly phrased the issue as, "how far a debtor-in-possession can stretch the bankruptcy laws to undertake transactions outside a plan of reorganization."[130] In this case, the transaction in question concerned the ability of Continental to enter into a lease agreement for two aircraft.[131] Some creditors objected on grounds that the transaction "represent[s] pieces of a creeping plan of reorganization."[132] The court agreed that these creditors' fears of being denied the rights guaranteed under a reorganization plan were valid.[133]

The court in *Braniff*[134] certainly seemed correct in disallowing the sale of such a large proportion of the assets as to render any chance of rehabilitation a nullity. While the court explicitly protected the rights of creditors in formulating and confirming a reorganization plan, the court implicitly protected the public interest. By not allowing the transaction, the court forced the airline to reconsider its reorganization plan and remain a viable airline.

Continental, on the other hand, defeated in part, the ability of a debtor-in-possession to operate the business under § 1108. Continental seemingly proposed a transaction that would increase its value and improve its position in a lucrative market. It not only articulated a business reason, it made a bold initiative for strengthening itself. Merely because a transaction involves a large amount of money does not mean its is "likely to short circuit the requirements of reorganization."[135] The result of *Continental* affects the ability of a debtor-in-possession to effectuate meaningful changes through the operation of its business. It may also alter the analysis of whether an individual business decision is sound by raising the level of scrutiny above that of the business judgement rule.[136] There may be sound reasons for requiring a higher burden upon the DIP than

129. *In re* Continental Airlines, Inc., 780 F.2d 1223 (5th Cir. 1986).

130. *Id.* at 1224.

131. *Id.* Continental's proffered reasons for entering the agreement were to "strengthen and enhance profitability and cash flow and to increase the asset value of its mid-Pacific and South Pacific operations."

132. *Id.* at 1227.

133. *Id.*

134. *In re* Braniff, 700 F.2d at 935.

135. *Id.* at 940. One commentator astutely recognized that "*Braniff* simply does not hold that § 363(b) precludes a sale of all or substantially all of the debtor's assets . . . [rather] the true holding of *Braniff* is that § 363(b) does not permit a sale of assets which would change the composition of the debtor's property and dictate the terms of any future reorganization plan." *From Airwaves, supra* note 121, at 270-71.

136. Courts have generally held that it will not scrutinize business decisions made by the DIP as long as the decisions are made in good faith and within the scope of its authority. *See generally, In re* Southern Biotech, Inc., 37 Bankr. 318 (Bankr. Fla. 1983); *In re* Johns-Manville Corp., 60 Bankr. 612 (Bankr. N.Y. 1986).

the business judgement rule, given that present management presumably caused the corporation to enter bankruptcy. However, this reason does not change the fact that the test for scrutinizing management's business decisions is whether it was in the DIP's sound business judgement.[137]

The *Braniff* and *Continental* decisions strongly endorse the need for debtors-in-possession to formulate and implement a plan of reorganization.[138] By forcing debtor's to "scale hurdles erected in Chapter 11," *i.e.*, information disclosure, voting, a plan developed in the best interest of creditors and subject to the absolute priority rule, the courts have encouraged debtors-in-possession to quickly formulate and implement plans.[139] The importance of confirming a plan benefits the debtor, creditors and the public as the rules for reorganization are laid out.[140] The failure to implement a plan may lead to the court appointing a trustee.[141] The bankruptcy court does not have the authority to compel a trustee to operate a debtor's business and this may not be in anyone's interest.[142] Often, the debtor-in-possession, as opposed to a trustee, is more likely to have a vested interest in running the debtor's business.

6. *The Appointment of a Trustee in Chapter 11: Eastern Airlines*

While the debtor-in-possession is generally the best entity to run the business during the pendency of the bankruptcy, there are circumstances

137. *Id.*

138. The debtor is given the first chance to propose a reorganization plan. 11 U.S.C. § 1121(b) (1988). Under § 1121(b) the debtor, and only the debtor, may file a plan within the first 120 days after the filing of a petition. This period may be extended or reduced after notice and hearing by the court. *Id.* at § 1121(d). This power to propose the plan is important because it allows the debtor-in-possession to control the Chapter 11 and post Chapter 11 proceedings via the plan of reorganization. Upon a plan being confirmed, it controls the workings of the Chapter 11 proceeding by binding parties whether they have accepted or not. *Id.* at § 1141(a).

Finally, parties in interest have a great deal of say in the formulation, acceptance and modification of a reorganization plan, because all affected parties are bound by the terms of a plan upon confirmation. *Id.* at § 1141. Any party in interest may file a plan subject to the first attempt being given to the debtor. *Id.* at § 1121. The contents of a plan are too long to be adequately dealt with in this article and the requirments can be found in § 1123 and § 1129. The plan must be voted on and accepted by one-half of the number of allowed claims and two-thirds of the amount of claims in each class. *Id.* at § 1126(d). Every claim holder must receive adequate information before casting a vote. *Id.* at § 1125(b). "Adequate information means information of a kind, and in sufficient detail . . . that would enable a hypothetical reasonable investor . . . to make an informed judgement about the plan." *Id.* at § 1125(a)(1). The court then must hold a confirmation hearing at which any party in interest may object. *Id.* at § 1128. The plan may only be confirmed once the requirements of § 1129 are met. The plan may be modified by § 1127.

139. *In re* Braniff, 700 F.2d at 940.

140. 11 U.S.C. § 1141 (1988).

141. *Id.* at § 1104(a).

142. *In re* Airlift Int'l, Inc., 18 Bankr. 787, 788 (Bankr. Fla. 1982). The trustee may operate the debtor's business if it is in the best interests of the estate, but the court may not force the trustee to run the business.

in which a trustee will be appointed to operate the debtor's business. A trustee may be appointed for cause[143] or if the appointment is in the best interest of the estate.[144] The trustee has all the power to operate the debtor's business.[145]

In the Eastern bankruptcy, the unsecured creditors petitioned for the appointment of a trustee.[146] The bankruptcy court, after analyzing Eastern's increased losses and reduction of amounts to creditors with each proposed reorganization plan, appointed the former President of Continental Airlines, Martin Shugrue, as trustee.[147] Mr. Shugrue's immediate intent seems to focus on the reorganization of Eastern rather than the sale of substantially all of Eastern's assets or its liquidation.[148] To achieve this end, Shugrue authorized the sale of Eastern's Latin American routes to American Airlines subject to the bankruptcy court's and Department of Transportation's approval.[149] In addition to formulating a plan that will pay creditors an acceptable amount and restoring positive cash flow, Mr. Shugrue will need to restore public confidence and ease labor tensions.[150]

7. THE AVOIDING POWERS: 11 U.S.C. §§ 544 AND 547

The Air Florida bankruptcy produced two important decisions concerning the power of the debtor-in-possession to recover preferences under § 547 and avoid liens under § 544.[151] In the first action, the DIP attempted to avoid the security interests of Trans World Airlines in the sale of a portion of a Fort Lauderdale, Florida airport terminal and two loading

143. 11 U.S.C. § 1104(a)(1). "Cause" includes "fraud, dishonesty, incompetence or gross mismanagement by current management."

144. *Id.* at § 1104(a)(2).

145. *Id.* at § 1106(a).

146. Chicago Tribune, Apr. 19, 1990, § 3 at 1, col. 6.

147. *Id.* Undoubtedly, Bankruptcy Judge Lifland's primary consideration in appointing Mr. Shugrue was his experience in restoring Continental to financial health during its bankruptcy.

148. Chicago Tribune, May 16, 1990, § 3, at 3, col. 5. However, rumors continue to abound about a possible buy-out of Eastern by Northwest Airlines. *Id.* July 4, 1990, § 3, at 1, col. 5.

149. *Id.* Apr. 25, 1990, § 3, at 1, col. 1. The effect of the sale would presumably ease Eastern's cash-flow and liquidity problems.

150. In fact, the appointment of Mr. Shugrue has already softened the stance of several unions, including the International Association of Machinists. *Id.*, July 4, 1990, § 3, at 1, col. 5.

151. 11 U.S.C. § 1107(a), gives the DIP all the rights of a trustee save for the right to receive compensation. The trustee's power to avoid preferences pursuant to § 547 is described *supra* at note 112.

A DIP may avoid certain liens pursuant to § 544. The DIP stands as a hypothetical lien creditor and may avoid transfers which are not perfected due to inadequate or incomplete documentation, unrecorded mortgages and unperfected security interests. *Ginsberg, supra* note 53, at 664. *See also*, Schechter and Heuer, *The Trustee's Avoiding Powers Under the Bankruptcy Code*, Chi. B.A. Bankr. Sem., at 8 (Sept. 17, 1990).

bridges to Air Florida.[152] The court reviewed and interpreted various memoranda agreements and determined the nature of the collateral and the adequacy of TWA in perfecting its security interests.[153] The court found the failure by TWA to file a financing statement with the Florida Department of State resulted in a failure to perfect its security interests, which the DIP could avoid and which resulted in the collateral being unsecured.[154]

Having determined that TWA's lien could be avoided, the court was left to decide whether payments to TWA in furtherance of the above note on the airport terminal and loading bridges constituted a preference.[155] The debt was now classified as unsecured and payments were made on account of an antecedent debt made while the debtor was insolvent. This allowed TWA to receive more than it would in a liquidation. The payments were a preference and could be avoided.[156]

In another Air Florida proceeding, the DIP was able to recover payments made to the Airlines Clearinghouse Inc. (ACH), which made payments to Eastern Airlines with money that Air Florida owed Eastern.[157] The payments were made as part of a reciprocal agreement between airlines to carry other airline's passengers.[158] Various airlines then filed claims with ACH for payment from other airlines.[159] Air Florida failed to make payments to ACH for three months totaling $3,015,601 and was expelled from the ACH.[160] To regain its privileges in the ACH, Air Florida satisfied the debt owed to Eastern.[161] The court found the payments were made to Eastern for an antecedent debt made while Air Florida was insolvent, allowing Eastern to receive more than it would in a liquidation proceeding.[162] Thus, the court allowed Air Florida to recover the payments made to ACH to regain its good standing.[163]

---

152. *In re* Air Florida Systems, Inc., 48 Bankr. 437, 440 (Bankr. Fla. 1985).

153. *Id.* at 439. The court examined a sublease, Bill of Sale, Chattel Mortgage and Security Agreement, and a Financing Statement.

154. *Id.* TWA had filed the Chattel Mortgage and Financing Statement with the public records office of the county where the airport was located and argued that this action perfected its security interests.

155. *Id.* at 440. The requirements for recovering a preference are discussed *supra* note 112.

156. *Air Florida*, 48 Bankr. at 440. Air Florida recovered $20,834.

157. *In re* Jet Florida Systems, Inc., 59 Bankr. 886, 891 (Bankr. S.D. Fla. 1986). ACH acted as an agent in "reconciling and settling debts" between airlines.

158. *Id.* at 888.

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* However, the court did allow Eastern a setoff for monies owed Air Florida through the ACH pursuant to 11 U.S.C. § 553. Eastern remitted to Air Florida $241,010. *Id.* at 889.

8. 11 U.S.C. § 1102: CREDITOR'S COMMITTEE

Section 1102, the right to have a creditor's committee appointed, may be one of the strongest tools the creditors have in forcing a debtor-in-possession into a confirmed plan status or the appointment of a trustee.[164] Until recently, it was unknown whether a union could be a creditor and sit on a committee. The court in *Altair Airlines*,[165] finally and firmly decided that a union, as exclusive bargaining agent, was an "entity" that had a right of payment.[166] Therefore, unions may sit on creditor's committees if they meet the requirements under § 1102(b).[167]

9. LABOR/MANAGEMENT RELATIONS

The union/debtor-in-possession relationship is among the most important in attempting a successful reorganization of any business.[168] Generally, labor costs are both the single largest variable cost (between airlines)[169] and the largest cost factor.[170] A large percentage of the ma-

164. This is due primarily to the great powers of investigation given to the committee to protect the interest of unsecured creditors as explained below.

11 U.S.C. § 1102(a) provides for the appointment of a creditor's committee. The creditor's committee consists of the seven largest unsecured creditors, although the make-up of the committee may be changed if the committee does not fairly represent the kind of claims to be represented. *Id.* at § 1102(b). Additional committees may be appointed "if necessary to assure adequate representation of creditors." *Id.* at § 1102(a)(2). The purpose of the creditor's committee is to assure that the class of unsecured creditors are treated fairly. *In re* AKF Foods, Inc., 36 Bankr. 288 (Bankr. N.Y. 1984).

To further this stated purpose, the committee has several rights and powers. One right is to employ "attorneys, accountants, or other agents to represent or perform services" for the committee. 11 U.S.C. § 1103(a). These representatives will ordinarily be paid an administrative expense, as their services will be "actual, necessary costs and expenses of preserving the estate." *Id.* at § 503(b)(1). The committee may also "consult with . . . the debtor-in-possession concerning the administration of the case," participate in formulating a plan and investigate the acts, conduct and financial condition of the debtor-in-possession. *Id.* at § 1103(c).

165. *In re* Altair Airlines, Inc., 727 F.2d 88 (3rd Cir. 1984).

166. *Id.* at 91. Essentially, an entity with a right of payment makes one a creditor. 11 U.S.C. § 101(9). Here the union represented 88 pilots of the airline. Their claims totalled $676,120, making it the second largest unsecured creditor. *Altair* at 89.

167. One commentator noted that there are five situations in which the union is not a creditor, and hence may not sit on the creditor's committee and, indeed, may not have a substantial voice in the reorganization. A union may not sit on a creditor's committee if the collective bargaining agreement is 1) assumed; 2) the rejection of the CBA is denied; 3) the debtor's operations are discontinued; 4) the union strikes in response to the filing of a petition and rejection of the collective bargaining agreement; and, 5) the collective bargaining agreement expires prior to rejection. McDonald, *Bankruptcy Reorganization: Labor Considerations for the Debtor-Employer*, 11 EMPLOYEE RELATIONS L. J. 7, 16-18 (1985) [hereinafter *Bankruptcy Reorganization*].

168. *See generally*, Gallagher, *Labor Contract Issues in Airline Bankruptcy*, 3 PRAC. L. INST. 137, 190 (Comm. L. & Prac. Handbook No. 391 1986) [hereinafter *Labor Contract Issues*] and Merrick, *Bankruptcy Dynamics of Collective Bargaining Agreements*, 91 COMM. L.J. 169 (1986) [hereinafter *Bankruptcy Dynamics*].

169. *Labor Contract Issues*, *supra* note 168, at 139.

jor Chapter 11 cases have significant unionized labor.[171] The situation was particularly grave in the pre-deregulated airline industry as wage rates were especially high.[172] "[A]irline management generally felt that it had made overly generous pre-deregulation concessions to the unions and that both labor as well as management should endure the post-deregulation shakedown."[173]

Section 1113 codified the debtor-in-possession's ability to reject a collective bargaining agreement.[174] It is primarily aimed at the danger of

170. *Bankruptcy Dynamics*, *supra* note 168, at 170.

171. *Id.*

172. Prior to 1978, management routinely conceded to union demands, particularly with respect to salaries. The CAB fostered a high rate structure. *Deregulation in the Airline Industry*, *supra* note 90, at 1003. Deregulation has seen labor costs reduced by 20 to 30 percent by some carriers. Kaden, *The Potential of Collective Bargaining Agreements in an Era of Economic Restructuring*, 1 LAB. L. & BUS. CHANGE 17 (1989) [hereinafter *Potential of Collective Bargaining*].

173. *Deregulation in the Airline Industry*, *supra* note 90, at 1015.

174. 11 U.S.C. § 1113. A collective bargaining agreement (CBA) between a labor union and management is an executory contract. *In re* Bildisco, 465 U.S. 513 (1984). However, CBA's have often been treated as a fundamentally different situation primarily because of the countervailing public policy considerations of the federal labor laws. *See generally, In re* Bildisco, 682 F.2d 72 (3rd Cir. 1982), *aff'd*, 465 U.S. 513 (1984); Local Joint Executive Bd., AFL-CIO v. Hotel Circle, Inc., 613 F.2d 210 (9th Cir. 1980); *In re* Brada-Miller Freight Sys., 702 F.2d 890 (11th Cir. 1983); Brotherhood of Ry., Airline, and S.S. Clerks v. REA Express, Inc., 523 F.2d 164 (2d Cir. 1975), *cert. denied*, 423 U.S. 1073 (1976); Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc., 519 F.2d 698 (2d Cir. 1975). For this reason, the courts developed a more stringent test than the business judgment rule in deciding when to allow rejection of a collective bargaining agreement.

A split in the circuits developed over the proper standard to use in allowing a debtor-in-possession to reject a CBA. *Compare* REA *with* Brada-Miller and Bildisco, 682 F.2d 72 (3rd Cir. 1982). This was the question the Supreme Court squarely faced in *Bildisco*, and held "that because of the special nature of a collective bargaining agreement, and the consequent 'law of the shop' . . . a somewhat stricter standard should govern the decision of the bankruptcy court to allow rejection of a collective bargaining agreement." 465 U.S. at 524. *Bildisco* noted that "there is no indication in section 365 of the bankruptcy code that rejection of a collective bargaining agreement should be governed by a standard different from that governing other executory contracts." *Id.* at 523. Commenting on the section 1167 special exemption of railway laborers from changes in their collective bargaining agreement, the Court stated "[C]ongress knew how to draft an exclusion when it wanted to." *Id.* at 522. The Court was faced with a decision of whether to apply the labor conscious standard of *REA* or whether to focus on the ultimate goal of Chapter 11 to reorganize the debtor's business. The Court in *REA* found that a debtor-in-possession could only reject a CBA if the debtor-in-possession "can demonstrate that its reorganization will fail unless rejection is permitted." *Id.* at 524. *See* REA, 523 F.2d at 167-69. The appellate court in *Bildisco* focused on the equitable powers of the bankruptcy court and the goal of reorganization. Bildisco, 682 F.2d at 74. The Supreme Court found the formulation in *REA* was unduly restrictive as "the authority to reject an executory contract is vital to the basic purpose of a Chapter 11 reorganization because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization." Bildisco, 465 U.S. at 528.

The Supreme Court in Bildisco found that rejection of a CBA was proper if that agreement is burdensome to the reorganization and that balance of equities favored rejection. *Id.* at 527. The

management initiating unilateral changes but essentially adopts the substantive and procedural guarantees of *Bildisco*.[175] This section has generally been interpreted by the test set forth in *American Provisions*,[176] with

---

court believed that balancing the equities included consideration of the debtor, creditors and employees with an eye towards a successful reorganization.

The Supreme Court was faced with a second issue in Bildisco, whether a debtor-in-possession which unilaterally rejects a CBA has committed an unfair labor practice under section 8(a)(5) and 8(d) of the National Labor Relations Act. *Id.* at 528. The Court concluded that a debtor-in-possession does not commit an unfair labor practice. *Id.* at 529. To conclude that an unfair labor practice had been committed "would largely, if not completely, undermine whatever benefit the debtor-in-possession otherwise obtains by its authority to request rejection." *Id.* at 529. The union has a remedy, it may file a proof-of-claim for damages stemming from the breach of the CBA. *Id.* at 530.

Congressional response to Bildisco was swift. The Bankruptcy Amendments and Federal Judgeship Act of 1984 adopted in substantial part the Bildisco standard for rejection of CBAs, but overruled the Court's determination that a debtor-in-possession could not commit an unfair labor practice by unilaterally modifying the CBA's terms. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, Title III, Subtitle J, § 541(a), 98 Stat. 390 (1984). Congress' response is now codified in 11 U.S.C. § 1113.

Section 1113 emphasizes the consensual nature of collective bargaining. The debtor-in-possession must "make a proposal . . . based on the most complete and reliable information . . . which provides for necessary modifications . . . necessary to permit the reorganization of the debtor and to assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably." *Id.* at § 1113(b)(1)(A). The debtor-in-possession shall provide the employees' representative with information relevant to evaluate the proposal. *Id.* at § 1113(b)(1)(B). The parties must meet in "good faith." *Id.* at § 1113(b)(2). The bankruptcy court shall approve a rejection of a CBA only if the above criteria are met, the employee representative refused the proposal without good cause and "the balance of equities clearly favors rejection." *Id.* at § 1113(c).

175. Zurofsky, *Repudiation of Collective Bargaining Agreements in Bankruptcy-A Practical History and Guide for Union Representatives*, 3 LABOR LAW. 809, 820 (1989) [hereinafter *Repudiation*].

176. *In re* American Provisions, 44 Bankr. 907, 909 (Bankr. Minn. 1984). The nine-part test is as follows:

> (1) The debtor-in-possession must make a proposal to the union to modify the CBA; (2) The proposal must be based on the most complete and reliable information available at the time of the proposal; (3) The proposal modifications must be necessary to permit the reorganization of the debtor; (4) The proposed modifications must assure that all the creditors, the debtor, and all the affected parties are treated fairly and equitably; (5) The debtor must provide to the union such relevant information as is necessary to evaluate the proposal; (6) Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union; (7) At the meetings, the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement; (8) The union must have refused to accept the proposal without good cause; (9) The balance of the equities must clearly favor rejection of the collective bargaining agreement.

See also, Miller & Dandeneau, *Bankruptcy Reorganization and CBA - An Alternative to Oppressive Labor Contracts*, 17 LABOR LAW AND BUSINESS CHANGE, 301-302 (1989). *See generally*, Wheeling Pittsburgh v. United Steelworkers, 791 F.2d 1074 (3d Cir. 1986); *In re* Carey Transportion, 50 Bankr. 203 (Bankr. S.D. N.Y. 1985); *In re* K&B Mounting, 50 Bankr. 460 (Bankr. N.D. Ind. 1985).

Essentially the debtor-in-possession must now make a proposal to the union to modify the

bargaining as the linchpin.[177] Therefore, it is a misnomer to label a collective bargaining agreement as rejected under § 1113, rather, it is a modification.[178]

10. The Conflict Between 11 U.S.C. §§ 1113 and 1167

While bargaining may be the linchpin of a modified collective bargaining agreement in airline bankruptcies because of § 1113, the normal mechanisms of negotiation do not apply.[179] It has been argued that collective bargaining agreements may not be rejected except by the method delineated under § 1167.[180] The Railroad Reorganization Act prohibits rejection of collective bargaining agreements except for the modification procedures under subsection VI of the Railway Labor Act.[181] In *Braniff* and *Air Florida*, the petitioner-unions attempted to boot-strap the inclusion of airline unions as governed by the RLA into the provisions of § 1167.[182] Both courts found that § 1167 pertained solely to railroads despite the references to the RLA and that rejection may be had by means other than those found at subsection VI of the RLA.[183] Both cases arose prior to § 1113 and were decided in accordance with 11 U.S.C. § 365, although *Air Florida* was decided in the post § 1113 era.[184]

11. Rights and Powers Retained by the Union

While unions may not have all the protections of the RLA, the airline

---

collective bargaining agreement based on complete and reliable information that is provided to the union. The proposal must be necessary to permit reorganization and to assure all affected parties are treated fairly and equitably. *American Provisions, supra* at 909. The necessity component of this test has resulted in a split of the circuits. *Cf.* Wheeling Pittsburgh, *supra* at 1079 ("necessity" should be strictly construed and should only be allowed to avoid debtor-in-possession from going into liquidation); *and* Truck Drivers Local 807 v. Carey Transportation, Inc., 816 F.2d 90 (2d Cir. 1987) (§ 1113 did not overturn the substance of Bildisco, it only codified the procedure). "Necessary should not be equated with 'essential' or bare minimum." *Id.* at 89. The court should look to the long term for "[C]hanges that will enable the debtor to complete the reorganization process successfully." *Id.* at 90. The debtor-in-possession and union must meet at reasonable times, in good faith, to attempt to reach a satisfactory modification. The union must have refused this proposal without good cause and the balance of equities must clearly favor rejection. *Id.* at 90. Thus, the union can have a powerful say in either rebutting a possible rejection or in setting the terms in a new modified agreement.

177. *Repudiation, supra* note 175, at 815.

178. Abram and Ceccott, *Protecting Union Interests in Employer Bankruptcy*, 17 LAB. L. & BUS. CHANGE 312 (1989) [hereinafter *Protecting Union Interests*].

179. American Provisions, 44 Bankr. at 909.

180. *In re* Braniff Airways, Inc., 25 Bankr. 216 (Bankr. Tex. 1982); *In re* Air Florida System, Inc., 48 Bankr. 440 (Bankr. Fla. 1985).

181. 11 U.S.C. § 1167. The Railway Labor Act, 45 U.S.C. § 156 (1926), governs railways and airlines. *See infra* notes 247-253 and accompanying text.

182. Braniff, 25 Bankr. at 217; Air Florida, 48 Bankr. at 442.

183. Braniff, 25 Bankr. at 217; Air Florida, 48 Bankr. at 443.

184. Air Florida, *Id.* at 444.

still retains the duty to bargain in good faith.[185] The union retains the right to strike[186] and may not be enjoined under the general power of the court to carry out the provisions of the code.[187] Its status as bargaining agent is unaffected by the expiration or rejection of a CBA,[188] and it may utilize its powers to investigate management's operations and garner knowledge as a member of the creditor's committee.[189] A union may be able to seek an appointment to a separate union-creditors' committee if its interests differ so substantially from other unsecured creditors' interests.[190] If a rejection of a CBA is authorized and a new CBA negotiated, the debtor-in-possession may not alter the agreement except with respect to subsection VI of the RLA.[191] In relationship to non-unionized labor, unionized labor is much better off in bankruptcy.[192]

It has been noted that § 1113 may allow a broader range of negotiation issues.[193] Unions are entitled to receive information in modification proceedings as a member of the creditor's committee. It may contest any reorganization plan to ensure that all are treated fairly and equitably. Subjects such as the number and type of managers, management salaries and fringe benefits, general corporate organization and the use of capital are ripe matters for collective bargaining discussion.[194]

While unions may be gaining some management control, particularly through stock options and seats on the Board of Directors,[195] Chapter 11 is not a tool "in which labor shares in the management of the enterprise."[196] While labor models and stances are becoming increasingly non-adversarial[197] and debtor-union cooperation may be a key compo-

185. *Labor Contract Issues, supra* note 168, at 84.

186. *Id.*

187. *In re* Petrusch, 667 F.2d 297 (2d Cir. 1981); *In re* Crowe & Assoc., 713 F.2d 211 (6th Cir. 1983), *cert. denied*, 456 U.S. 974 (1981) (§ 105(a) allows the court to "issue any order, process, or judgement necessary or appropriate to carry out the provisions of this title.").

188. *Protecting Union Interests, supra* note 178, at 315.

189. *Id.* at 310, and *Bankruptcy Reorganization, supra* note 167, at 8.

190. *Bankruptcy Reorganization, Id.* at 19. A special union-creditors' committee was established in the Continental bankruptcy proceedings.

191. *Id.* at 11.

192. Judge Merrick noted that employers will normally reduce non-organized labor as a matter of course. "Non-unionized labor compensation maybe reduced without prior explanation or external approval. . . . Reduction (of wages) is swift and certain for unorganized employees but slow and conjectural for organized employees. . . . Newspaper accounts of the outrage of union leaders over the Bildisco decision suggest that the addition of Section 1113 was political and not cerebral." *Bankruptcy Dynamics, supra* note 168, at 228. Section 1113's focus for cost cutting must not be directed exclusively at unionized workers.

193. *Repudiation, supra* note 175, at 816.

194. *Id.*

195. *Potential of Collective Bargaining, supra* note 172, at 17.

196. *Bankruptcy Reorganization, supra* note 167, at 8.

197. *Potential of Collective Bargaining, supra* note 172, at 8.

nent to a successful reorganization,[198] ultimately Chapter 11 reorganization has multiple objectives.[199] A commentator notes, "[u]nderstandably, the union desires to emerges from this proceeding having preserved the terms and conditions of its collective bargaining agreement. However, if by doing so, the company is pushed into liquidation, the union's victory will have been a Pyrrhic one."[200]

C. THE RESULTS OF AIRLINES IN BANKRUPTCY

News accounts of airlines in bankruptcy are often greeted by front page news. Yet, the coverage subsides as the on-goings of bankrupt airlines are often relegated to the business section. This clearly demonstrates that the public has, to a great degree, accepted the fact that businesses, even service industries, go into bankruptcy without the sky falling.[201]

The theoretical balancing of equities inured in the Code has worked remarkably well in the real world of airlines. The ideal path of a bankrupt airline and the path of airlines in the deregulated era are strikingly similar. The airline industry, just like individual airlines in bankruptcy, goes through a painful, cathartic period. They emerge a more lean, productive, efficient and profitable business.[202] Bankruptcy proceedings have an ability to "run silent, run deep." They effectuate great changes within the structure of an airline, yet allow the industry as a whole to function well.

The bankruptcy forum is the ideal arena for determinations of liquidation and reorganization. The bankruptcy court's great equitable powers and flexibility allow it to work changes on an individually troubled airline without affecting the industry as a whole. The debtor's, creditor's, and public's interest can be balanced in the bankruptcy forum far better than by a plodding, unresponsive bureaucracy. The bankruptcy court has been particularly adept at remedying three main concerns of the deregulators: 1) what to do with non-viable airlines; 2) providing financing to a credit-starved industry; and 3) dealing with the gamut of management-labor problems.

Deregulation spurred a tremendous growth in the number of opera-

198. *Bankruptcy Dynamics, supra* note 168, at 232.

199. *Id.* at 188. *See supra* notes 54-62 and accompanying text.

200. Vian, *Collective Bargaining Agreements Under Code Section 1113*, 91 COMM. L.J. 252, 258 (1986).

201. One of the main goals proffered by the authors of the Bankruptcy Code was to remove the stigma of bankruptcy. Many commentators have noted an emerging acceptance of bankruptcy, particularly given the major, household name corporations who have sought Chapter 11 protection. *See generally, Bankruptcy Reorganization, supra* note 167, and Krusc, *Impacts of Deregulation on the U.S. Airline Industry and the Role of the Bank Lender*, 1 PRAC. L. INST. 41 (1989) [hereinafter *Impacts of Deregulation*].

202. *Potential of Collective Bargaining, supra* note 172, at 17.

tional airlines.[203] This was foreseeable, as was the fact that many airlines would cease operations, merge or declare bankruptcy.[204] The bankruptcy court's ability to liquidate airlines that are deeply in debt and have a going concern only as airplanes, slots, employees and management, is formidable. The assets are sold to other airlines or returned to creditors. Debts are paid in part and workers may retain jobs.[205] Certainly this is preferred to a situation of idle planes, workers and customers.[206]

1. *Midway: Building an Airline Through Bankruptcy Acquisition*

Midway Airlines is an example of building an airline through bankruptcy liquidation or sale of assets pursuant to a reorganization plan. Much of Midway's growth can be attributed to purchases from bankrupt airlines. Midway purchased substantially all of Air Florida's assets during the latter's bankruptcy proceeding.[207] The bankruptcy court found this sale was in the best interest of creditors and employees as there was no other "prospective purchaser and no other operating plan."[208] Midway also purchased eight gates and aircraft from Eastern in Philadelphia.[209] The effect of this purchase was to give Midway a foothold in the eastern markets and challenge the strong position held by USAir in the Philadelphia market.[210] Midway has further attempted to strengthen its Florida position by offering to purchase three gates from Braniff at Orlando International Airport for $2.25 million.[211]

---

203. The number of certified carriers in October, 1978 was 38, and 123 in February, 1984. *Impacts of Deregulation, supra* note 201, at 13. Today the number stands at 22. Wall Street J., Sept. 29, 1989, § A, at 3, col. 1.

204. There seems to be the assumption that bankruptcy necessarily means the termination of business. This is not the case. Airlines may continue to operate during the pendency of the bankruptcy. Examples include Eastern and Continental which decreased service, but did not stop flying upon filing Chapter 11. Moreover, the slack caused by airlines that do stop operating is usually quickly picked up. For instance, in Braniff's case, passengers' tickets were honored by several competitors. Wall Street J., Sept. 28, 1989, § A, at 5, col. 6.

205. *In re* Air Florida Systems, Inc., 48 Bankr. 440, 442 (Bankr. S.D. Fla. 1985).

206. Upon Braniff's second bankruptcy filing, American, Eastern and Continental honored Braniff tickets on a "space available" basis. Agents booked customers on "preferred airlines" such as Pan Am, Continental, TWA, Midway, America West, Alaska Air and U.S. Air. Wall Street J., Sept. 28, 1989, § A, at 5, col. 6.

207. *In re* Air Florida Systems, Inc., 48 Bankr. 440, 442 (Bankr. S.D. Fla. 1985).

208. *Id.*

209. Chicago Tribune, Nov. 16, 1989, § 2, at 1, col. 2.

210. *Id.*

211. Chicago Tribune, Feb. 10, 1990, § 2, at 7, col. 2. The sale is pending approval before the bankruptcy court. Finally, there has been speculation that Midway may expand to Kansas City by acquiring Braniff's 28 gates and 52 aircraft at Kansas City International Airport. Chicago Tribune, Nov. 13, 1989, § 4, at 1, col. 5.

2. Reorganization and Rehabilitation

A better gauge of bankruptcy success is the rehabilitation of a debtor. One of the problems facing airlines is great debt coupled with an inability to gain adequate financing.[212] Richard Gritta prophetically predicted which airlines would seek bankruptcy based on debt/equity ratios in 1982.[213] Braniff's tale is particularly revealing as its initial bankruptcy was preceded by an aggressive expansion program. Its second bankruptcy was preceded by its great expansion in Kansas City.[214] Financing airlines in bankruptcy is not particularly hazardous.[215] General financing,

---

212. Miller, Ho and Rosen, *Obtaining Credit and Incurring Debt by a Trustee or Debtor-In-Possession Under the Bankruptcy Code*, 4 PRAC. L. INST. 211 (Comm. L. & Prac. Handbook No. 391 1989) [hereinafter *Obtaining Credit*].

213. Gritta, *Bankruptcy Risks Facing the Major U.S. Airlines*, 48 J. OF AIR L. & COMM. 89, 90-97 (1982) [hereinafter *Bankruptcy Risks*]. Gritta explained that debt financing "presents opportunities for higher rates of return, but it also increases risk. The ultimate risk is [that] an air carrier may not be able to pay interest charges and therefore may become insolvent." *Id.* at 93. Gritta found the financial strategy of accumulating debt had been going on in the airline industry for 20 years. The airline industry was particularly vulnerable to recessions, and the combination of debt and recession would cause many bankruptcies. *Id.* at 91. Indeed the three major airlines with the highest debt/equity ratios, Braniff, Continental and Eastern, all declared bankruptcy. The fourth highest, Western, merged with Delta. The remaining big five, United, American, Delta, Northwest and TWA continue to operate.

214. Chicago Tribune, Sept. 29, 1989, § 3, at 3, col. 5. Further, it was attempting to triple its size by 1991. Wall Street J., Sept. 29, 1989, § A, at 3, col. 1.

215. The debtor-in-possession may obtain credit and incur debt under § 364. *See generally, Obtaining Credit, supra* note 212. Often the success or failure of a Chapter 11 is predicated on obtaining sufficient funds to continue the business. *Id.* at 211, and *Benefits of Bankruptcy, supra* note 121, at 393.

As under § 363, § 364 may be neatly divided between obtaining credit in the ordinary course of business and outside the ordinary course. 11 U.S.C. § 364(a)-(d). The debtor-in-possession "may obtain unsecured credit . . . in the ordinary course of business." *Id.* at § 364(a). This debt will be allowed as an administrative expense under § 503. *Id.* at § 364(a). A debtor-in-possession's administrative expenses are paid out immediately after all secured debt is repaid from the secured property or the secured property is abandoned to the secured creditor. Typically, ordinary course debt will include trade credit and utility services. *Obtaining Credit, supra* note 215, at 220.

The debtor-in-possession may also obtain credit and incur debt outside the ordinary course of business. § 364(b) allows the trustee, after notice and hearing and with court approval, to obtain non-ordinary course debt. 11 U.S.C. § 364(b). The financing must be for an appropriate purpose. *Obtaining Credit, supra* note 215, at 225; *In re* Club Development and Management Corp., 27 Bankr. 610, 611-12 (Bankr. 9th Cir. 1982). This credit or debt is unsecured but generally is entitled to an administrative priority. 11 U.S.C. § 364(b). The most common forms of non-ordinary credit or debt are funds to pay operating expenses or payroll. *Obtaining Credit, supra* note 215, at 220.

If a debtor-in-possession in unable to entice sufficient credit or debt through § 364(a) and (b), the court may authorize credit or debt under § 364(c), which provides that after notice and hearing, a creditor may be given priority over 1) all administrative expenses, or 2) a security interest on otherwise unencumbered property, or, 3) a junior lien on encumbered property. 11 U.S.C. § 364(c)(1-3).

If sufficient credit cannot be generated by the provisions of § 364(c), the court may authorize

outside the ordinary course of business, is usually secured by unencumbered property or by super lien.[216] Aircraft and equipment is protected to an even greater degree by § 1110,[217] under which a debtor must cure all defaults and make all payments in a timely fashion or face repossession.[218]

While it may be easier to obtain financing in bankruptcy because of the reduced risks, it may also be easier to retire an airline's debts. Lenders prefer airlines to reorganize rather than liquidate.[219]

The establishment of an estate protects an airline from being dismembered by a particularly rabid creditor and thus preserves the assets and increases the chance for reorganization for all creditors. Bankers have become increasingly flexible in repayment plans[220] and innovative in new types of financing.[221]

Similarly, bankruptcy has ushered in a new era in labor/management relations. Certainly § 1113 is a management tool that allows the airline to cut labor costs and institute other work rule changes. An aggressive, active union may use its role as either a creditor or a rejectee of a collective bargaining agreement to its advantage. It is entitled to vast information in either role.[222] The union may negotiate on issues it could not previously insist upon.[223] While organized labor wages have gone down while increased productivity has been required,[224] bankruptcy has created opportunities to participate in fundamental business decisions not available under the labor laws.[225]

Bankruptcy law has perhaps been more responsive to the changes in

---

a "super lien" under § 364(d). A super lien is credit or debt secured by a "senior or equal lien on property" that is already secured. *Id.* at § 364(d)(1). The court may only authorize this type of credit when the debtor-in-possession "is unable to obtain such credit otherwise." *Id.* at § 364(d)(1)(A), i.e. the DIP is not able to obtain credit via §§ 364(a)-(c) and there is adequate protection for the already secured property. *Id.* at § 364(d)(1)(B). The trustee has the burden of proof on the issue of adequate protection. 11 U.S.C. § 364(d)(2).

216. 11 U.S.C. § 364.

217. 11 U.S.C. § 1110. *See supra* note 102. The lender who extended such credit would come ahead of the unsecured creditors if there's trouble down the road. L.A. Daily J., May 17, 1982, § 1, at 5, col. 1.

218. 11 U.S.C. § 1110.

219. *Bankruptcy Risks, supra* note 213, at 107. "The world wide market in used aircraft is already gutted and prices are falling."

220. *Id.*

221. The idea of the operating lessor is but one innovation. *Impacts of Deregulation, supra* note 201, at 12.

222. As a member of the creditor's committee it may oversee operations and investigate actions. *See supra* note 174. As the recipient of a rejection it is entitled to all relevant information used by the company in formulating a modified agreement. *See supra* note 164.

223. *Repudiation, supra* note 175, at 816.

224. *Deregulation in the Airline Industry, supra* note 90, at 1027.

225. *Protecting Union Interests, supra* note 178, at 307.

labor/management relations than the traditional labor laws. The complex demands of a new economic order have emphasized cooperation rather than conflict, and performance-based compensation.[226] Rigid rules on classifications have been relaxed in order to facilitate change and there has been a recognition of the industry's need for smarter, better-educated workers whose skills are constantly changing to match the demands of new technology.[227] Even the more traditional, adversarial unions have had to soften their positons.[228]

3. *CONTINENTAL: A BANKRUPTCY SUCCESS*

Perhaps the most well-known success story of airlines in bankruptcy is Continental Airlines.[229] Continental operated the eighth largest airline, employing 12,000 people and generating $1.5 billion in annual revenues prior to filing bankruptcy.[230] However, it had lost $520 million since 1978 and was unable to compete due to high labor costs.[231] Having no free assets, cash flow problems and failure to reach satisfactory modifications with its creditors and unions, it fled to Chapter 11.[232]

Continental's many court battles have been documented above.[233] But Continental's case of Chapter 11 was a sound one. It staved off creditors, reduced costs and formulated an aggressive, expansion-oriented reorganization plan.[234] As Continental emerges from bankruptcy, it is interesting to note that it is at the approximate pre-filing size,[235] and flies double the seat miles.[236] Continental's management decided that it must

---

226. *Id.*

227. *Potential of Collective Bargaining, supra* note 172, at 19-20.

228. For instance, many of Eastern's pilots have crossed the picket lines since a strike began on March 4, 1989, and a war has boiled over on the question of whether to end the strike, leading to the replacement of the ALPA President with a "more militant leader." Wall Street J., Sept. 11, 1989, § B, at 11, col. 1. The Eastern flight attendants recently ended their 8½ week strike. Chicago Tribune, Nov. 24, 1989, § 3, at 1, col. 5.

229. The contention that Continental has succeeded is hotly disputed by those proponents of organized labor who saw their wages cut by as much as 50% and then saw the dismantling of union power at Continental. Comment, *Deregulation in the Airline Industry: Toward a New Judicial Interpretation of the Railway Labor Act*, 80 NW. U.L. REV. 1003, 1016 (1986). However, the animus between management and organized labor was so great that it became apparent that one had to go. Continental was legitimately in bankruptcy because of its high costs, debt and inability to compete. *In re* Continental Airlines, Corp., 38 Bankr. 67, 70-71 (Bankr. Tex. 1984).

230. *Bankruptcy Reorganization, supra* note 167.

231. *Id.*

232. *In re* Continental Airlines, Corp., 38 Bankr. at 70-71.

233. *See supra* notes 69-75 and accompanying text.

234. Labor strife continued for most of the Continental bankruptcy proceeding as unions struck the airlines for almost two years. *Bankruptcy Reorganization, supra* note 167, at 7. The upshot of the strikes played into Continental's hands as Continental could lay-off and fire strikers rather than seek a drastically modified and reduced collective bargaining agreement.

235. *Id.* at 298.

236. *Airline Operations, supra* note 78, at 526.

grow to compete or face a failed reorganization.[237] Thus Continental came armed to the bankruptcy court with reliable financial projections and detailed expansion and marketing plans.[238] In the first half of 1989, Continental reported net income of $15.6 million on revenues of $2.1 billion.[239] The result is a rehabilitated airline.

Deregulation opened the market to new entrants, price-slashing, cost consciousness and improved efficiency. Deregulation has strengthened some airlines, but others have failed or should not have entered the market in the first place. Bankruptcy is concerned with the losers of the game. Its broad powers to effectuate changes where administrative agencies cannot, its inability to interfere with healthy airlines (which administrative agencies can-and often do-effect across-the-board industry changes) and its unique ability to balance the equities has worked at the microeconomic level to which it is aimed. Bankruptcy is not aimed at institutional stability or consumer desires, yet it has served those interests well. It is through the bankruptcy process that the airline industry was able to pull through a trying period of confusion and recession. The conditions that caused problems in the airline industry were problems that affected business in general and problems that are often solved through resort to the bankruptcy process.

IV. Impact Of Bankruptcy and Conclusions

Because general economic conditions and the policy decisions of airline management during the pre-deregulated era and the infancy of the deregulated age caused many of the problems facing the airline industry today, it is disheartening to hear some "solutions" which so completely misperceive the problem.[240] The problems have fermented and have only recently come home to roost. One particularly appalling suggestion is the so-called "two-time loser" bill. A recent congressional proposal would disallow airlines from entering bankruptcy a second time. There is little possible good that can come from passing this bill into law. In bankruptcy, either an airline is rehabilitated and allowed to provide service or its assets are sold to those airlines that can provide service. The two-time loser bill cannot assure the same orderly system of rehabilitation or redistribution.

Industrial problems often set off a clarion call for regulatory schemes heralded as a solution for an industry's ails.[241] More often problems that

237. *Id.*

238. *Id.*

239. Chicago Tribune, Oct. 14, 1989, § 3, at 2, col. 3.

240. The problem is large debt and high costs pulled through a recessionary period. *See supra* notes 212-213 and accompanying text.

241. *See supra* notes 4-8 and accompanying text.

occur in an industry are caused by the tension that remains in a newly deregulated industry, which remains, in part, regulated. Certainly this seems to be the present situation of the airways. Robert Poole, of the Reason Foundation, has found that the monopoly of airlines in certain cities has not been caused by cutthroat competition which reduced the number of airlines that compete in a given market.[242] Rather, remnants of the regulated era have caused monopolies. During the regulated era airports and airlines signed long-term leases which often gave the dominant airline veto power over bond issues for airport expansion.[243] These long-term leases made perfect sense in the regulated era, when government dictated price, routes and allocation of slots.[244] Today, the long-term leases are barriers to airlines which would ordinarily attempt to move into markets where excessive fares are the rule.[245] Rather than a regulatory scheme which would adjust fares in those monopoly markets, the airports should be deregulated.[246]

There has also been a proposal that the airlines be subjected to a set of parallel bankruptcy provisions as provided for the railroad industry.[247] Therefore, it is somewhat worthwhile to examine the special provisions for railroad reorganization under the Code. The purpose of the Railroad Reorganization Act is to protect the public interest.[248] A trustee is appointed as a matter of course.[249] The Interstate Commerce Commission, Department of Transportation and state regulatory commissions may appear on any issue.[250] Collective bargaining agreements may only be modified in accordance with subsection VI of the Railway Labor Act,[251] where abandonment of a railway line may only be had if it is in the "best interest of the estate; or . . . essential to the formulation of a plan; and . . . consistent with the public interest."[252] Railroad reorganization is far more concerned with the interests of the public and unions. Railroad reorganization restricts the flexibility of the court, eliminates the debtor-in-possession and reduces the input of creditors in the reorganization process.

There is some facial resemblance between the railroad and airline industries. Both are transportation industries providing a public utility. Certain provisions in the Railroad Reorganization Act would be particu-

242. *Onward and Upward,* NATIONAL REVIEW, June 11, 1990, at 14.
243. *Id.*
244. *Id.*
245. *Id.*
246. *Id.*
247. 11 U.S.C. §§ 1161-1174.
248. *Id.* at § 1165.
249. *Id.* at § 1163.
250. *Id.* at § 1164.
251. *Id.* at § 1167.
252. *Id.* at § 1170(a).

larly helpful to airline creditors.[253]

But there are historical and practical differences between the industries that are so great that a parallel airline subchapter would make airlines vulnerable to successful rehabilitation. First, it is far easier to build new landing strips and gates than it is to build railroad lines. Second, airline routes are multi-directional while railway lines are bi-directional.[254] While any number of airlines may fly the same routes, railways are far more monopolistic, and the regulation over price and routes is necessarily greater. High labor and other fixed costs fit easily into the price figuration in a monopoly setting. Airlines, in price competition, must be acutely aware of its fixed costs. The Railroad Reorganization subchapter posits a traditional labor model where collective bargaining agreements may only be modified by subsection VI of the Railway Labor Act.[255] Airlines have increasingly abandoned union labor or have developed a new model for labor/management relations.[256] By triumphing the public interest and union rights, the Railroad Reorganization subchapter may have hurt both. The delicate balance of equities, rights and powers has been removed.[257]

It is precisely the balancing of equities, rights and powers that has allowed airlines in bankruptcy to successfully rehabilitate while selling off the on-going enterprises of non-viable airlines. What might we expect from airlines in bankruptcy? Less of the same. The lion's share of reorganization, liquidation, merger and consolidation has taken place. The most debt-ridden, inefficient airlines have been lost in a war of attrition. Twenty-two airlines, most of them healthy, have survived. Perhaps a few airlines, due to mismanagement, over-aggressive expanison, high costs, poor service or inefficiency may be subjected to bankruptcy. After all, the decision to deregulate was a policy decision based upon a belief that management could run the airlines better than government.[258] Economic

253. For instance, the rights of a secured creditor of rolling stock under § 1168 are parallel to those of a secured creditor of airline equipment under § 1110.

254. Airline routes may be conveniently set up provided embarking and disembarking are possible. The same claim cannot be made about railway lines; railway lines do not share the flexibility of air routes.

255. 11 U.S.C. § 1167.

256. At TWA, the "Icahn Agreements . . . demonstrate a new framework for bargaining, covering not only wages and work rules, but also stock plans, investment and capital spending requirements, business strategy, restriction on [the] ability [of membership] to dispose of TWA assets, and extensive information sharing." *Potential of Collective Bargaining, supra* note 172, at 17.

257. 11 U.S.C. §§ 343, 1102, 1104, 1105, 1107, 1113, 1129(a)(7) and 1129(c) do not apply.

258. This decision reminds one of de Toqueville's ruminations on how government, and especially bureaucracy, blunts the creative powers of mankind. "Above this race of man stands an immense and tutelary power, which takes upon itself alone to secure their gratifications and to watch over their fate. That power is absolute, minute, regular, provident, and mild. It would be

deregulation has to a great extent worked in opening the skies to more people at reduced fares to more destinations.[259] This is all it promised. Where deregulation has failed, bankruptcy has adequately filled the gap. It has kept some airlines flying and sold off the effective parts of airlines that could not stay afloat. It has balanced the interests of all concerned, including the government and the public on a microeconomic level that has produced positive results on a larger scale. Bankruptcy does not and will not trample the ability of strong airlines to effectively run their business. It is an excellent complement to economic deregulation.[260]

> 'It's hard to fathom,' said a Braniff pilot on learning that this company had suspended operations. 'You can chalk this one up to deregulation.' . . . in one sense, the pilot was right. Deregulation gave Braniff the latitude to make errors, mistakes by management that proved fatal in the unforgiving climate of a recession. Such freedom is what free enterprise is about and it is difficult to believe the country would be better off without it. Braniff's collapse can be traced to a decision in 1978 to expand as rapidly as the airline deregulation law allowed. Before deregulation, airline had to have government permission to fly new routes. Such applications were usually held up for years by challenges from competing carriers. But the new law let Braniff grow, in months, from a regional airline serving the Midwest and Latin America to a giant carrier among major cities on four continents. . . . The expansion was poorly planned. Travelers will not suffer much; other carriers will fill the gap. If the loss of Braniff's jobs is blamed on deregulation, then the new jobs at upstart airlines . . . must be credited to deregulation. In any case, it is not the government's duty in a free economy to guarantee total employment in any particular industry. No one should take pleasure from Braniff's troubles. Workers' lives are being disrupted, investors' capital lost. But without the possibility of failure, there is no way to penalize inefficiency. A Braniff kept alive by government patronage would be even worse than a Braniff in bankruptcy.[261]

---

like the authority of a parent if, like that authority, its object was to prepare men for manhood; but it seeks, on the contrary to keep them in perpetual childhood; . . . it provides for their security, forsees and supplies their necessities, facilitates their pleasures, manages their principal concerns, directs their industry, regulates the descent of property, and subdivides their inheritances; what remains, but to spare them all care of thinking and all the trouble of living?" DE TOCQUEVILLE, *Democracy II*, in Hayek, THE CONSTITUTION OF LIBERTY, at 251 (1960).

259. *See generally*, Secretary's Task Force on Competition in the U.S. Domestic Airline Industry, Report by the Secretary of Transportation, Feb., 1990.

260. Of course, the authors would have no objection to strict regulation of airline safety, including maintenance. The Secretary of Transportation has the duty to uphold the policy statement of the Airline Deregulation Act which provides: "The Congress intends that the implementation of the Airline Deregulation Act of 1978 result in no diminution of the high standard of safety in air transportation attained in the United States on October 24, 1978." 49 U.S.C. § 1307. Further, the authors would suggest that a more aggressive antitrust policy in monopolistic markets might address the problems of predatory pricing and restore healthy market conditions.

261. L.A. Daily J., May 18, 1982, § 1, at 4, col. 1.