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Twelve Years of Turbulence
Corporate Crisis and Insolvency

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Driven in part by the decreased demand for air travel resulting from the 9/11 terrorist attacks and the crash of American Airlines Flight 587 two months later, American was losing billions of dollars a year by the early 2000s. And, like most other major air carriers, it was forced at that time to consider filing for protection under Chapter 11 of the Bankruptcy Code. But while United, US Air, Delta, and Northwest had all commenced Chapter 11 cases by the mid-2000s, American was able to effectuate an out-of-court restructuring in 2003 that enabled it to avoid bankruptcy for another eight years. Unfortunately, a spike in the price of jet fuel, the substantial labor-cost disadvantage resulting from the restructuring of its competitors, and the global recession of the late 2000s all contributed to American's filing for Chapter 11 relief in 2011. Two years later, however, the company emerged from bankruptcy after undergoing one of the most successful corporate restructurings in history.

Twelve Years of Turbulence tells the story of the events that occurred at American Airlines during the years following the terrorist attacks of 9/11. The story illustrates the valuable roles that lawyers, senior officers, and the board of directors play in managing corporate crises. It also demonstrates both the challenges and the rewards of operating under Chapter 11 protection. American's case was further complicated as a result of its decision to merge with another air carrier while under bankruptcy protection and the Justice Department's efforts to enjoin the proposed transaction. Finally, because American and its parent, AMR Corporation, filed their Chapter 11 cases in the Southern District of New York despite being based in Dallas/Fort Worth, the story provides a springboard for discussing the issues that have arisen in the debate concerning bankruptcy venue reform.

I. Crisis Management

A. The Role of Lawyers

A company's financial crisis heightens the responsibilities of its lawyers. During a crisis, it is imperative that attorneys representing the company stay focused on an overall strategy for addressing the company's underlying problems rather than merely dealing with tactical issues of immediate concern. Lawyers also must avoid the pitfall of zealously attempting to save the company at all costs and should guard against efforts to stretch the limits of what is appropriate. Or, as the Model Rules of Professional Conduct (the "Rule(s)") put it, a lawyer has the obligation "to protect and pursue a client's legitimate interests, within the bounds of the law." Preamble to the Rules ¶ 9. In short, financial crisis is a time for vigilance balanced against a responsibility to advance only the legitimate objectives of the company.

It is also important for lawyers representing a company during a financial crisis to remember who the client is in order to properly address "cross-loyalty" issues that can arise out of the allegiance the lawyers might feel to the company's senior management and its board of directors. In this regard, Rule 1.13 provides as follows regarding the client-lawyer relationship when the organization is the client:

> (a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.
>
> . . . .
>
> (f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

Rule 1.13.

In sum, in order for a company to survive financial crisis, its attorneys must properly exercise their important roles. The lawyers representing American in connection with its out-of-court restructuring and later Chapter 11 case did so, ultimately contributing to the company's recovery from financial distress.

B. The Role of the Board of Directors and Management

Good corporate governance—including the proper exercise of the fiduciary duties that state law imposes on the board of directors—also plays a critical role in the success of any restructuring. Under the law of Delaware where American was incorporated, the members of the board were bound by the duties of due care and loyalty, *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998), and their conduct was subject to review under the business judgment rule, *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). In fulfilling their duties, the board members were permitted to rely on the company's corporate officers, because Delaware law expressly authorizes a board to rely on the statements and representations of management:

> A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's

> professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.

Del. Code Ann. tit. 8, § 141 (West 2018).

The professionalism exhibited by American's management had a positive effect on the conduct of the board of directors, and the members of the board remained supportive of management during the airline's years of financial turmoil. Further, despite the enormous strain and difficulties facing the board, there were no defections, and any boardroom dissension that existed did not become public. All of this contributed to the success of the reorganization.

II. The Challenges and Rewards of Chapter 11

Chapter 11 of the Bankruptcy Code is a powerful restructuring tool for companies in financial distress. And "[a] robust, effective, and efficient bankruptcy system rebuilds companies, preserves jobs, and facilitates economic growth with dynamic financial markets and lower costs of capital." *American Bankruptcy Institute Commission to Study the Reform of Chapter 11: Final Report and Recommendations*, 23 Am. Bankr. Inst. L. Rev. 1, 4 (2015). Not surprisingly, a remedy offering so many benefits also presents challenges that must be overcome before the rewards can be realized.

A. The Challenges

1. Loss of Control

For one thing, the debtor is not completely in control of the process. To be sure, the typical Chapter 11 debtor remains, as did American, a "debtor in possession" and in that capacity may operate in the ordinary course of business while at the same time having most of the rights, powers, and duties of a bankruptcy trustee. *See* 11 U.S.C. § 1101(1) (providing that "debtor in possession" means debtor unless a trustee has been appointed); 11 U.S.C. § 1108 (providing that a trustee, and thus the debtor in possession, may operate the debtor's business unless the court orders otherwise); 11 U.S.C. § 1107 (providing the debtor in possession with most of the rights and duties of a trustee). But there are other players in the bankruptcy process, who also have an important say in how the case proceeds, including:

- *The Bankruptcy Judge*. Certain decisions become subject to the approval of the bankruptcy court once a Chapter 11 case is filed. This is true from the first day, when debtors typically file numerous motions seeking, among other things, to continue their existing cash management systems, honor obligations under their prepetition customer programs, and pay various prepetition claims, including claims of employees for wages, salaries, and benefits. *See generally* Debra Grassgreen, *et al.*, *First Day Motions: A Guide to the Critical First Days of a Bankruptcy Case* (3d ed. 2012). Bankruptcy court approval is also required before a debtor takes certain actions that typically come later in a case, including: (a) selling property outside of the ordinary course of business (*e.g.*, selling substantially all the assets of the debtor), 11 U.S.C. § 363(b);[1] (b) retaining or jettisoning the benefits and burdens of executory contracts and unexpired leases (in bankruptcy parlance, "rejecting," "assuming," or "assuming and assigning" the contracts and leases), 11 U.S.C. § 365; and (c) settling disputes with creditors and other parties in interest, Fed. R. Bankr. P. 9019(a). Further, a debtor may emerge from bankruptcy only after it solicits the requisite votes on a Chapter 11 plan using a court-approved disclosure statement and persuades the court that the plan meets the requirements of the Bankruptcy Code. 11 U.S.C. §§ 1121–1129. In addition, so long as it does so in a manner consistent with the Bankruptcy Code and related rules, the bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code, 11 U.S.C. § 105(a), and may enter any orders that it "deems appropriate to ensure that the case is handled expeditiously and economically," including orders setting the date by which the debtor must assume or reject executory contracts and unexpired leases and the date by which it must file a disclosure statement and plan. 11 U.S.C. § 105(d)(2)(A) & (B). In short, the bankruptcy judge exercises considerable authority to manage the course of the Chapter 11 case and decide issues that arise in it.

● *The United States Trustee* (the "UST"). The UST program, a component of the Department of Justice, is responsible for overseeing the administration of bankruptcy cases. The Bankruptcy Code provides that the UST "shall convene and preside at a meeting of creditors." 11 U.S.C. § 341(a). The Code further provides that the UST "shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate," 11 U.S.C. § 1102(a)(1), and that the UST "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. The UST also is charged with monitoring Chapter 11 plans and disclosure statements and reviewing applications filed for compensation and reimbursement under § 330 of the Bankruptcy Code. 28 U.S.C. § 586(a)(3)(A) & (B).

● *The Unsecured Creditors' Committee*. One of the most active players in any large Chapter 11 case is the official committee of unsecured creditors appointed by the UST under § 1102 of the Bankruptcy Code. A committee may hire its own attorneys and other professionals, and those professionals may be paid from the estate in the same manner as the debtor's professionals are compensated. 11 U.S.C. § 1103(b); § 330(a)(1). The unsecured

[1] In 2001, American acquired substantially all of the assets of Trans World Airlines pursuant to a § 363 sale. *See In re Trans World Airlines, Inc.*, 322 F.3d 283, 286 (3d Cir. 2003).

creditors' committee "represents all unsecured creditors," *In re McLean Indus., Inc.*, 70 B.R. 852, 862 (Bankr. S.D.N.Y. 1987), and the Bankruptcy Code authorizes the committee to perform any services that "are in the interest of those represented," 11 U.S.C. § 1103(c)(5). The Code also expressly authorizes the committee to (1) consult with the debtor in possession about the case, (2) investigate the debtor and its business, including "the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan," (3) "participate in the formulation of a plan," and (4) request that the court order the appointment of a Chapter 11 trustee or examiner under § 1104 of the Bankruptcy Code. 11 U.S.C. § 1103(c)(1)–(4). Because of these powers, the committee often wields substantial influence on the outcome of the case. The unsecured creditors' committee in American's case—whose nine members included the Allied Pilots Association, the Transport Workers Union of America–AFL-CIO, and the Association of Professional Flight Attendants—actively participated in all aspects of the case. In fact, the committee stated early on that it saw its role as "particularly essential in these cases where the absence of debtor-in-possession financing[[2]] also means that the operating covenants, milestones, and other limitations normally imposed on debtors are also absent." Statement of the Official Committee of Unsecured Creditors Regarding Matters to Be Heard on Dec. 22, 2011, *In re AMR Corp.*, Case No. 11-15463, Doc. 403 at 4 (Bankr. S.D.N.Y. Dec. 20, 2011).

2. Uncertainty and Risk

Another challenge of Chapter 11 is the substantial uncertainty and risk involved in the process, which rarely unfolds as planned. For example, when it filed its case, "American anticipated that, *after emerging from bankruptcy*, it would consider merging with another carrier, to expand its network and make it more competitive with the newly expanded United and Delta." J. Bruce McDonald, *Successful Merger of American Airlines and US Airways Shows Importance of Coordination Between M&A and Antitrust Counsel*, 18 No. 7 M & A Law. 1 (July/Aug. 2014) (emphasis added). But that is not how things played out. During the case, American, together with its labor unions and the creditors' committee, developed a plan of reorganization centered on a merger with US Airways. The Department of Justice, however, brought a lawsuit to enjoin the merger, threatening to derail American's plan of reorganization. The government alleged that the merger would lessen competition and "tend to create a monopoly," thereby resulting in substantial harm to consumers, including higher airfares as a result of increased airline consolidation, in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. It was only after significant political pressure, congressional hearings, and an offer from American and US Airways to

[2] "[American] went into bankruptcy with a record amount of cash reserves, enabling [it] to eschew DIP financing." Andrew B. Dawson, *Labor Activism in Bankruptcy*, 89 Am. Bankr. L.J. 97, 118 (2015).

divest substantial assets that the Department of Justice agreed to settle the litigation and allow the merger to proceed.

B. The Rewards

"Chapter 11 strikes a balance between a debtor's interest in reorganizing and restructuring its debts and the creditors' interest in maximizing the value of the bankruptcy estate." *Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 51 (2008). Both interests were fully realized in American's case. The settlement with the Department of Justice was approved, *see Fjord v. AMR Corp. (In re AMR Corp.)*, 502 B.R. 23 (Bankr. S.D.N.Y. 2013), and the Chapter 11 process was a success for both the company and its various constituencies.

Although the traditional Chapter 11 case in which a corporate debtor has time after the filing to negotiate a restructuring with its stakeholders has become increasingly rare, American entered Chapter 11 with considerable cash reserves. American therefore had the time to improve its financial condition and restructure its operations while in bankruptcy, thereby achieving a competitive and sustainable cost structure and enhancing its going concern value. Other parties in interest also benefited, because the savings and lower cost structure achieved in bankruptcy, combined with the synergistic value of the proposed merger, led to substantial recovery for creditors and other stakeholders. *See generally The American Airlines Chapter 11 Case: How Extraordinary Value was Achieved for AMR's Creditors and Equity Holders*, 091714 ABI-CLE 163 (Sept. 2014). As the bankruptcy court found in its opinion approving the settlement with the Department of Justice, "[g]eneral unsecured creditors [were] projected to receive a full recovery (including interest)." *AMR Corp.*, 502 B.R. at 44. Indeed, "all creditors, from aircraft financiers to unsecured creditors, received a full recovery (with interest) under the bankruptcy plan." Annika Wolf *et al.*, *Failing Birds in the Sky: Dealing with Airlines in Financial Distress and Beyond*, 26 No. 5 J. Bankr. L. & Prac. NL Art. 6 (Oct. 2017). This was remarkable in and of itself, because "[v]ery few bankruptcy cases result in the payment in full of creditor claims." John J. Rapisardi & Mark G. Douglas, *Looking Elsewhere for Creditor Recovery: Insurance Claims, D&O Actions, Inter-Creditor Remedies and Hidden Jewels*, 050601 ABI-CLE 269 (May 2001). In addition, "American's employees would receive an equity stake in New American valued at more than $2 billion[,] and holders of American's [existing] equity would receive New American stock valued at more than $4 billion," *AMR Corp.*, 502 B.R. at 44—a rare feat in the Chapter 11 case of a public company. In all, equity valued at over $10 billion was distributed, including to various labor groups. On top of all this, most employees received pay increases. *See id.* (finding that the increased compensation to American's employees was estimated to be approximately $400 million annually). Ultimately, American's bankruptcy was one of the most successful corporate restructurings in history.

III. Bankruptcy Venue Reform

There has been intense debate for several years now over the need for bankruptcy venue reform. *See, e.g.*, *Great Debates: Resolved: Venue Should Not Be Based on Place of Incorporation*, 091312 ABI-CLE 5 (Sept. 2012) (presenting, in connection with a debate between Judge Steven Rhodes (Ret.) and Judge Kevin Carey, the congressional testimony of Judge Frank Bailey and others on the subject of venue reform legislation in Chapter 11 cases). American's bankruptcy case is relevant to this topic because, according to one commentator, "[m]any bankruptcy lawyers across the country say the . . . American Airlines case[] expose[d] a flaw in the bankruptcy code that allows businesses seeking to restructure and reorganize to do so in jurisdictions where the companies have few or no assets or business operations." Mark Curriden, *Playing on Home Court: New York and Delaware May Lose Their Grip on Bankruptcy Cases*, 98-MAR A.B.A. J. 16, 16 (Mar. 2012). Indeed, despite the success of American's bankruptcy, I am a proponent of bankruptcy venue reform and believe that American should have filed its Chapter 11 case in the location of its headquarters (Dallas/Fort Worth).

Currently, a Chapter 11 case may be commenced in the district:

> (1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or
>
> (2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership.

28 U.S.C. § 1408.

Thus, under § 1408 a corporate debtor is permitted to file for bankruptcy in the district in which it has: (a) its domicile, which is "generally held to be its state of incorporation," *In re Dunmore Homes, Inc.*, 380 B.R. 663, 670 (Bankr. S.D.N.Y. 2008); (b) its principal place of business in the United States; (c) its principal assets; or (d) an affiliate that has already filed for bankruptcy. Rather than filing their Chapter 11 cases in the Northern District of Texas where they had their principal place of business, AMR and American, relying on the affiliate rule of § 1408(2), filed in the Southern District of New York on the basis of the prior filing of American Airlines Realty (NYC) Holdings, Inc., a New York corporation and subsidiary of American.

The current venue provisions encourage forum shopping and filing in jurisdictions that have only a tangential relationship to the debtor's business. In turn, forum shopping leads to a disproportionate number of cases filed in Delaware and New York, allegedly because such forums provide: (a) greater sophistication and enhanced ability to manage complex cases; (b) better developed case law favorable to debtors; and (c) convenient geographic proximity of attorneys, financial advisors and bankers. But forum shopping impedes access to justice. And the current venue provisions, which limit the opportunity to observe and participate in court proceedings, are fundamentally unfair to employees, retirees, and creditors. Accordingly, venue filing options should be narrowed to restrict filing in far-flung jurisdictions having little relationship to the debtor's business.

Senators John Cornyn and Elizabeth Warren, the sponsors of the Bankruptcy Venue Reform Act of 2018 (Senate Bill 2282), agree. According to the findings contained in their bill, "the wide range of permissible bankruptcy venue options has led to an increase in companies filing for bankruptcy outside of their home States, or the district in which their principal place of business or principal assets are located, a practice known as forum shopping," which "prevents small businesses, employees, retirees, creditors, and other important stakeholders from fully participating in bankruptcy cases that will have tremendous impacts on their lives, communities, and local economies[.]" Bankruptcy Venue Reform Act of 2018, S. 2282, 115th Cong. § 2(a)(2)–(3) (2018). The bill would foreclose the opportunity to file in a debtor's state of incorporation and instead would allow companies to file only in jurisdictions where their principal assets (which do not include cash or cash equivalents) or principal place of business in the United States are located. In addition, a company could file a bankruptcy case in a district in which an affiliate's case is pending only if that affiliate "directly or indirectly owns, controls, is the general partner, or holds 50 percent or more of the outstanding voting securities, of the person or entity that is the subject of the later filed case" and only "if the pending case was properly filed in that district under this section." *Id.* § 3(1). For example, under the affiliate provision proposed by Senators Cornyn and Warren, American Airlines Realty (NYC) Holdings, Inc. could have filed a Chapter 11 case where American had already filed its case, but not vice versa. This would effectively close the affiliate filing loophole.

Consideration of the venue issue brings the discussion back to where it began—with the role of the financially distressed company's attorneys and its management and board of directors. Absent venue reform, attorneys providing advice regarding the pros and cons of the available venue choices, and officers and directors who make the ultimate decision about where to file, will more often than not continue to favor venues viewed as predictable and safe even if those venues have only a tangential relationship to the business being reorganized. Bankruptcy venue reform would take forum shopping out of the equation.

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CRISIS MANAGEMENT

An Airline in Crisis

- AA is shattered by the terrorist attacks of 9/11 and the crash of Flight 587 in Belle Harbor, New York two months later
- Driven by weakened demand for air travel and the rising cost of jet fuel, AA loses billions of dollars
- The world’s largest airline is teetering on the edge of the cliff

An Airline in Crisis

- Strong likelihood the company will not survive as a going concern
- Fast track to the steps of the bankruptcy court

Crisis Management and the Role of Lawyers

- The crises at AA, like those at other companies, carry heightened responsibilities for lawyers
- Imperative to focus on overall strategy, not dwell on immediate tactical issues
- Must avoid pitfall of zealous efforts to save the company at all costs

Crisis Management and the Role of Lawyers

- Beware of efforts to stretch the limits of what may be legal or appropriate

- A time for vigilance, balanced against a responsibility to advance legitimate objectives of the company

CORPORATE GOVERNANCE

Corporate Governance

- AA board of directors remained supportive of management throughout the airline's crisis-laden years
- Board is bound by duties of care and loyalty (*Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998))
  - Actions of the board are analyzed under the Business Judgment Rule (*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984))
- No defections and little public boardroom turmoil despite enormous strain and difficulties

Corporate Governance

- Under Delaware Law, the board is authorized to rely upon statements and representations of management (DEL. CODE ANN. tit. 8, § 141(e) (2018))

Corporate Governance

- Lawyers must remain mindful about who it is they represent – the company, the board, an individual? (Model Rules of Professional Conduct, Rule 1.13)
- Lawyers often face "cross-loyalty" issues arising out of allegiance to senior management and board vs. duty owed to the company and its shareholders

INSOLVENCY

Insolvency

- In the years following the 9/11 terrorist attacks, most major air carriers filed for Chapter 11 protection
- American opted for a voluntary restructuring in 2003
- With the spike in jet fuel, a global recession, and a substantial labor cost disadvantage, AA filed for bankruptcy in November 2011 in SDNY

Insolvency

- Chapter 11 of the Bankruptcy Code is a powerful restructuring tool for companies in need
- The proceeding carries substantial uncertainty and risk
- The process and outcome rarely unfold as planned

Insolvency

- Debtors cede substantial control to third parties, including judge, US Trustee, lawyers, and creditors' committees
- The Official Committee of Unsecured Creditors has a vast array of powers and duties, and often wields substantial influence on outcome of the case (11 U.S.C. §1103)

Insolvency

- American, along with its labor unions and the creditor's committee, developed a plan of reorganization centered on a merger with US Airways
- The savings and lower cost structure achieved in bankruptcy, combined with the potential synergistic value of the proposed merger, would lead to substantial recovery for creditors and other stakeholders

Insolvency

- The Department of Justice filed a lawsuit in August 2013 to enjoin the merger, threatening to derail the debtor's plan of reorganization

Insolvency

- After significant political pressure, congressional hearings, and an offer from AA and US Airways to divest substantial assets, the DOJ agreed to settle the litigation and allow the merger to proceed
- The merger of the two airlines closed in December 2013

Insolvency

- The American Airlines bankruptcy was one of the most successful corporate restructurings in history
- All unsecured creditors received 100 cents on the dollar, plus accrued interest
- Most employees received pay increases, and labor groups were awarded substantial equity stake in the new company
- AA shareholders received equity valued at over $10 billion

Bankruptcy Reform

Bankruptcy Reform

- Despite the success of the American bankruptcy proceeding, debtor venue selection is in need of reform
- Current statue authorizes a debtor to file in its principal place of business, its state of incorporation, or where an affiliate conducts business (28 U.S.C. § 1408)
- Encourages forum shopping and filing in jurisdictions with only tangential relationship to the debtor's business

Bankruptcy Reform

- Forum shopping leads to a disproportionate number of cases filed in Delaware and New York, allegedly because such forums provide:

Bankruptcy Reform

- Forum shopping impedes access to justice
- Broad venue provisions are fundamentally unfair to employees, retirees, and creditors
- Limits opportunity to observe and participate in court proceedings
- Despite the success of AA’s bankruptcy, the company should have filed in Dallas/Fort Worth

Bankruptcy Reform

- Venue filing options should be narrowed to restrict filing in far-flung jurisdictions having little relationship to the debtor's business
- Senate Bill 2282, introduced by Senators Cornyn and Warren, would allow companies to file only in jurisdictions where their principal place of business or principal assets are located
- The legislation would foreclose the opportunity to file in a debtor's state of incorporation and would close the affiliate filing loophole