FRONTIER BANKRUPTCY: A FINAL PERSPECTIVE

[distributed to United pilots in late 1986. NOTE: Where "ALPA" referred in the original document to the United Airlines ALPA Master Executive Council, the term "UAL MEC" has been substituted for clarity.]

INTRODUCTION:

Since the rebirth of "New Continental" United Airlines has had a long and difficult struggle to make its second largest hub in Denver profitable. The existence of two low cost competitors, Continental and Frontier Airlines, made it almost impossible for United to raise air fares to a level that would guarantee an acceptable return on its investment. This situation gives credence to the position of most airline analysts that a major hub such as Denver cannot support more than two strong competitors.

At the conclusion of the United pilot strike, corporate management proceeded with a plan to squeeze out the competition in Denver. In fact, Richard Ferris hailed his new pilot contract as the competitive agreement that UAL needed to flex its muscle and eliminate some of its low cost or financially troubled competitors. The Denver market became one of United's main focal points in its war to become the undisputed giant of the airline industry.

United's strategy worked well - so well in fact that management from People Express Airline approached United management hoping, at first, to sell its 747 fleet to United to raise cash to offset huge losses at Frontier. When United managers saw the high level of debt secured against the PEX wide body fleet, they refused to even bid for the aircraft. Desperate for cash, PEX then offered to sell its subsidiary, Frontier Airlines, to United. At last United could realize its dream of control of the Denver hub. The only question remained was how best to use the Frontier deal.

This booklet will show how United's managers executed a well-thought-out plan to: Eliminate a competitor in DEN; strip away Frontier's assets; financially cripple People Express; and to cast off Frontier employees, creating a pool of qualified applicants to be hired as new employees at "B"-Scale pay rates.

THE PROPOSAL:

Originally, United agreed to pay People Express $146 million for Frontier Airlines. The purchase price included all Frontier facilities and, ostensibly, its 4,700 employees. The net asset value of equipment and facilities was about $64 million. The balance of $80 million was a business consideration for "goodwill," an intangible value placed on a business entity, which takes into account name recognition, passenger loyalty, advanced bookings, etc.

A primary condition of the agreement was that United reach an accord with each of its unionized labor groups by August 31, 1986, a condition that would lead to the eventual demise of Frontier and seriously threaten the future of People Express.

SUMMARY OF NEGOTIATIONS:

From the beginning, United management took the position that they would not negotiate with other labor groups until an acceptable agreement was reached with the [United Airlines Master Executive Council of the] Air Line Pilots Association. Indeed, formal talks with [the UAL MEC] did not begin until July 25th.

Faced with the certainty of long membership ratification procedures required by other unions, it is still uncertain how management planned to complete all required contract ratifications by the end of August.

Prior to beginning direct negotiations with United pilot negotiators, United management spent several days talking with Frontier pilot leaders and negotiators. Because there would be a need to amend the United pilots' contract to allow for the transition of the Frontier pilots to UAL, there was no need for the company to talk to anyone other than United pilot negotiators. However, the company did waste several days in discussions with Frontier pilots, thus giving the impression that there was no real time pressure on management.

July 25th: United pilot negotiators met with a management team at EXO. John Zeeman, Senior Vice President of Marketing gave a short presentation outlining how the deal came into being. He also stated how this deal could enhance United's overall market strength throughout its entire route system. United Airlines had no plans to operate Frontier as a separate airline in Denver, rather the plan was to redistribute the Frontier assets and employees throughout United's present domicile system. Clearly, Frontier as an entity would cease to exist. The airline that was losing $10 million a month would be disassembled, and its parts moved nation wide to strengthen other United hubs, while removing a low cost competitor in Denver.

At this meeting, management made a proposal to the pilots outlining how the Frontier pilots were to be paid. Their offer called for the Frontier pilots to remain at their current levels of pay for five years and then receive raises equal to one third the difference between their rates and United rates over the next three years. Basically, it would take them eight years to reach parity. The meeting adjourned.

July 29th: In conjunction with Frontier negotiators, United pilots constructed a proposal that not only dealt with pay, but included other items relative to the transition of Frontier pilots to United's property. The pay section, however, called for the Frontier pilots to immediately be paid United pilot rates for working as pilots for United Airlines. This proposal reflected exactly the treatment afforded Pan Am pilots when they transferred to UAL.

July 30th: Management proposed that the Frontier pilots reach parity in six years, and failed to respond to other transition items outlined in the pilots' proposal. At this meeting, Mr.Pringle stated that UAL would not request an extension from the D.O.T. This was viewed by [the UAL MEC's] negotiators as the first clear indication that United was willing to dump the whole deal.

July 31st: [The UAL MEC] proposed 50% of the pay difference for the Frontier pilots immediately, and then another raise to parity in six months. Management then verbally proposed pay raises of 6% per year until FAL pilots reached parity. The meeting broke for lunch. UAL management stated that they would have a written formal proposal after the break. The formal proposal was amended to give 7% annual raises until parity. Under this plan, assuming no raises for current UAL pilots, parity would be reached by the mid 1990's! The pilots then proposed that FAL pilots reach parity by 3-31-88. Pay raises in the interim were to be negotiated. The meeting recessed.

August 14th: United management proposed that FAL pilots maintain their current rates of pay for five years, and then jump to parity.

August 15th: [The UAL MEC] proposed three equal pay raises roughly six months apart to achieve parity on 3-31-88. Management rejected this offer. Management then opened discussions concerning new hire rates of pay. They indicated they would sign a non-prejudicial letter attesting to the purity of their offer that the FAL pay issue would not be a topic of discussion during the "B"-Scale arbitration. This arbitration is scheduled, by contract, to occur in early 1990. Management also offered to consider dispensing with the arbitration of the "B"-Scale pay rates in 1990 and review our competitors' costs and rates of pay, and then consider adjusting our "B"-Scale accordingly. (This position was the company's last "B"-Scale offer prior to the strike in 1985!)

August 24th: This round of discussions resulted from the efforts of Colorado Congressman Tim Wirth to bring the two parties to the table. The meeting convened late in the afternoon on Sunday, and lasted until approximately 3:00 AM on Monday. Because management refused to budge from its last proposal, [the UAL MEC's negotiators] finally presented management with three possible options.

The first offer was the previous proposal of Aug. 15th, which called for parity on 3-31-88. The second option was to merge the FAL "A"-Scale pilots to parity on September 1, 1988. Further, both United and Frontier "B"-Scale pilots would be paid according to Delta's recently agreed to "B"-Scale rates. (There [were] approximately 115 pilots at FAL on their "B"-Scale.) These rates of pay would be consistent with "B"-Scales recently negotiated or arbitrated on not only Delta, but USAir, Aloha, and Alaska.

The third proposal called for all pilots, both "A"- and "B"-Scalers, to merge to United's "A"-Scale on December 31, 1989. The purpose of the last two offers was to clearly demonstrate that the pilots were, indeed, ready to negotiate, and to discuss various ways of resolving the differences between the two parties. However, not only did management refuse to accept any of the three offers, they steadfastly refused to even discuss them. Even more disturbing, they refused to offer any change in their offer of August 14th, made over ten days earlier!!!

Starting at eleven o'clock in the evening, company negotiators began to press to leave the negotiations stating that they saw no productive reason to stay. Obviously, if they did not want to reach a settlement, then the entire evening's work was never going to be productive.

August 25th: Roger Hall called United President and Chief Executive Officer, Mr. James Hartigan, in an attempt to bring the parties closer together. Mr. Hartigan refused stating that the company had moved as far as it would in offering the five years at current rates, and then a jump to parity. Included in this deal was the assurance that any raises that United pilots negotiated in the interim would be passed on to the FAL pilots. Again, the company's bottom line remained unchanged.

August 28th: After a two-day special meeting of the United pilot leadership in Chicago where a presentation was made by Captain Walker, Chairman of the Frontier pilots, and Don Osmundson, President of the Frontier Labor Coalition, [the UAL MEC] again developed another way to break the deadlock. A final phone call was made to management by the Chairman of the United pilot negotiating team, Captain Pat Austin. Captain Austin contacted Mr. Pringle to offer to meet and propose an arbitrated settlement to the dispute. This plan centered around the position that both parties would take their final proposals to a neutral party who would resolve the remaining issues. In such cases, the arbitrator would have the ability to impose a solution that would be binding on both parties. Each side would have the right to defend its position, based on economic facts. Again the arbitrator could award the decision to either side, or craft an award which could be viewed as somewhere in the middle. The bottom line of the pilots offer was that the Frontier pilots would come to work for UAL immediately, at their current rates of pay, until the arbitrator decided as to the length of time it would take for the FAL pilots to reach parity.

Additionally, in an attempt to represent and protect new hire United pilots on our "B"-Scale, [the UAL MEC] proposed that the 1990 arbitration relative to their merge to parity take place at this time. Please be aware that this position could have resulted in management being awarded a five-year merge. [The UAL MEC's] position could have been rejected completely by the neutral. Incredibly, even this offer to meet was refused.

At 4:44 PM Mountain Daylight Time, Chapter 11 bankruptcy papers were filed in Court in Denver.

[THE UAL MEC's] POSITION:

First, why would [the UAL MEC] attempt to bring Frontier pilots to parity at such a rapid pace? If United management planned to operate Frontier as a separate entity, then a case could be made to maintain pay rates at current levels. However, because of the route duplication between UAL and Frontier, approximately a 60% overlap, management planned to shut down Frontier and redeploy its assets. At that point all Frontier employees transferring to United would become a part of an immediate expansion of UAL, and commence generating revenues for this company. Therefore, those employees should expect to be compensated at United rates of pay. After all, isn't that what happened to the PAN AM people that joined us?

Why were the Frontier pilots working for rates so much lower than United pilots? For several years, Frontier has been caught in a competitive vice between United and Continental. Their employees banded together and attempted to save their company. They reduced their direct wages to assist management. In return for their cash concessions, they were given ownership in their company, so their total compensation package remained strong if their company survived, or was purchased. United was unwilling to compensate them for their ownership positions when Frontier was purchased, and further, United management was unwilling to continue the Frontier pilots' profit sharing agreement. UAL managers were only willing to let them maintain their lower rates of pay, and treat them as second class citizens.

Why couldn't [the UAL MEC] accept the company's final offer? Many will remember that the strike in 1985 occurred because both parties could not agree on the terms of a "B"-Scale for new hire pilots. [The UAL MEC] had no interest in a long term scale that would greatly reduce the income for new pilots. The company desired a seventeen year reduced salary level for new hires. Regardless of how emotional the strike became, one should remember that the"B"-Scale issue, and in fact all outstanding issues, were resolved by the fourth day of the strike. In this case, United management was willing to submit the "B"-Scale issue to a neutral party for binding arbitration, if the two parties [failed] to reach accord on the issue of parity with "A"-Scalers by the end of 1989. (It continues to puzzle us as to why management was unwilling to take the same position concerning the FAL pay issue.)

Further, accepting the final offer from the company would have introduced another factor into the pay equation, specifically a "B"-Scale captain. Clearly, management desired to open up issues supposedly resolved at the signing of the last contract. Now with no valid justification management was trying to revisit issues well beyond the scope of the Frontier situation.

Also, using Frontier pay to place a wedge between our current "B"-Scale and "A"-Scale pilots would [have], in our view, put the 1990 arbitration at risk. Placing the over 1200 United new hire pilots' future at risk after the strike of 1985 [was] unacceptable. By offering merge dates beyond the scheduled arbitration, management knew that they stood to undermine the effect of this arbitration. An offer to write a side letter to exempt the Frontier pay from the arbitration was an empty gesture, as the Railway Labor Act, law which governs our contracts with UAL, specifically limits the effectiveness of this type of approach.

Lastly, Mr. Pringle, Senior Vice President of Human Resources, has continually stated that he intends to reduce pilot pay over the next few years. Obviously, the introduction of a third pay scale a few months prior to the resumption of negotiations would serve as a very effective wedge to weaken the collective bargaining strength of the pilots.

As to [the UAL MEC's] proposal calling for a merge to parity by 3-31-88. Despite Pan Am employees gaining parity immediately, [the MEC] ultimately proposed this concessionary solution. Was this offer too expensive for management to accept? Consider that if all Frontier employee groups accepted the pilots' concept for an eighteen month merge to parity with their UAL counterparts, the total savings in direct employee costs to management would have been $156 million. That savings would have exceeded the total purchase price of Frontier by $10 million!!!!!

We think that an offer that would have recouped United's total investment in eighteen months, plus a $10 million bonus, coupled with the fact that these employees and equipment would, almost immediately, be out generating revenue for a stronger United Airlines, is one hell of a deal for any manager. Yet UAL management dismissed this offer as too expensive. WHY?

Subsequent offers by [the UAL MEC], which were immediately dismissed by management without discussion, made it more and more evident that management had another agenda, one far beyond the negotiating table.

WHY DID THE DEAL FAIL?

It is the belief of the United pilots that the deal United management truly wanted did not fail! The agreement between People Express and United management consisted of two distinct parts. One section called for the transfer of Frontier assets for a cash advance to a struggling People Express, and the rest of the deal hinged on reaching successful accords with labor groups. A clear understanding of this situation would explain why United management refused to progressively advance any counter proposals at the bargaining table.

In the last week of July, the Denver City Council approved the transfer of Frontier's most valuable assets to United Airlines for the cash sum of approximately $56 million. Interestingly, because People Express' plight had become so acute, the Newark based carrier had also been willing to sell to United additional landing slots in Chicago and Washington, DC., specifically, 14 PEX slots at DCA, 21 PEX slots at ORD, and 14 Britt slots at ORD.

There was an additional slot sold to UAL that PEX evidently owned but did not operate. There is speculation that the airline's management did not know that it owned the slot until United offered to purchase it! These slots sell on the average of $250,000 each, and are the life-blood of airlines operating out of slot controlled airports. The sale of the slots signaled just how critical the low cost carriers' position was. By delaying the complete purchase of Frontier, United stood the chance of not only removing Frontier from the picture in Denver, but also severely crippling the "source" of many of the low fares across the country. With the asset transfer UAL controlled six FAL gates in DEN. The rest were sold to the city of Denver to speed the transfer of asset approval, and also to reach an accord with the city over a noise problem. UAL acquired eight FAL Boeing 737-200s, five FAL slots in ORD, two MD-80 production line slots, two hangars in DEN where United will create a mid-continent aircraft maintenance center, assorted spare parts, three gates at DFW, and five People Express 737-200s which will be leased back to PEX for $150,000 per month. (PEX [did] have the right to buy these planes back, as soon as they [could] raise the cash.) These [were] the major assets that United truly was interested in.

All that remained of Frontier was a fleet of aircraft leased from other companies. Because of huge losses the Frontier name was being identified as a loser by the combined managements of PEX, UAL, and FAL in the press. Travelers started to book away from Frontier as the rumors spread about its pending demise. United had won in court the right to a joint marketing agreement with the failing carrier. This agreement allowed United to move up FAL flights in the Apollo computer reservation system, thus creating a link in the minds of travel agents between the two carriers. Additionally, the computers told United everything it needed to know about future bookings on Frontier. The Frontier identity was almost gone!

The completion of the acquisition called for the transfer of over $80 million to People Express. The question now becomes, "For What!?" Frontier had been all but eliminated with the transfer of assets. The money to be paid PEX would only go to aid that airline in restructuring its aircraft to try to appeal to business travelers. Naturally, United management did not want to aid People Express in its attempts to attract one of UAL's staples, the business traveler that pays a premium for short notice travel. It was clearly United's desire to eliminate, not assist PEX. Is the plan working? On September 5th, 1986 the ratings on all People Express debt was drastically lowered. The rating service noted the failure to secure a cash infusion from the failed United acquisition of Frontier Airlines.

With the asset transfer complete, what was truly left for United to buy? Unfortunately, in the eyes of United management, nothing. Clearly, employees are not the concern of money managers. Spokesmen for management were precise in their statements that they would continue to bargain in good faith, yet nowhere was the statement made that they intended to reach agreement. That fact was becoming all too clear.

Rather than throw such a large sum of money to a competitor and gain nothing other than the employees of Frontier, United looked for a way to escape from the deal. Understand that it is considered prudent business to craft contracts with an escape clause or clauses in case the environment surrounding a deal changes. UAL's escape route came through the collective bargaining requirements outlined in the contract. By refusing to move off a position that management knew the pilots could not accept, the failure of the deal was assured. The corporation had kept millions of dollars from a competitor, and seized the most valuable equipment from a failed competitor.

The corporation also had gained several other benefits from the planned failure. First of all the image of the Friendly Skies remains basically untarnished in the eyes of the traveling public. Corporate communicators went to great lengths to place the blame for the failure of the acquisition on the "unreasonable" stand of the United pilots.

Lastly, and most tragically, the corporation will benefit from the thousands of unemployed Frontier employees' misery. Because these fine professionals have lost their jobs, United will make great public relations mileage out of offering to give jobs to them. The fact is that these people have years of experience, United will benefit greatly by hiring them, and corporate greed will be rewarded by offering them jobs at low entry-level pay. United will screen these people, and only offer jobs to those select few who do only as management desires. These people will obviously be used in United's next attack on organized labor on this property.

IN SUMMARY:

It is a fact that competition will lead to the failure of many companies throughout this and other industries in this country.

Indeed, United Airlines seems on its way to becoming a strong survivor in this newly deregulated industry. For all of us here at United, that is good news. However, that strength and growth will come at a cost. Managers at companies can move on, and usually up the corporate ladder almost regardless of the fortunes of their previous employers. Mr. Pringle left his last company which was in bankruptcy, to join United management. Those of us who are committed to this industry are going to have to reassess how much damage we are willing to let be inflicted upon our fellow employees at other airlines, by temporary managers who are trying to apply "business practices" learned in other industries to the aviation industry. Labor protection must become part of this nation's laws, so that managements can be precluded from this type of activity.

Perhaps the failure of this deal can be best described as a triumph of the "bean counters" and those who view employees as merely "Human Resources" rather than the individuals who make companies work, quite often in spite of managers, over marketing experts. After all, this was originally a marketing decision to acquire Frontier. Certainly, putting all those Frontier assets to work for United overnight would be a marketing manager's dream.

The sheer dimensions of UAL's size make certain things clear. First, let there be no mistake that United's Chairman, Mr. R. J. Ferris, heralded his current pilot contract as being cost competitive, and in fact used his lower costs to squeeze Frontier out of existence. Being one of the cash rich players in the industry, Ferris was able to dictate terms on a contract to People Express. There was no other true competition for the Frontier assets, for no other carrier would want to try to compete with the two remaining carriers in DEN. Lorenzo was never a player because he never uses cash for his purchases. Rather he floats debt in the form of junk bonds to pay for his acquisitions. People Express needed cash. Left alone to deal as he wished Mr. Ferris was able to string out that airline to the brink of extinction, while accomplishing several goals. As labor on the property, there was little we could do to stop the human carnage. Because management is currently free to write its own rules when making deals, labor must proceed very cautiously or face losing the victories of the past.

United's managers crafted a well conceived deal in which it could not lose. Two major competitors are all but gone, and United has valuable assets that it purchased at "fire-sale" prices which it will now use to increase its strangle-hold on the marketplace. It now has created a hungry pool of experienced labor to fuel its expansion plans, and these people will enter at the lowest pay rates available. With its strangle-hold in Denver, United is left to compete only with Continental. How will that battle turn out? As of this writing, both Continental and United have announced that they are raising fares in the Denver market.

United's corporate leaders have told the pilots time and time again that they will manage, and pilots will fly planes. Fine, then they should own up to the results of their management policies and actions. Pilots do not make corporate decisions. Pilots do not make multimillion dollar deals to purchase airlines or car rental companies, and at no time can the pilots be correctly blamed for the failure of a business transaction. Pilot costs are quite clearly defined in the pilot contract, and a prudent manager will make deals based on those costs. As pilots, we bear the responsibility for the safety of our passengers and the million-dollar aircraft that we fly, period. Corporate morality is a board room responsibility.

United's plan, from a strictly business standpoint, was a good one, that was pulled off without a hitch. Unfortunately, from a human perspective, faced with the plight of the people of Frontier, it falls sadly short.

The following excerpts are **direct quotations** from the November 7, 1987, report entitled, "The United Airlines Purchase of Frontier Airlines or Portions Thereof," prepared by the **Frontier Pilots Legal Review Committee**.

ALLEGATIONS OF MISCONDUCT BY UNITED AIRLINES

United did not make an honest attempt to purchase Frontier [emphasis added].

1) ...Under the cover of a stated stock purchase, United's intent as exemplified by their behavior was to raid the assets of Frontier Airlines to the point where Frontier would cease to be an operating entity.

2) The requirement of satisfactory union agreements as a purchase condition is understandable although vaguely worded. United's agreement "to use its best efforts to obtain such agreements" is very clear. The failure to initiate any dialogue with 80% of the unions representing 90% of the union members is by no means a best effort. United's negotiations with [the UAL MEC] more represented initiation of internecine warfare than a good faith attempt to reach an accord. United failed to make a good faith effort to fulfill the main condition of the stock purchase portion of the agreement by: 1) refusing to move from its initial offer, 2) refusing to deal with unions other than [the UAL MEC], and 3) refusing [a UAL MEC] offer to enter into binding arbitration.

3) United ignored the legal restrictions contained in the October 17th Agreement. The United Vice President [Joseph O'Gorman], who earlier signed the October 17th Agreement while Frontier's president, was party to the stock and asset purchase agreement for United and knew fully of the asset sale and other restrictions therein.

4) United misrepresented facts and intent in representations to the Denver City Council and the Department of Transportation, Department of Justice and the Federal Trade Commission.

5) Once United gained the transfer of the Frontier assets it discontinued efforts to consummate the stock purchase agreement. One of the examples of this [was] United's failure to file a Section 408 application with the D.O.T. regarding approval for the stock purchase. The joint D.O.T. application for the asset transfer states rather inaccurately: "An application for Section 408 approval of the stock acquisition will be filed with the Department at the earliest possible date." On August 20th, before Frontier ceased operations and before the August 31st contractual deadline for union ratification, United notified the D.O.T. that it would not be making an application to purchase Frontier's stock.

6) United was notified by Frontier, prior to the August 24th cessation of operations, of Frontier's idea to shut down in order to pressure [the UAL MEC]. United's knowledge of this went to presidential level and United did not object. The Frontier managers [were] still under the impression that United agreed to the shut-down plan. Upon that act, United declared that Frontier had been irreparably harmed and they had no further interest in purchasing Frontier. They gave Frontier notice to vacate its hangars and other facilities on August 27th, giving Frontier 10 days to vacate.

7) Before United broke off negotiations with [the UAL MEC], People Express verbally offered to make up the contested difference in the Frontier pilots salary. United Airlines refused this offer.

8) After Frontier shut down but prior to the bankruptcy, People Express offered United Frontier's stock free if they would assume Frontier's liabilities. United's answer was that People Express would have to "pay United" to take Frontier's stock. In essence, a company that United agreed to purchase for $146 million just six weeks earlier was available for $103 million less and United refused the offer.

9) United did not pay or otherwise compensate Frontier for the sale of Frontier assets as was required by the Master Asset and Lease Agreement signed by the two parties. The resulting intercompany transfer of assets was also proscribed by the October 17th Agreement.

10) United can easily be accused of fraudulent conveyance, misrepresentations, fraud, bad faith bargaining and anti-competitive practices.... Frontier, at Continental's direction, filed suit against United for two counts of fraudulent conveyance, preferential transfer, turnover proceeding (to recover assets) and fraud.

...In the above actions and omissions, People Express engaged in fraudulent conveyance, misrepresentations to city and federal agencies and acted in a fraudulent manner as to the employees and creditors of Frontier Airlines.