Coping with Change

By Jalmer Johnson, ALPA General Manager

As ALPA recognizes both its 75th anniversary this year and the fifth anniversary this month of the terrorist attacks of 9/11, much of the Association's focus has been on the challenges and accomplishments related to the heart and soul of the union—representation and safety—and for good reason. ALPA exists because its founders realized the need and advantage of forming a union to bargain for and enforce contracts, to protect pilot jobs, and to ensure a safe working environment for the airline piloting profession.

While representation and safety have shared the spotlight, the Association would not have been able to confront the challenges, address the problems, deliver the successes, and be an effective advocate for its members without adequate resources. At ALPA, resources take many forms. They include pilot representatives, from local council representatives to master executive council officers and committees to ALPA's national officers and committees; professional and administrative staff; general counsel and other outside consultants; and financial resources, including budgets, contingency funds, and other financial reserves.

The challenges and crises ALPA has faced over the past five years are well known: terrorist attacks, war, softening of the U.S. economy, increased competition from low-fare airlines, substantial increase in taxes on airlines, high fuel prices, poor airline management decisions, airline bankruptcies, record airline industry losses totaling more than $42 billion, job losses, widespread concessionary bargaining, a pension crisis resulting in the termination of many defined-benefit plans, pay-to-play and ACMI corporate strategies, and on and on. What is notably absent from this list is a financial crisis at ALPA.

Jalmer Johnson has been the general manager of ALPA since 1999; he had been director of ALPA's Economic and Financial Analysis Department from 1993 through 1998 and its manager from 1985 to 1993. He has worked for ALPA for 25 years.

A look back

ALPA's positive financial picture is in stark contrast to the period beginning with the deregulation of the U.S. airline industry in October 1978 and continuing through the mid-1990s. During this period, ALPA was in a chronically weak financial condition, finding

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itself challenged as it confronted widespread concessionary bargaining, some of ALPA's most difficult strikes (Continental in 1983, United in 1985, and Eastern in 1989), and demands by members to enhance services and resources to balance the playing field with ever-aggressive airline managements.

ALPA found itself frequently establishing study committees to find internal solutions after growing financial problems became full-blown crises. The following are excerpts from several of these ALPA studies that provide a valuable historical perspective:

- The pattern of operating deficits "is a problem of grave concern, which has been building in intensity for several years and which now represents an immediate threat to the survival of the Association as we know it." *Budget Construction Analysis Committee Report,* BOD, 1980.
- "Long-range fiscal planning of the Association…does not exist.… For approximately the last decade, ALPA has provided services to the membership at a rate considerably greater than dues income. This has all been made possible by the reassignment of assets, principally the members' equity.… The end has been reached. We no longer have assets to deploy." *Special Policy, Structure, and Fiscal Planning Review Committee Report,* Executive Board, May 1987.
- "The Association must incorporate a long-term fiscal responsibility program that provides control and monitoring of expenditures.… During the past decade, ALPA governing bodies have enacted legislation that essentially addressed the symptoms, and not the cause, of the financial woes of our organization.… We faced [a fiscal] crisis every few years, and each downturn has increased in severity and becomes increasingly more difficult to handle.… Time is of the essence to address this critical situation." *Fiscal Planning Committee Report,* Executive Board, September 1988.
- "Our Association has, like many families today, become accustomed to living on the equivalent of credit card debt. The working capital of the orga-

nization, which is required to pay bills as they become due, is being provided from short-term borrowing." *ALPA Finance and Support Structure Committee Report,* Executive Board, May 1990.

- "We continue to saddle ourselves with a complex patchwork of fiscal policies that reflect no long-range plan but are merely designed to control spending. For a variety of reasons, even that limited goal has gone unmet…. The financial condition of the Association has received more attention over the past 10 years, both from members and corporate [airline] management, than any other aspect of our operations. The members are concerned that they receive full value in return for the dues paid, while corporate management is measuring the financial strength of an Association they would enjoy seeing disappear. Unfortunately, member concern is warranted, and management has had reason in the past to be hopeful." *Report of the Special Committee for Restructure and Finance,* Special Executive Board, March 1992.

In hindsight, it is clear that ALPA simply did not have the necessary financial resources to fight the early post-deregulation battles. As a result, the Association found itself taking dramatic steps to generate the necessary resources, including the following:

- ALPA members increased their dues from 1.35 percent to 2.35 percent and established the Major Contingency Fund (MCF) in 1985, with the bulk of the early contributions going to pay for expenses associated with the Continental strike that began in 1983 and the United strike of 1985.

By the time the funding of the MCF through dues ceased in December 1994, members had contributed $158.7 million, and ALPA had spent $98.4 million on airline negotiations and strikes. Nearly two-thirds of these expenditures—$63.4 million—had been used to fund ALPA's war against Eastern Airlines and Frank Lorenzo.

- ALPA recouped $5.1 million, after buying annuities for its employees, when it terminated their defined-benefit plans and replaced them with 401(k) retirement plans. The Association negotiated this in 1984 with the unions that represent its employees.
- Also in response to growing deficits, ALPA laid off 32 employees in December 1984.
- In July 1985, ALPA moved the majority of its staff and operations from its headquarters at 1625 Massachusetts Ave., N.W., Washington, D.C., to Herndon, Va., to lower its office rental expenses.
- As ALPA lost money during the late 1980s and early 1990s, it supported itself largely through loans secured by its Washington, D.C., and Herndon buildings. ALPA's debt grew to $24 million, which was paid off by loans from the MCF to ALPA secured by the two buildings.
- In 1994, the Association laid off 19 more employees.
- The Association regularly overhauled its financial policies in an attempt to rein in spending.

Many of the services and professional resources that ALPA takes as a given today—financial analysis of airline business plans, economic valuations of ALPA and company negotiating proposals, strategic planning and broad-based bargaining strategies, pilot-to-pilot and family awareness communications strategies, corporate strategies for labor (including the use of investment bankers), ALPA training programs, and many other tools—can trace their origins to this 10-year period from 1985 to 1995. To help perform these services, ALPA's staff grew from fewer than 300 in 1985 to 353 by 1995.

Fast forward

Today we find an industry and a profession in transition. The challenges and crises faced today—from industry losses to concessionary collective bargaining—bear an eerie similarity to the circumstances in the early 1980s and the early 1990s. One major difference: during the period since 9/11, the airline industry's financial losses and restructurings both inside and outside bankruptcy have been more significant and the magnitude of the concessionary bargaining more severe and widespread. The other major difference: ALPA has avoided a financial crisis. ALPA is neither broke nor burdened with debt. It has not been forced to gut the resources of the organization, nor has it had to rely on the MCF to bail itself out. This is all great news for ALPA's members and its employees, but how did it happen?

On the industrial side, the origins

Total ALPA Operating Dues Income 1985–2005

(1) In 1988, the allocation of dues to Operations increased by 37% (from 1.35% to 1.85% of member income).
(2) In 1995, the allocation of dues to Operations increased by 5.4% (from 1.85% to 1.95% of member income).
(3) Dues revenue figures for 2006 are budgeted dues.

of how ALPA got to where it is today can be traced to 1998 and the Northwest strike. The Northwest pilots were the first major-airline pilot group to negotiate contract improvements after the rounds of concessions in the mid-1990s. The industry-leading contract that the Northwest pilots achieved with their 15-day strike laid the groundwork for the United pilots (2000) and the Delta pilots (2001) to set higher standards for pilot contracts and compensation. US Airways pilots benefited from all of these contracts because of a pay-parity provision in their 1997 contract. On the express side, the 2001 Comair strike enabled that pilot group to set the $100-per-hour RJ captain standard and was followed by Air Wisconsin, Atlantic Coast, ExpressJet, and Mesaba.

The airline industry was also experiencing dramatic growth in the 1999 to 2001 period, which is reflected in ALPA's membership statistics. ALPA's dues-paying membership grew from 45,744 in January 1999 to 51,452 in January 2001, a 12.5 percent increase in just 2 years. The combination of higher pay and more members caused ALPA's dues income to increase from $90.2 million to $110.1 million from 1998 to 2000, a 22.1 percent increase.

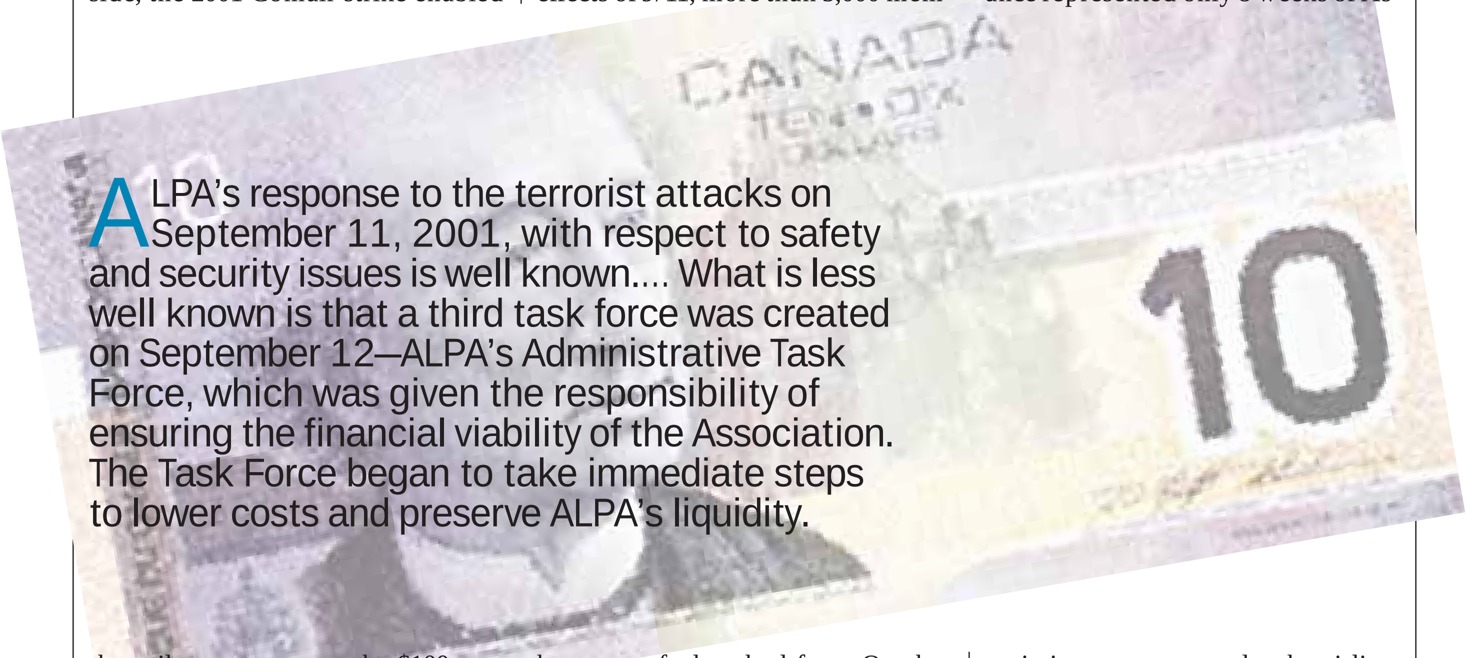
Revenue growth accelerated in 2001 and 2002, largely because of implementation of ALPA's Pilot Unity strategy through ALPA's mergers with the Independent Association of Continental Pilots in June 2001 and with the FedEx Pilots Association in June 2002. The two independent unions collectively brought more than 9,500 members and $25 million in dues revenue to the Association. ALPA also absorbed each union's respective operations, including expenses and staff, which, because of their previous status as independent unions, were bigger than comparably sized MECs. ALPA's staff grew from 407 in 1998 to 444 at the end of 2002. ALPA's revenue jumped to $133.2 million in 2001. But, as ALPA began to experience the effects of 9/11, more than 5,000 members were furloughed from October 2001 through the end of 2002, largely offsetting the increase in dues from FedEx; dues revenue climbed marginally to a peak of $135.3 million in 2002.

Although the union enjoyed significant dues growth from 1999 through 2001, it was still experiencing a core problem seen in the mid-1980s and mid-1990s—ALPA had little cash for operations. In fact, in July 1999, the Association, exclusive of Special MEC Reserve Account (SMRA) funds and the MCF, was out of cash in both its operating account and in the Operating Contingency Fund (OCF).

ALPA, learning from its past, in 2000 made building its cash balances its highest financial priority. That year, ALPA sold its D.C. building for cash and deposited the net proceeds of the sale ($21.5 million) into the MCF. The outstanding loan of $2.5 million is secured by the Herndon building, which has no other debt.

Through cost containment, the benefits of higher revenue, and the priority strategy of limiting the growth of operations despite growth in membership, ALPA posted surpluses each year from 1999 to 2001 and built its operating cash balance to $10.7 million by the end of 2000 and $24.5 million by the end of 2001. Despite the rate of increase in operating cash, the cash balance level was relative—the 2001 balance represented only 8 weeks of Association revenue, modest by airline, let alone corporate, standards.

ALPA also overhauled the OCF, which provides supplementary funding primarily to nonsystem major MECs during contract negotiations. After the OCF was depleted in 1999, the Association established three separate accounts in the OCF. These included the Operating Fund, which through the use of cost- and revenue-forecasting models was created to prefund MECs based on their size and status in negotiations. Funded annually with approximately 3.5 percent of ALPA's total dues revenue, the fund balance in the OCF available to MECs rose from nothing in 1999 to $5 million in 2003, while allocating $15.9 million to MECs over this 5-year period.



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The response to September 11

ALPA's response to the terrorist attacks on Sept. 11, 2001, with respect to safety and security issues is well known. The union immediately created a Security Task Force, which focused on several critical projects—strengthening cockpit doors, arming cockpit crews, and expanding the Federal Air Marshal Service—all of which were ultimately implemented by the government and industry. ALPA's president, Capt. Duane Woerth, was named to the federal government's security Rapid Response Team that focused on enhancing airliner security. In addition, ALPA successfully advocated for immediate federal financial aid to U.S. airlines, and created a Collective Bargaining Task Force, which became the coordinating hub for ALPA pilot groups to exchange information and strategies with respect to managements' actions and bargaining demands.

What is less well known is that a third task force was created on September 12—the Administrative Task Force, which was given the responsibility of ensuring the financial viability of the Association. The Task Force began to take immediate steps to lower costs and preserve ALPA's liquidity. Within a month of 9/11, dozens of initiatives were implemented, including freezing employee hiring; eliminating or deferring nonessential expenditures; revising internal spending policies; enhancing oversight of department, committee, and MEC spending; reviewing and revising vendor agreements; and distributing ALPA publications electronically. These changes enhanced ALPA's financial condition, and they also created a foundation for the Association's reengineering program.

In 2002, ALPA found itself at the top of what has become an ever-declining revenue curve. Sizable pay concessions, capacity cutbacks, and productivity concessions at system majors, along with growing concessions at express airlines, general industry retrenchment, and the failure of airlines such as Independence Air, have all contributed to the large slide in revenue. Total dues income has declined 2 out of the past 3 years for a total of 18.2 percent from 2002 to 2005 and is projected to slide an additional 5.5 percent in 2006 to a budgeted level of $103.2 million, $32.0 million (or 23.7 percent) below the 2002 peak.

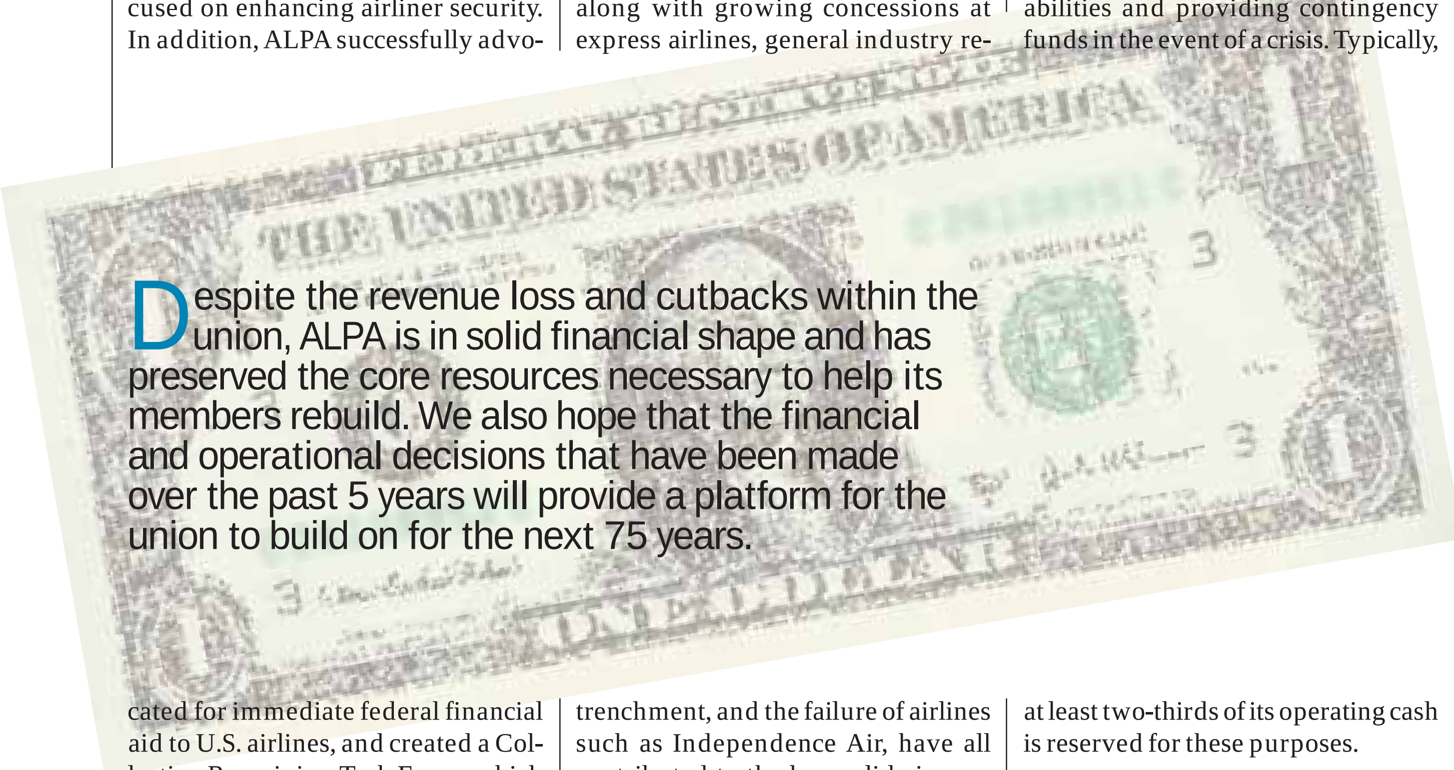
Despite this dramatic decline in revenue, ALPA generated surpluses each year from 2003 to 2005. It used some of these surpluses to cover previously uncovered obligations—including an $8 million deductible under its Kitty Hawk insurance structure and enhancing the funding of its underfunded employee retiree medical plan. By the end of 2005, ALPA's operating cash balance stood at $25.2 million, MEC SMRA balances totaled $19.7 million, and ALPA's unrestricted member equity (exclusive of the investment balances in the MCF and Kitty Hawk) was $38.1 million (compared to a deficit of $12.1 million in 1995). The total assets in the MCF and Kitty Hawk were $87.9 million and $18.8 million, respectively.

ALPA uses its operating cash for a variety of purposes, from providing minimum liquidity reserves and covering monthly float requirements to reserving funds for outstanding liabilities and providing contingency funds in the event of a crisis. Typically, at least two-thirds of its operating cash is reserved for these purposes.

ALPA reengineering

With an eye toward the future, and in contrast to the past, ALPA in 2004 began to proactively implement strategies to avoid financial problems rather than studying financial problems after they turned into crises. The keys to ALPA's financial success in these difficult times can be summarized as follows:

- Devise strategies and make decisions to achieve a balance among providing services needed by members, retaining skilled and motivated employees, and maintaining the financial viability of the union.
- Focus on the core resources, services, and assets needed to support ALPA's



Despite the revenue loss and cutbacks within the union, ALPA is in solid financial shape and has preserved the core resources necessary to help its members rebuild. We also hope that the financial and operational decisions that have been made over the past 5 years will provide a platform for the union to build on for the next 75 years.

strategic plan, and eliminate those not related to the core.

• Engage in bottoms-up reengineering of the operations of the union.

Under the banner of "ALPA Reengineering," the Association has implemented broad-based changes to the operating footprint of the Association, touching nearly all aspects of ALPA's operations:

• Retrenching the core functions of representation and safety, which has resulted in restructuring several ALPA departments, closing ALPA's Print Shop, and eliminating nonessential functions. Nearly 70 ALPA employee positions have been eliminated, through retirement, resignation, or termination, from a peak of 454 employees in 2003.

• Reducing ALPA's expenses by more than $6 million per year by 2006 through new contracts negotiated with the unions that represent ALPA's professional and administrative employees and new salary and administrative programs put in place for management and nonbargaining employees in 2003 and 2004. These changes included 1-year pay freezes; sizably lower merit raises after the pay freeze; modifications to active and retiree medical plans, including monthly contributions by retirees; and other benefit-cost reductions.

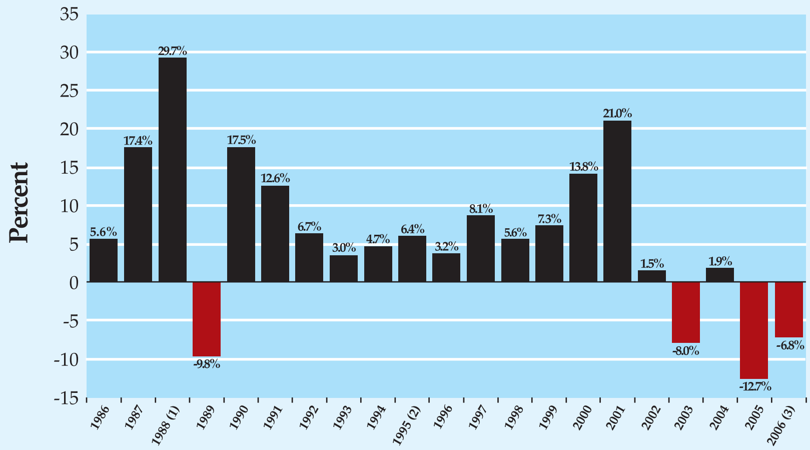
• Reducing general operating expenses—from travel and office rent to insurance and printing and mailing. Nonessential capital expenditures have been eliminated, and ALPA has overhauled its investment strategies to generate greater investment income.

• Reducing budgets for ALPA's governing bodies—the Board of Directors, Executive Board, and Executive Council—by streamlining operations and processing business more efficiently. National Committee expenditures have been reduced through a narrower focus on priority projects. The organizing budget in the Administrative and Support Account has been eliminated.

• Establishing new ALPA policies covering a wide range of financial issues, from flight pay loss and a greater use of electronic communications to standardizing computers and wireless plans for ALPA business. In addition, many MECs have secured commitments for increased flight pay loss reimbursement by their airlines.

The change brought on by such reengineering initiatives has by no means been easy or painless. For example, the heightened demand for professional services during an unprecedented 5-year period of concessionary bargaining with more than 60 fewer employees has stretched ALPA's staff in many areas to the breaking point. Fortunately, the quality, experience, and dedication of our staff have helped our pilot groups address this challenging period to the maximum degree possible.

Year-Over-Year Change in ALPA Dues Income



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Challenges remain

Most MECs have spent most, if not all, of their SMRA balances funding crisis-bargaining activities, requiring them to rebuild their balances to prepare for the next round of negotiations. In a similar vein, the OCF continues to shrink as smaller airlines tap the Fund to cover similar activities.

With the Association committing to more modest annual pay raises for its employees than in the past, it risks higher turnover among the staff. Rest assured that those within the union responsible for the Association's finances and operations will continue to seek the balance among member services, the staff, and the Association's financial condition.

Anniversaries provide us with the opportunity to both reflect on the past and contemplate the future. As ALPA pilot groups near the end of this terrible period of concessionary bargaining, they are already preparing for future negotiations to recoup losses and return to progressive pattern bargaining. Fortunately, despite the revenue loss and cutbacks within the union, ALPA is in solid financial shape and has preserved the core resources necessary to help its members rebuild. We also hope that the financial and operational decisions that have been made over the past 5 years will provide a platform for the union to build on for the next 75 years.

This is not to say that ALPA has not faced financial challenges since 2001. A 23.7 percent reduction in revenue would challenge any organization. For many, it may have resulted in steep financial losses and possible bankruptcy. Fortunately for ALPA and its members, it did not lead to either outcome. In fact, due to effective leadership and planning, the opposite has occurred, positioning the union with the resources to rebuild the profession.