

A Chill Wind Blows in Dallas...



...and we are not talking about American Airlines.

Gary Kelly, CEO of Southwest Airlines, recently penned a letter to his “warriors” at the “maverick” Southwest Airlines. It started out as a review of the dysfunction and resultant bankruptcy at his cross-town rival, American Airlines. The letter degenerated into a sales pitch on how Southwest employees, particularly pilots, need to trim costs and bump up productivity, lest they meet the same fate as employees at American Airlines.

This is clearly a shot across the bow of the pilots of Southwest Airlines, however due to the tradition of trustworthy management, many employees may not see this for what it is. A Southwest Airlines pilot has never had to watch his back, but that appears to be changing.

We have reposted many of the paragraphs in Kelly’s letter and have commented on what he wrote. We believe Kelly’s letter is a very ominous sign for pilots everywhere, especially at Southwest. It shores up our belief that the American Airlines bankruptcy isn’t the last chapter in the ATA’s war on employees, but the first skirmish in the next campaign of the same war. This 30 year war is by no means over, nor is its outcome certain.

We start a few paragraphs into Kelly's letter.

*Just as I wrote in an article in LUVLines after 9/11: **While an airline needs to be good at many things to be successful; low costs and profitability, ultimately, mean the difference between survival or not.** To be clear, American Airlines, as you knew it, will not survive. Bankruptcy, by definition, means that it will be radically reorganized, or it will be completely shut down and liquidated.*

There are more things about the airline business than "low costs." Revenue is just as important, if not more so, than "low costs." At some point, you must have an airline people desire to use for their travel needs. Incremental costs are acceptable if the incremental revenue justifies it. Wouldn't anyone increase their costs \$20 if they could gain an additional \$35 in revenue? Of course. A Fairmont Hotel certainly has higher costs than a Motel 6, but it also is more profitable, because it commands higher revenue.

Why no mention of revenue, but lots of ink on costs? Easy. Operational employees are only capable of partially controlling costs, by volunteering part of their paycheck or quality of life to the cause. They can't influence revenue.

That's management's job.

Why did AMR file for bankruptcy protection? Costs were certainly part of the issue, but revenue was a much larger portion of the problem. They were losing their higher premium passengers to more comprehensive networks.

*American isn't the only airline not to survive without bankruptcy. Let's look back to 1989 the year Southwest became the newest member of the old major airline club, based on annual revenues. **All the majors from 1989 have gone bankrupt.** Pan Am. Eastern. Braniff. Continental. America West. TWA. US Air. United. Delta. Northwest. And now, American. Every single one failed. **Why? Not because of Customer Service, but because of high costs.** Great Customer Service cannot overcome high costs. That is the imperative I wrote about a decade ago: low costs.*

- Pan Am had no domestic feed for its foreign operations (revenue problem).
- Eastern went out of business because Lorenzo was destroying the airline as a means to grind the employees down “to reduce costs.” The employees decided to take him down with them.
- Continental was caught in the vortex of Lorenzo’s malfeasance.
- TWA - managerial malfeasance
- Northwest - regional jets and labor relations
- United - regional jets and stock swindle
- Delta - regional jets
- American - regional jets, labor relations, and managerial incompetence

Southwest does not have managers trying to fund airline operations through employee give-backs nor are they trying to outsource labor to the lowest bidder while attempting to cut costs with capital equipment carrying the highest CASM in the history of the industry. They treat their employees as assets, rather than inert burdens they carry; give good value to the passenger; and have steadfastly avoided miscapitalizing their fleet with a manifestly idiotic gimmick to whipsaw labor while irritating premium passengers.

Notice that Kelly said “*Great Customer Service cannot overcome high costs.*” Why would he say that? It is because Southwest routinely leads the industry in customer satisfaction, so there is little room for employees to enhance customer service to protect their W-2s. Kelly is clearly saying that the only option is cutting costs.

Southwest Airlines is the only major airline from 1989 that has survived this tumultuous industry without bankruptcy. Why? Because our low costs have preserved our profits. Period.

Wrong! Southwest has avoided the revolving door of bankruptcy and employee relations disasters because it has treated its “warriors” with respect and dignity. In return, Southwest’s “warriors” have never had any reason to not trust management. They can take risks, offer flexibility, and know they won’t end up in arbitration proceedings with management/government stacking the deck against them and walking away with tortured interpretations of the clear text of their contract or the law.

Kelly has no idea how good he has it, and he is on the verge of blowing it.

Southwest became the industry leader because it was fighting against its competition at the same time its competition was fighting its own employees.

*If American Airlines emerges from the ashes of bankruptcy, and I believe they will, you can be certain their costs will be substantially lower, especially their labor and aircraft costs. If they can't achieve that, they will cease to exist (like Pan Am, Eastern, Braniff, and TWA). If they do emerge from bankruptcy, as I believe they will, they will join the New United, New Delta, and New US Airways as giant, lower-cost airlines. **They are, collectively, much more formidable competition than their predecessors.** The term, "Legacy Carrier," no longer will apply.*

*In the good old days, when the Legacy Carriers costs were higher, we brought our low costs and low fares to their markets, stimulated demand, and expanded dramatically. Now, while our costs are still lower, **our advantage has been cut in half. We currently do not have a sufficient cost advantage to stimulate the market** because our fares are much closer to our New Airline competitors. These New Airlines, reconstituted from their Legacy ashes, join younger, lower-cost airlines like JetBlue and Frontier, as well as an even newer group of ultra low-cost airlines like Allegiant and Spirit. As predicted, the industry has transformed to lower costs.*

Thus begins the "managing of expectations." This is always the first step in moving for the employee give-backs. The "New Airline" competitors have eaten into Southwest's cost advantage and now Southwest says its business model must change ("We **currently** do not have a sufficient cost advantage to stimulate the market").

Of course, one major point of low costs is to drive profits. The old airline industry was famous for not achieving profits, which rendered them very weak competitors. The New Airline industry is profitable. In fact, the New Delta and New United had better profit margins than Southwest in the third quarter, despite the magnificent gains we've made over the last four years with our Customer Experience

*enhancements and our revenues. On that front, we have outperformed all competitors. **We have a cost challenge, and it is one that looms large.***

This cost challenge “looms large.” That is why Kelly is talking to employees, because labor is their number two expense. Absent another prescient fuel hedge, labor is going to be asked to take the brunt of the cuts or the brunt of the blame.

History says they will take both.

*American Airlines lost its way. It made promises it could not keep. It tried very hard to avoid bankruptcy. As every other major airline used that tortured strategy, American became higher and higher cost relative to the New Airline industry. Just when we thought 2011 would be safe from the perils of the 2009 recession, American is posting another massive loss. The New Delta and the New United are producing strong profits. Why? You know lower costs. It puts New Delta and New United in a position to grow from here. American has shrunk dramatically this past decade. They will shrink more. That may provide Southwest some opportunities to capture more Customers and grow; however, we will have to compete with a stronger marketplace for Americans customers. **You know how much harder that is because of our diminished cost advantage.***

More talk about their diminished cost advantage. Kelly is setting up his employees, particularly pilots, to fix this problem. Southwest pilots were able to drive cost cutting in pilot labor due to increased productivity. SWAPA would be well advised to understand that “productivity” isn’t just how many hours/trips you work in a month, or how fast you can turn a plane, but how much each of those hours/trips cost in terms of dollars.

If pilot “A” works 95 hours per month for 75% of the hourly pay that pilot “B” works, and pilot “B” also works 95 hours per month, pilot “B” is 33% less productive than pilot “A.”

Southwest pilots are already very close to knocking on the ceiling of lawful productivity. When the new Flight Time/Duty Time limits come out, with the 9 hour “hard time” daily limits, the public relations departments will

start squawking about how “Southwest pilots work nine or ten days per month and make in excess of \$200,000 annually at a time most Americans are suffering from economic uncertainty.”

If SWA pilots think they can strike, they need to think again. If a Democrat administration wouldn't release American Airlines pilots after five years of impasse, what makes anyone think a Republican administration would release SWAPA against the backdrop of those kinds of P-R blasts? They are now too big to strike. That's another “club” they have joined.

We can play this game until all of us are working to the FARs (we are pretty close) and we undercut one another until we are at minimum wage. The only way management could squeeze more productivity would be to get the minimum wage lowered or the FARs raised.

The juiciest target in the entire passenger transportation industry **was** the American Airlines pension. That's all but gone. The next juiciest target is the W-2 of Southwest pilots. We are not the only one who realize this - the ATA is well aware of it.

*American's employees will make many sacrifices. It is convenient to lay the blame at the feet of American's management. Certainly, they deserve their share of the blame. But, just as employees deserve credit when a company does well, **so do they deserve some of the blame when it does not. American has outdated and inflexible work rules that render it less productive than the New Airline industry. That's just one example of how the company lost its way, and just one example of what is imperative to change, lest they be shut down.***

To set the record straight, American's employees (as well as those at United, US Airways, Continental, Delta, and Northwest) **HAVE** made many sacrifices, and they will get a Section 1113 term sheet for their efforts. It is convenient to lay the blame at management's feet, because it is where it belongs.

Kelly now lays the foundation to go after Southwest's labor protections and quality of life. This is a pretty thinly veiled threat that if Southwest employees, particularly pilots, don't play ball, Southwest will enter the conga line into bankruptcy. Labor friendly work rules = liquidation. It is

fanciful to contemplate liquidation for Southwest, as it is the strongest airline over the past 15 years. Things change fast; just ask any long-term employee of American, United, Delta, or Eastern.

*For us, the bottom line is simple. **There may be some near-term opportunities for Southwest as American shrinks and is distracted with the human struggle of bankruptcy. American will be governed through a bankruptcy court and a creditor committee, and it will be sheer hell for them. Once they get through it though, several years from now, they will join the New Airline industry as a much more formidable competitor. We need to prepare ourselves better right now for this New Airline industry.***

Is Kelly asking for Southwest “warriors” to give now, while American is on the mat? We don’t know and it would be foolish for him to attempt it. The Southwest culture drives its profits. It is that goodwill the employees need to protect. Look at what happened to Delta, after its employees bought the company a 767 and new-era management took over in the 90s. Once the culture goes, the bankruptcy and labor relations merry-go-round certainly follows.

Name one airline that the employees saved from bankruptcy via concessions. Up through November 28, 2011, you could name “American Airlines,” and no others.

*So, what if we don’t? As stated earlier, **Southwest is the only 1989 major airline that has survived without bankruptcy.** Why? Because our low costs have preserved our profits.*

American used to say that.

***Our labor rates are now, far and away, the highest in the industry.** Through bankruptcy, very large New Airlines have emerged with lower rates than us and better productivity. **Next to fuel, labor is our highest expenditure. We can’t have lower overall operating costs if our labor costs aren’t lower. We cant have lower labor costs if we aren’t more productive.** The good news is that we have a lot of opportunities to improve our productivity, eliminate waste, and preserve our pay rates and benefits for the foreseeable future. Its*

crucial that we take advantage of those opportunities.

That's a pretty clear ultimatum, as far as Southwest corporate communications go. Kelly is very, very clearly saying that labor is going to have to come down to stay out of bankruptcy, since he has, "far and away," the highest labor rates in the industry. His heavy maintenance is done offshore and his flight attendants are not at the top of the industry, by any stretch.

That leaves one large labor group that has, without a doubt, the highest W-2s in the industry. They had better get very smart in a very big hurry, or they will be outflanked by the same tactics the rest of the managerial teams used - the government and the courts.

SWAPA, are you paying attention to this? You are not immune. At one time, Eastern pilots were on top. American pilots had their day. We all know about how United and Delta pilots once led the industry.

You now lead. All those other pilot groups were eventually outflanked by the courts, RLA, and soulless management. To think you are smarter than they were will certainly result in your fall. All you have had is the quirk of good timing and a management team that has yet to betray your trust. Trust only goes so far and timing always runs out.

*The imperative I spoke about nearly a decade ago has been fulfilled by our remaining, formerly "Legacy," competitors. **The imperative is now squarely upon Southwest. I know you all understand the evidence hundreds of airlines perished since deregulation. No 1989 major airline has survived without bankruptcy except Southwest. We are the maverick. We are different.** That's how we have prevailed with a Warrior Spirit, a "Never Give In" resolve, and a burning desire to be the very best. **The sloth-like industry you remember competing against is now officially dead and buried. We fought them, and we won.***

Won? Perhaps. It is more accurate to say that Southwest management seized upon a once-in-a-lifetime opportunity to defeat an army whose officers were preoccupied with decimating the troops and looting the war chest, in an effort to increase morale. That doesn't take much talent.

What is important to take from this is that the old “enemy” is no longer. If Southwest is to continue its trajectory, where is this new enemy? Kelly tells us.

*Now, **the enemy is our own cost creep, our own legacy-like productivity, and our own inefficiencies.** **Fighting this cost enemy is an imperative to remain the Maverick. We will fight, and we will remain the Maverick.***

Remember this when he asks for more productivity enhancements. Southwest paychecks and family time are the new “enemy.” SWAPA, are you paying attention, or are you asleep at the switch, as ALPA and APA were when outsourcing began, or during the introduction of the “B Scale,” or when Lorenzo brought the sword?

It is important to say that low costs, alone, will not win the day. Our People are most important. It is our People who produce this great low-cost airline. It is our People who serve our Customers in an outstanding way. And, it is our People who will continue to transform Southwest with four big initiatives: AirTran, All-New Rapid Rewards, B737-800, and a new reservation system.

How touching. He knows that Southwest values its people. He just finished a lengthy letter to these same “people/warriors/mavericks” telling them they will have to dig deep and cut costs, lest they end up spending a Thanksgiving hearing American, United, and Delta employees being “thankful” they don’t work at Southwest.

*Finally, please remember, **all the great things our People do will be for naught without low costs. Just ask the old “Legacy” airlines.** I am very grateful and very thankful for all of you.*

Nice close. All their history and effort will be “for naught” if they don’t cut costs. This is a direct appeal to the pilots, because Southwest pilots are the very same as the rest of us, and they can’t stand to be the cause of failure. They won’t sleep well if their fellow employees blame them for the mess. Give, or everything will be “for naught.” If you want to twist the knife in a pilot, just tell him someone he has never met is disappointed in the failure

he caused.

Yes, this is the season of giving. American Airlines employees will “give” at the direction of a bankruptcy court. Southwest pilots are being led down that same path.

There are those who have, and those who will.

SWAPA had better get smart in a big hurry. Rather than adopting a “beggar thy neighbor” approach to their work, perhaps they can join in an effort to stop the race to the bottom, while they are on top. End this decades long war against airline pilots on terms favorable to pilots - all pilots. They have the luxury of either learning from our mistakes or repeating our mistakes.

We at OPERATION ORANGE never thought Southwest management would be so foolish as to take this course. We didn't believe Southwest pilots could be motivated to join our efforts, but perhaps we were mistaken.

Section 4 of our proposed legislative draft puts the minimum compensation very close to what Southwest pilots presently make. It builds in work rules and anti-pilot pushing into the law.

There is something there for all pilot groups. We would like to welcome our brethren at Southwest into the effort.

For more information, please visit OPERATIONORANGE.org