

WORKING DRAFT

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Southwest Airlines

EPC labor discussion

Discussion document

Sept 4, 2012

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Today's discussion

- Overall labor strategy update
- Section 6 progress
 - AMFA
 - TWU 555
 - SWAPA

Our labor teams, Employees, and Unions have worked together to achieve a number of successes in the past year

Thanks to an excellent Team effort...	...we have achieved a number of labor-related milestones in the past year			
<ul style="list-style-type: none"> ▪ Labor relations teams ▪ Employee resource teams ▪ Operating departments ▪ Integration teams ▪ FP&A ▪ Southwest and AirTran Employees ▪ Union leaders 	<hr style="width: 30%; display: inline-block; vertical-align: middle;"/> Integration <hr style="width: 30%; display: inline-block; vertical-align: middle;"/>			<p> Complete</p> <p> Pending Union vote</p>
	SLI/Transition agreements	Near International/Overwater	Other milestones	
	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Pilots <input checked="" type="checkbox"/> Flight Attendants <input checked="" type="checkbox"/> Ramp, Ops, Provo <input checked="" type="checkbox"/> Mechanics <input checked="" type="checkbox"/> CS&S, CSA <input type="checkbox"/> Material Specialists 	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Pilot SL 12 & 14 <input checked="" type="checkbox"/> Flight Attendant SL 10 	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Dispatcher CBA <input checked="" type="checkbox"/> IAM outsourcing SLs (e.g., EYW) 	

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We are still addressing several near-term priorities, but today's discussion is focused on our long term strategy

 Today's discussion

Key priorities for Labor
September 2012

	Pilots	Flight Attendants	Ramp/Ops/Provo	Mechanics	CS&S CSA	Other
Near term		<ul style="list-style-type: none"> SL 10 voting 	<ul style="list-style-type: none"> Potential mediation Geographic scope discussions (e.g., SJU) 	<ul style="list-style-type: none"> Material Specialists SLI 	<ul style="list-style-type: none"> SLI voting Geographic scope side letters 	
Medium/long term	<p>Work with Unions to agree on contracts that will:</p> <ul style="list-style-type: none"> Close cost gap with competitors Gain flexibility to meet our 5-10 year strategic plans Maintain distinctive Southwest Culture 					

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Four of our five largest unions are currently in Section 6 negotiations

Top 5 unions (% of spend)

	Contract timing	Current status of contract discussions
TWU 555 (17%)	<ul style="list-style-type: none"> Open since July 2011 	<ul style="list-style-type: none"> Contract has been open for 14 months 555 leaders have notified us that they plan to file for mediation
SWAPA (43%)	<ul style="list-style-type: none"> Opened May 2012 	<ul style="list-style-type: none"> Randy Babbitt has helped facilitate competitive landscape alignment sessions for last 2 months to align on problem with SWAPA leaders
IAM (10%)	<ul style="list-style-type: none"> Opened August 2012 	<ul style="list-style-type: none"> Held first round of competitive landscape alignment sessions with National and Local leaders the week of Aug 27th
AMFA (7%)	<ul style="list-style-type: none"> Opened August 2012 	<ul style="list-style-type: none"> Held first round of competitive landscape alignment sessions with National and Local leaders the week of Aug 20th
TWU 556 (22%)	<ul style="list-style-type: none"> Not open until May 2013 	

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Process to develop a 5-10 year labor strategy across workgroups



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A Our competitive labor cost challenge

- In order to continue to be the low fare brand and hit our earnings targets, we need to regain our historic low-cost advantage
- Our labor costs have grown faster than competitors' in the past decade. Our labor cost per ASM is now ~8% higher than Legacy competitors, and ~33% higher than LCC competitors¹
- Our higher labor costs have undermined our overall low cost position in the industry
 - LCCs: Allegiant and Spirit have replaced us as the lowest cost carriers²
 - Legacies: Our overall cost advantage has been eroded by our higher labor cost per ASM

¹ Detailed in Appendix. Based on labor cost models that adjust for Form 41 inaccuracies in certain workgroups (e.g., Outsourcing, Mainline/Regional cross-staffing)
² FY2011 CASM ex-Fuel, adjusted to combined WN/FL stage length

B Our labor cost challenge is difficult, but a handful of other unionized companies have reduced labor costs outside of bankruptcy

How they regained competitive labor costs



Late 1990s

- Used non-traditional, collaborative approach with unions to reduce labor costs back to industry average and improve operating margins
- Key cost savings drivers were work rule changes to drive productivity and OT reductions
- Also reduced grievance rate over same time period



Late 1980s

- Over a decade, reduced crew size from 3 to 2 in order to regain competitive costs with trucking
- Negotiated one-time payments to union members to buy back outdated roles (e.g., brakeman and fireman)
- Secured more flexible work rules (e.g., increased length of trip, increased outsourcing)
- Used trucking as a common enemy



2009

- During 2009 downturn, worked with unions to reduce labor costs by \$210M
- Package included combination of more flexible work rules, wage freezes, alternative scale for new employees, and exit bonuses
- Historically positive relationship with Unions enabled quick action, although Harley had leverage of moving production

Implications for Southwest

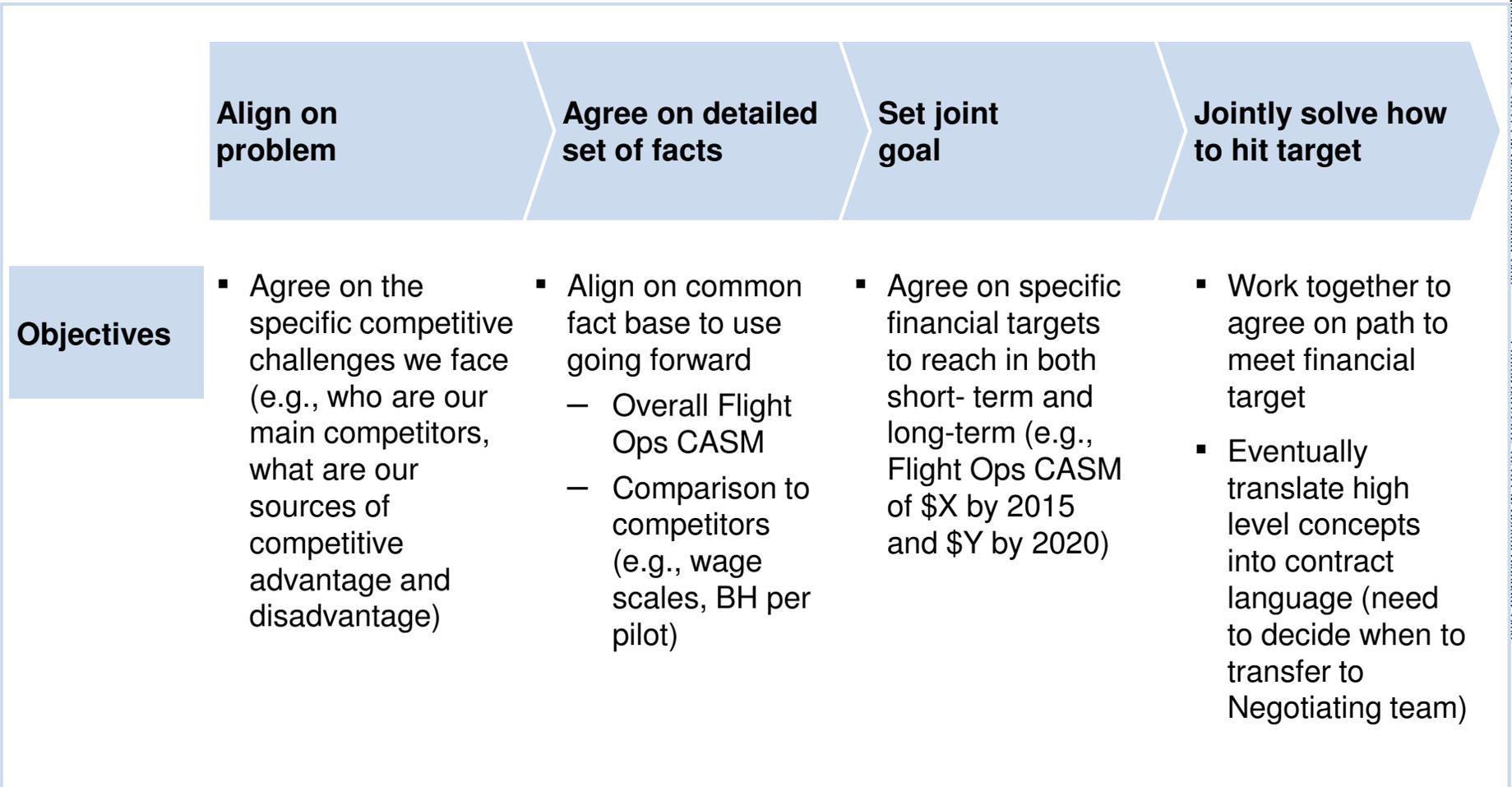
- A successful solution will have to involve a combination of elements (6 themes detailed on next page)
- An interest-based approach focused on a common enemy is more likely to be effective than a traditional approach

In order to regain competitive labor costs in a way that is consistent with our Culture, we want to pursue 6 themes jointly with our Unions

6 key themes across workgroups

- Wage scale that protects existing Employees at current rates with “loyalty credits” and introduces new Employees at a market rate
- Programs to reduce average tenure (e.g., early retirement, Jumpstart)
- Incentive-based bonuses based on multiple targets (e.g., Company, Group/Station, Individual)
- Logical work rule changes to increase productivity, including:
 - Greater flexibility to match Employees to current operating model (e.g., PT for Ground Ops, relaxation of RON constraint for Pilots)
 - Use of technology/automation
- Absence Management Program
- Strategic flexibility requirements (e.g., International)

With SWAPA, IAM, and AMFA, we are following a 4 step process to engage them in interest-based problem solving



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Our early discussions with SWAPA, IAM, and AMFA have highlighted a set of requirements for us to be successful

- **Consistency across workgroups:** The 3 workgroups we've engaged thus far do not want to be "hung out to dry" if they agree to contract changes before other workgroups
- **Communication with Employees:** Union leaders may recognize the competitive cost challenges that we see, but they will need help communicating these challenges to our Employees/their Members
- **Need for common enemy:** Employees are much more likely to respond to a common, external enemy (e.g., Spirit and Allegiant are using our playbook to steal our Customers)
- **Alignment on cost problem:** While our cost challenges are difficult to dispute, some Unions may use other arguments to delay a focus on labor costs (e.g., SWAPA has focused on our revenue/fee strategy as a bigger issue than labor costs)

Maintenance and Engineering Labor update

- **Voting Results and SLI Next Steps**
- **DEN MX Station Update**
- **Consolidated MX Workforce**
- **Section 6 update**

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AMFA SLI has been ratified and estimated for approval in mid-Sept; IBT cannot reach agreement among Locals and is headed to arbitration

Voting results

AMFA:

SLI/Transition Agreement:

For—65%

Against— 35%

LOA #7 401k & Denver Maintenance

For—72%

Against—28%

LOA #8 – Tech Support Mechanic

For— 59%

Against—41%

IBT:

SLI/Transition Agreement:

Voted—89%

For—77%

Against- 23%

SLI timelines

AMFA:

Vote – June 21st

Pay Rates – July 1st

SLI Filing – July 27th

Badges – August 16th

SLI ruling from NMB – (anticipated early Sept)

SLI Approval – Mid September (estimate)

Uniforms – Order August 16th, Wear once SLI approved

Workrules – October 20th (estimate)

IBT:

Cannot reach an Agreement among the Locals

Arbitrator selected in August

M&E: Denver

Maintenance Station: DEN

- Must open within 90 days of agreement as stated in contract
- Anticipated staffing levels five AMTs
- Positions for Denver should be posted on **SWALife** in September
- Station will open in October 2012



What does this mean?

Southwest

- New Stations: DEN, MKE, FLL, ATL
- New combined Stations: BWI & MCO
- Culture is preserved by having one work group
- Relief from using contract maintenance, provides better Customer Service, increases ontime performance, and saves money

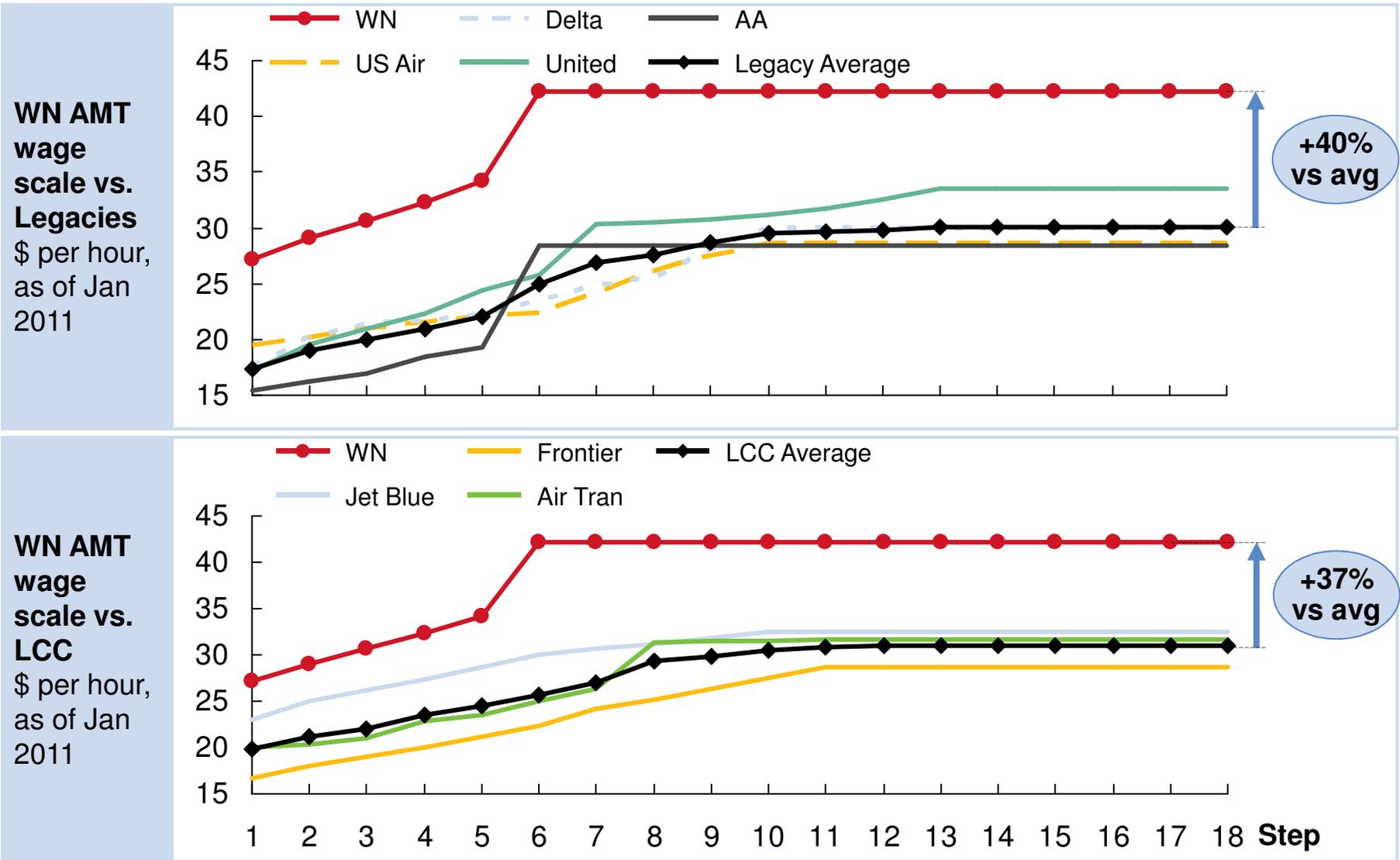
Maintenance

- One union for Mechanics (AMFA)
- Culture preserved by agreeing on the proposed Seniority List
- New stations for Appearance Technicians (ATL and MCO)
- Employees can now have more flexibility when it comes to bids

Our current situation with AMFA

- We pay our Mechanics significantly higher wage scales than competitors, and our contractual requirement to move 4th heavy line in-house will hurt our insourcing/outsourcing mix
- We started Section 6 discussions with AMFA the week of August 20th and are following the interest-based approach. We are initially going to be focused on aligning on our competitive cost challenges
- Finding an acceptable solution for the 4th line is our highest priority, given that it will add ~\$9M in costs annually and has a shrinking window of opportunity
- However, if we are unable to reach a quick agreement on the 4th line, we will have to compensate for these higher costs by negotiating a contract that includes a combination of the 6 common themes across workgroups

We pay ~35-40% higher wage scales than competitors at top-out



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Source: Jan 2011 Air Conference results and publicly available contracts. Where detailed in contracts, incorporates longevity and license premiums into hourly wage rates

In order to compensate for our higher wage scales, we need to work with AMFA on a combination of items

	Description	Value in 2016 \$ M ¹
4 th line	<ul style="list-style-type: none"> Negotiate to avoid bringing 4th line of heavy maintenance to Dallas (incremental headcount of ~164) 	9, plus 0.8 of capex savings
Market wage scale for new Employees	<ul style="list-style-type: none"> Wage scale that protects existing Employees at current rates with “Loyalty Credits” and introduces new Employees at a market rate 	3, but grows significantly by 2030
Tenure programs ¹	<ul style="list-style-type: none"> Programs to reduce average tenure of workgroup² 	TBD
Key productivity improvements	<ul style="list-style-type: none"> Workrule changes to reduce premium time by 15-20% <ul style="list-style-type: none"> Restrict Duty Time (limit time on clock to 2 shifts) Limit Inspections Day Trade with AMTs 	6-8
Incentive-based bonuses	<ul style="list-style-type: none"> Bonuses linked to multiple performance targets (e.g., individual small group, Company) 	~0
Absence management program	<ul style="list-style-type: none"> Revise absenteeism policies to incent Employees to come to work³ 	4
Total		22-24+

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¹ Tenure programs like early retirement do not need to be negotiated as part of the CBA

² For AMTs, a ~\$45k difference between new hire and topped-out Employee. See detail in Appendix

³ Reduce sick bank size and slow accrual rate, Reduce take home wages during an OJI to be slightly less than a working Employee, Close disability coverage gaps

Preferred option is a quick agreement on the 4th line plus a few additional items

	<i>Preferred option</i>	<i>Option 2</i>	<i>Option 3</i>
 Required for agreement  Additional negotiating points	Quick agreement	Intermediate negotiation	Full negotiation
Estimated timing	▪ 6 months	▪ 18 months	▪ 2-3 years
<u>Items to negotiate</u>			
4th line			
Market scale for new Employees			
Tenure programs			
Key productivity improvements			 +
Incentive-based bonuses			
Absence management program			

- We have a limited window of opportunity to negotiate the 4th line, as we are already hiring Employees
- AMFA will have its own set of needs, and we will have to be responsive to those for the interest-based process to be effective

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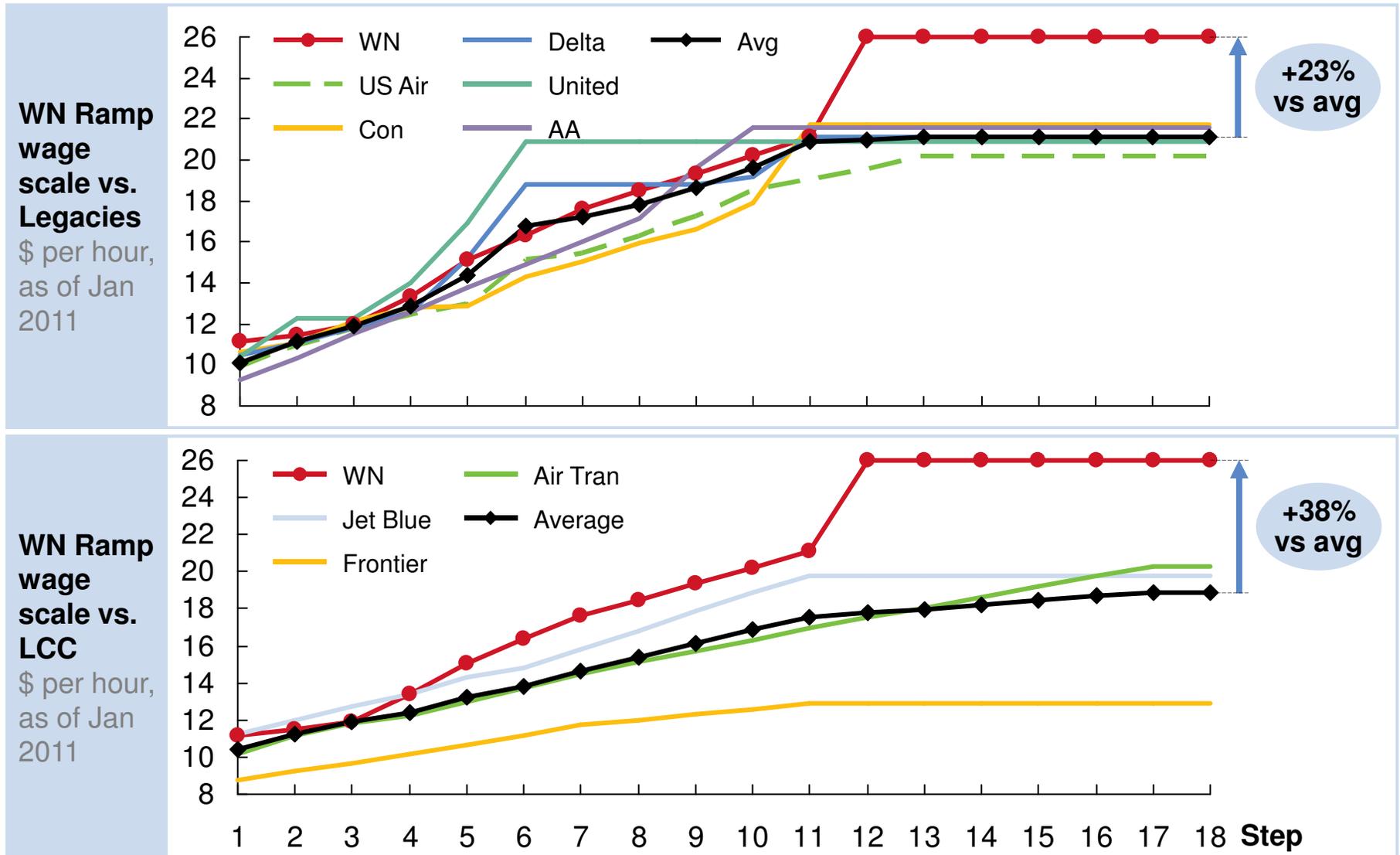
Next steps with AMFA

- In order to enable quick agreement on 4th line, will need to present comprehensive proposal by Sept 14th
- Continue coordinated communications effort with Mechanics, focused on educating them on our competitive challenges
- If 4th line agreement is not reached, will pursue more full Section 6 negotiation

Our situation with TWU 555

- We are at a significant labor cost disadvantage in our Ground Operations
 - Wage scales are ~20-40% higher than industry at top-out
 - We have significantly less flexibility than competitors to use part time or outsourced staffing
 - Our network and business model allows us to staff fewer total Employees per departure, but this productivity advantage is not enough to make up for our other disadvantages
- During 14 months of negotiations, the Union has been unwilling to address these major cost and flexibility issues and has instead focused on 3 issues of their own:
 - Guaranteed -800 bin staffing
 - Covered work done by Supervisors
 - Mandatory OT rules
- On August 30th, 555 delivered a new comprehensive proposal with much more aggressive elements, and notified us that they will file for mediation. This development complicates the interest-based approach we are using with other workgroups
- Due to the impending mediation, we will need to submit a comprehensive proposal by Sept 11th. The proposal will be consistent with the 6 themes that we are trying to achieve across all workgroups

Our Ramp agents are paid 23-38% more than competitors at top out...



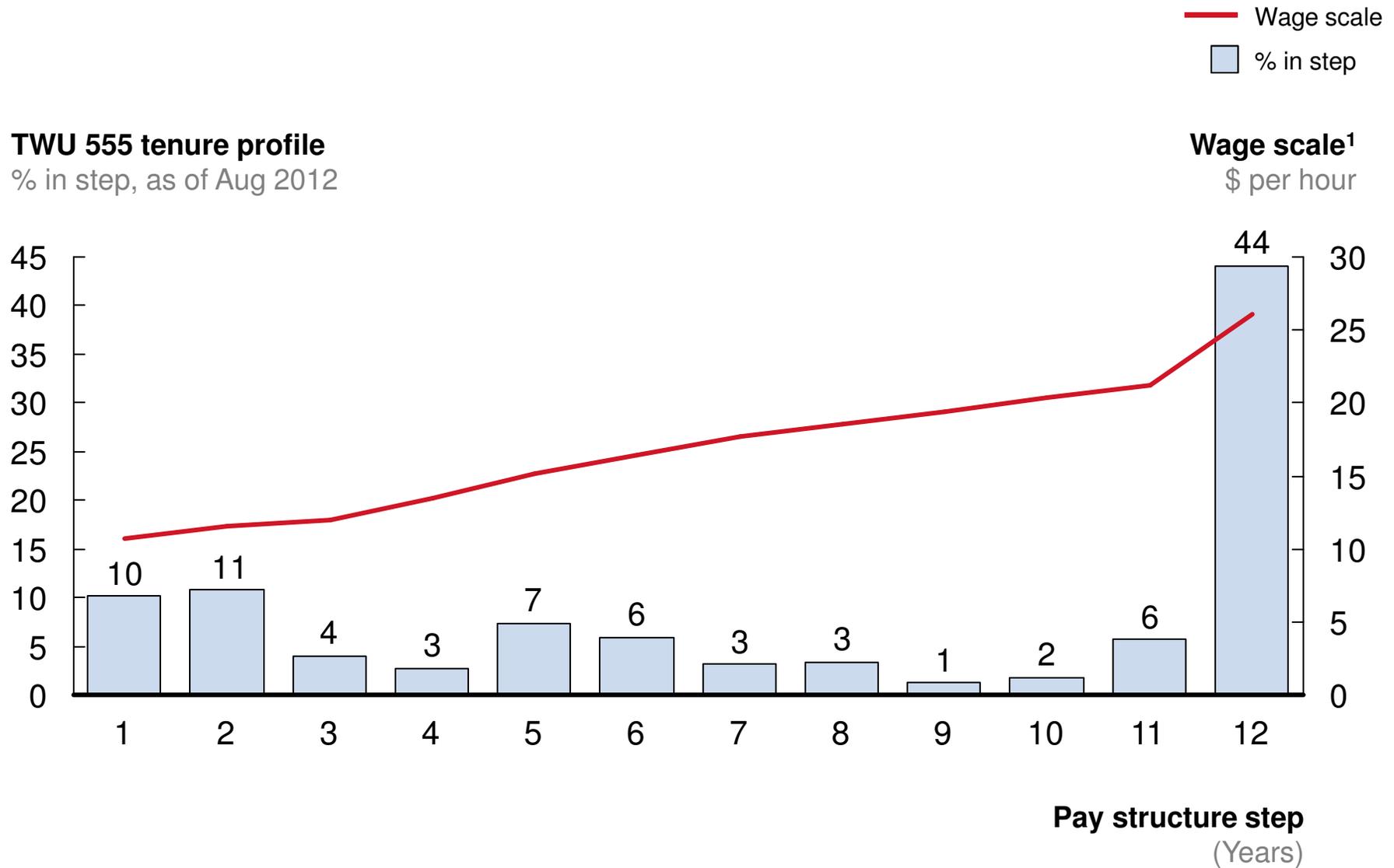
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Source: Feb 2011 Air Conference results; Airline Pilot Central; Publicly available contracts

...and ~50% of our Employees will be topped out in two years

TWU 555 tenure profile
% in step, as of Aug 2012



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1 Wage scale based on weighted average scales of Ramp/Provo agent and Ops/Cargo agent
Source: TWU555 total cost model, tenure as of August 30, 2012

We have the least flexible part-time rules in the industry

- Our competitors have much more flexibility to hire part-time Employees. Their caps range from ~40% for Alaska, United, and US Air to 100% flexibility for Delta and most LCCs
- We currently utilize 4% part-time within our 10% contract cap, mainly due to small station limitations. Our competitors utilize ~35% part time Employees¹
- To increase our percentage of part-time Employees, we need to alter the station-by-station restriction in addition to raising the overall cap

¹ Includes entire agent category of fleet service and customer service agents. AirConference , Feb 2011

Prior to delivering their Aug 30th comprehensive proposal, TWU 555 was focused on three main items...

Ideas proposed by TWU 555

Description	Fits with 5-10 strategy?	Rationale
<ul style="list-style-type: none"> ▪ Guaranteed minimum of two agents in rear bin of 800 series 		<ul style="list-style-type: none"> ▪ We will staff the appropriate number of people to do the work safely and properly ▪ However, we do not want to write these restrictions into the contract ▪ No other carrier has aircraft-specific staffing restrictions in its ground ops contracts
<ul style="list-style-type: none"> ▪ Restrictions on work Supervisors can perform 		<ul style="list-style-type: none"> ▪ Proposal goes against our core values of teamwork ▪ Restricts flexibility during irregular ops or Employee absence
<ul style="list-style-type: none"> ▪ EE only required to work MOT on one scheduled day off per month 		<ul style="list-style-type: none"> ▪ Restricts ability of stations to meet demand surges ▪ However, could improve quality of life

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...but TWU 555's new comprehensive proposal includes more aggressive elements, and we need to respond by Sept 11th

TWU 555's revised comprehensive proposal (submitted 08/30/12)

- **Wage scale:** 6% annual wage scale increases, plus longevity premiums (i.e., would put our top-out rate ~40% above Legacy average)
- **Sick & Occupational Injury Benefits:** Rejection of AMP proposal. Instead, propose sick bank payout of 100% at time of retirement (less cost of retiree medical coverage), and increase of salary continuation from 12 to 14 weeks of coverage
- **Retirement :** Increase Company 401K match to 10% and expand Retiree Healthcare Coverage to age 70
- **Holidays and Vacation:** Increase Company paid vacation to 6 weeks Maximum and increase Paid Holidays by 1 day

Our approach and timeline

- **Aug 30th:** Received TWU 555's comprehensive proposal
- **Sept 4th:** Align on path forward with EPC
- **Sept 4th -11th:** Finalize response to TWU 555
- **Sept 11th:** Submit response to TWU 555 prior to start of mediation
- **Late Sept-Oct:** Likely first meeting in mediation

Our new comprehensive proposal will include elements of the common themes across workgroups

Potential elements	Description	Value in 2016 \$ M ¹
Market wage scale for new Employees	<ul style="list-style-type: none"> Wage scale that protects existing Employees at current rates with “Loyalty Credits” and introduces new Employees at a market rate (would likely only affect top-out rate for 555) 	~0 in 2016, but grows to 25-40 by 2030
Tenure programs²	<ul style="list-style-type: none"> Programs to reduce average tenure of workgroup (e.g., early retirement, Jumpstart program--under review with Legal) 	TBD
Key productivity improvements	<ul style="list-style-type: none"> PT flexibility: Eliminate small station restrictions , and raise overall cap to 15% 	5-12 ³
	<ul style="list-style-type: none"> Bids, trades, & overtime online 	2
Incentive-based bonuses	<ul style="list-style-type: none"> Bonuses linked to multiple performance targets (e.g., individual small group, Company) 	~0
Absence management program	<ul style="list-style-type: none"> Revise absenteeism policies to incent Employees to come to work 	15-25
Total		22-39

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1 Dollars are from forecast to 2016 normalized to 2011 headcount and spend

2 Tenure programs like early retirement do not need to be negotiated as part of the CBA

3 Preliminary figures, with ranges based on how much of the flexibility is ultimately used; currently only using ~4% of the 10% overall cap

4 Reduce sick bank size and slow accrual rate, Reduce take home wages during an OJI to be slightly less than a working Employee, Close disability coverage gaps

SWAPA update

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