Economics of Transportation ∎ (∎∎∎∎) ∎∎∎–∎∎∎

Contents lists available at ScienceDirect

Economics of Transportation

journal homepage: www.elsevier.com/locate/ecotra

What's your number? Interpreting the "fair and equitable" standard in seniority integration for airlines and other industries

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ARTICLE INFO

Article history:
Received 25 May 2013
Received in revised form
5 December 2013
Accepted 6 December 2013

Keywords:
Airlines
Seniority
Mergers
Furloughs
Workforce integration
Unions

ABSTRACT

This paper develops an analytical framework for assessing the effects of workforce seniority integration resulting from a merger or consolidation of two firms, with a focus on the airline industry. In addition to developing the first formal model that can be used to analyze the relative equity effects of integrating two workforces following a merger, we demonstrate why the interpretations of the "fair and equitable" standard embedded in the two most commonly proposed methods of seniority integration used in the airline industry (the so-called "date-of-hire" and "ratio" methods) are in conflict, thereby necessitating binding third party arbitration. We also demonstrate that measures of aggregate equity distortion can often be reduced using a hybrid method that combines elements of both the date-of-hire and ratio methods.

> "*There are four basic lessons to be learned from those submissions… that each case turns on its own facts; that the objective is to make the integration fair and equitable; that the proposals advanced by those in contest rarely meet that standard; and that the end result, no matter how crafted, never commands universal acceptance.*" (*Federal Express and Flying Tiger Pilots Seniority Integration Decision of Arbitrator Nicolau, (1990) at pp. 27–28.*)

1. Introduction

Among the many challenges facing two firms attempting to merge is the issue of labor force integration.[1] Potential problems related to workforce integration can become especially acute when some or all employees at one or both of the merging firms are ranked according to seniority, which commonly occurs in industries such as the airline industry. Because an employee's relative position on his or her seniority list can dramatically impact that employee's current and future compensation, job security and other benefits, the method by which two seniority lists are integrated and the resulting ranking of employees is of paramount interest to the employees of merging firms.[2] For example, over the past decade there have been a number of U.S. airline mergers that have required binding, independent arbitration between the pilots of the pre-merger airlines, some of which have even resulted in post-arbitration litigation or new U.S. Federal legislation.[3] The recently enacted McCaskill–Bond Amendment, which explicitly requires U.S. airline mergers to provide for the integration of seniority lists in a "fair and equitable" manner, for example, was a direct result of dissatisfaction by the two U.S. senators from the state of Missouri (the former headquarters of TWA) over the "stapling" of TWA's flight attendants to the bottom of American's seniority list following the TWA-American merger in 2001.[4] In other instances, failure to successfully negotiate a method of seniority integrationpre-merger has prevented one firm from acquiring another. For example, in 2009, the inability of the pilots from Southwest Airlines' and Frontier Airlines' to agree upon a method of seniority integration was the primary reason why Southwest's attempted bid for Frontier failed.

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[1] See, for example, "United Feeling Merger Pains", *The Wall Street Journal*, September 26, 2011 and "US Airways pilot' seniority disputes may muddle merger", *The Arizona Republic*, March 7, 2013.

[2] Although the details of how two seniority lists are integrated is typically left in the hands of the respective workgroups, the merging firms nonetheless have a direct interest in the process, as labor disruptions can significantly impact a firm's operational and financial performance.

[3] For example, in 2013, pilots from US Airways' "East" and "West" groups were still embroiled in a seniority integration dispute resulting from the 2005 merger of US Airways and America West. *See* Don Addington et al., Plaintiffs, vs. US Airline Pilots Association and US Airways, Defendants. *In the United States District Court for the District of Arizona, No. CV-08-1633-PHX-NVW.*

[4] See "McCaskill and Bond Work to Protect Airline Workers In Mergers", December 17, 2007, http://mccaskill.senate.gov/?p=press_release&id=226.

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http://dx.doi.org/10.1016/j.ecotra.2013.12.002

Although the effects of the seniority system on wages, earnings, efficiency, and employment have been well-studied by economists (Grossman, 1983; Lang, 1984; Frank, 1985; Milgrom, 1988; Blakemore and Hoffman, 1989; Drazen and Gottfries, 1994; Booth and Frank, 1996), there has been surprisingly little attention paid to the economics of seniority *integration* since the early work of Kahn (1955), Kennedy (1963) and Mater and Mangum (1963), which examined the broad principles surrounding several seniority integration arbitration decisions from the first half of the 20th century in the railroad (and other) industries.[5] This is somewhat surprising in light of the significant implications on both workers and firms that mergers and a resulting seniority integration can have. For example, when economic conditions dictate that a firm must reduce the size of its workforce, furloughs are virtually always taken off the bottom of a seniority list when one exists.[6]

This paper attempts to fill this void in the literature in several ways. We start by developing a simple model of seniority integration. We note at the outset that the focus of our model is on what we believe to be the most critical aspect of the seniority integration problem: the relative position of employees on the integrated seniority list. In doing so, however, our model abstracts from certain details that may be at issue in a particular integration of workforces, such as differences in wages or rates of attrition across the two pre-merger firms. Nevertheless, we believe that our model enables one to systematically analyze important questions regarding equity and fairness, which is the cornerstone of the seniority integration problem.

With our basic framework in hand, we then turn to analyzing several pertinent (and heretofore unaddressed) questions regarding seniority integration. The first question we attempt to shed light on is why seniority integration is typically such a contentious issue. To answer this question, we turn to the airline industry, where a history of consolidation both in the U.S. and abroad combined with unionized workforces has resulted in frequent, well-documented seniority disputes, particularly amongst pilots of merging carriers.[7] An examination of several airline seniority integration disputes reveals a repeated pattern whereby one of the merging workgroups advocates for what is known as "date-of-hire" integration while the other advocates for what is known as the "ratio" method. These methods will be discussed in detail in Section 2; however, "date-of-hire" integration consists of constructing the post-merger seniority list by ranking employees solely based on their longevity at their respective *pre-merger* firm, while the "ratio" method constructs the new seniority list with the characteristic that each employee's pre- and post-merger percentile ranking on his or her seniority list remains constant.

When examined closely, however, we demonstrate that these two methods reflect differing views of how one should interpret the "fair and equitable" benchmark that governed past seniority integrations in the U.S. airline industry for nearly four decades under the Allegheny–Mohawk Labor Protective Provisions (LPPs), and likewise applies to today's mergers under the more recent McCaskill–Bond Amendment. At the core of the "fair and equitable" standard in the date-of-hire method is the notion that the only determinant of an employee's competitive rank within a firm should be his or her experience at that firm. Put differently, any worker senior to another on the merged seniority list should be from a cohort with equivalent or greater length of service with the pre-merger firm, a property we refer to as the ability to *retain cohort stability*. In contrast, the interpretation of the "fair and equitable" standard embedded in the ratio method is one based on the premise that if a member is above (below) a relevant threshold pre-merger (i.e., is unlikely to be furloughed or qualifies for premium pay assignments), he should remain above (below) the same threshold post-merger, a property we refer to as the ability to *preserve initial status*. We demonstrate that the conditions under which the two methods are equivalent (thereby satisfying both concepts of what is fair and equitable) rarely hold. Consequently, a main proposition of our analysis formalizes why the two interpretations of what is fair and equitable are in direct conflict, thus explaining why seniority integration in the airline industry is frequently the subject of binding arbitration.

We then turn our attention to an analysis of the equity distortions resulting from different methods of seniority integration. After defining measures of equity distortion that can be used to compare and evaluate competing methods of integration, we characterize the conditions under which a "hybrid" method that combines elements of the "date-of-hire" and "ratio" methods can reduce aggregate equity distortion. We believe that our findings can serve as a useful tool for arbitrators that are frequently confronted with choosing between conflicting proposals.[8] Indeed, the "hybrid" method proposed in this paper was recently adopted in the arbitration decision integrating United and Continental's pilots following the merger of those carriers.[9]

It is important to emphasize that while the most direct application of our analysis is in the context of a merger involving two (typically unionized) labor forces (e.g., airline pilots, flight attendants, mechanics, etc.) there are a host of other real-world contexts in which seniority integration can and does occur. Indeed, seniority integration issues can even arise without the triggering event of a merger. For example, if a firm downsizes and is forced to consolidate its operations and close certain facilities, employment contracts may dictate that employees from the shuttered facilities are "merged" with employees from the remaining facilities. Likewise, a municipality that is forced to consolidate schools or fire stations because of budget cuts may likewise need to merge seniority lists prior to furloughing teachers, school administrators and fire-fighters.[10]

[5] Kahn (1990) studied occupational safety provided by firms in unionized industries and found that firm-supplied safety reflects the preferences of the most senior and most junior workers in terms of seniority. Hodge (2008) provides a legal perspective overview of many seniority arbitration decisions from the airline industry.

[6] Likewise, the seniority integration dispute between US Airways "East" and "West" pilots was identified as one of the factors leading up to an illegal work slowdown by its East pilots in the summer of 2011. *See* Memorandum Opinion and Order, US Airways, Inc., Plaintiff, vs. US Airline Pilots Association and Michael J. Cleary, Defendants. *United States District Court Western District of North Carolina Charlotte Division 3:11-cv-371-RJC-DCK*, September 29, 2011.

[7] While our examples primarily rely on case studies from the U.S. (where there is an extensive public record of seniority integration disputes), the seniority integration problem is relevant throughout the world as mergers (in the airline and other industries) as well as government austerity measures may increase the need to consolidate and combine workforces.

[8] For example, arbitrators in the recent Delta-Northwest pilot seniority integration noted that "Notwithstanding months of vigorous negotiations and subsequent good faith participation in mediation efforts, the parties to this dispute are deeply divided, as is apparent from their respective proposals: Each does little more than stack the deck for their own constituencies in ways that are neither fair nor equitable." *See* Integrated Seniority List and Award, *In the Matter of the Seniority Integration Between the Pilots of Northwest Airlines and the Pilots of Delta Air Lines, Before the Seniority Integration Arbitration Board Richard I. Bloch, Dana E. Eischen and Fredric R. Horowitz,* December 8, 2008, p. 15.

[9] In his award, the arbitrator found that "It is also clear to us that using a hybrid methodology that combines elements of both the Date-of-Hire and Status-Category ratio models can reduce aggregate equity distortion." See Arbitration Proceedings, Air Line Pilots' Association Merger Policy, In the Matter of the Seniority Integration Arbitration Between The Pilots Of Continental Airlines—And—The Pilots Of United Air Lines, 2013, p. 34.

[10] While it has been well-documented (Hirsch, 2008; Hirsch and McPherson, 2003) that the percentage of the overall U.S. labor force that is unionized has declined from nearly 25% in the 1970s to approximately 12% in 2008, there are still numerous sectors of the economy where union membership (and thus the potential for seniority integration issues) is quite high. For example, the percentage of rail and air transportation workers that were unionized in 2012 stood at 65.6% and 41.8% respectively. Likewise, while the percentage of U.S. workers that are unionized has become relatively low, rates of union membership in other countries

Please cite this article as: Lee, D., Singer, E., What's your number? Interpreting the "fair and equitable" standard in seniority integration for airlines and other industries. Economics of Transportation (2014), http://dx.doi.org/10.1016/j.ecotra.2013.12.002