

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

THE INTERNATIONAL ASSOCIATION OF MACHINISTS
AND AEROSPACE WORKERS and AIR TRANSPORT
DISTRICT 143 OF THE INTERNATIONAL ASSOCIATION
OF MACHINISTS AND AEROSPACE WORKERS,

Index No. 602476/03

Plaintiffs,

-against-

NORTHWEST AIRLINES CORPORATION f/k/a Wings
Holdings Inc., and Newbridge Parent Corporation,

Defendants.

THE INTERNATIONAL BROTHERHOOD OF
TEAMSTERS, LOCAL 2000, NORTHWEST AIRLINES
FLIGHT ATTENDANTS UNION, affiliated with the
International Brotherhood of Teamsters, and WILLIAM
H. BLACK, as Trustee for the Trust for the International
Brotherhood of Teamsters Employees constituted by
certain Flight Attendants for Northwest Airlines Corporation,

Plaintiffs,

-against-

NORTHWEST AIRLINES CORPORATION
f/k/a Wings Holdings, Inc.

Defendant.

HELEN FREEDMAN, J.:

Motion sequence numbers 001 and 002, in which plaintiffs seek partial summary judgment on their claims for breach of contract, are consolidated for joint disposition. For the reasons set forth below, plaintiffs' motions are granted.

Overview – This lawsuit centers upon stock “put” rights that defendant Northwest Airlines Corporation (“Northwest” or the “Company”) granted to unionized employees in 1993 in exchange for wage and benefit concessions. Pursuant to their agreements with the unions, Northwest issued a new class of Series C Preferred Stock (the “Preferred Stock”) to be held in trust for the benefit of the union members. The Preferred Stock holders also received an option to sell their shares to Northwest in 2003 at a specified prices, payable in cash, Northwest common stock, or a combination of cash and common stock. Henceforth these rights, which are described in more detail below, will be referred to as the “Put Rights.” In August 2003, the trustees controlling the Preferred Stock exercised their Put Rights with respect to all or nearly all of the outstanding shares.

The airline has not yet redeemed any of that Preferred Stock, however. In June 2003, Northwest publicly announced that it had “elected” to repurchase the Preferred Stock with cash, yet at the same time claimed that it could not consummate the repurchase, because it would “impair” Northwest’s capital and thereby violate Delaware law¹, under which Northwest is incorporated. Northwest acknowledges its obligation to repurchase the Preferred Stock, but contends that the law requires it to defer the transaction until its financial condition improves.

Immediately after the June 2003 announcement, plaintiffs The International Brotherhood of Teamsters, Local 2000, Northwest Airlines Flight Attendants Union (“IBT”) and William Black, as trustee of the IBT members’ Preferred Stock, sued Northwest, alleging that Northwest was required to repurchase the Preferred Stock in 2003. They assert claims for breach of

¹Specifically, Northwest contends that the purchase would have violated Delaware General Corporation Law § 160. *See infra* at 7.

contract, the implied covenant of good faith and fair dealing and unjust enrichment, and seek a declaration of IBT's rights under its agreement. In August 2003, after Northwest's board of directors (the "Board") confirmed that Northwest would not repurchase the Preferred Stock, plaintiff International Association of Machinists and Aerospace Workers and Air Transport District 143 of the International Association of Machinists and Aerospace Workers (jointly, "IAM"), sued Northwest for breach of its contract with the union, and also sought specific performance and a declaratory judgment. The two lawsuits which arise from the same events and concern contracts that are identical in relevant part, were consolidated in December 2003.

Background – In 1992 and 1993, Northwest obtained wage and benefit concessions worth about \$ 886 million from its union and non-union employees over a three-year period from 1993 to 1996². Three major unions (the "Unions") represented Northwest employees: the Air Line Pilots Association (the "ALPA"), which did not join in this lawsuit; IBT, which represented Northwest flight attendants; and IAM, which represented mechanics, office personnel and others not working on board flights. On behalf of their members, IBT and JAM entered into separate Equity Labor Agreements with Northwest dated August 1, 1993 (the "Agreements").

The following summarizes the identical Put Right set forth at Section 3.5 of each Agreement, and other relevant provisions: During a 60-day period (the "Put Exercise Period") leading up to August 1, 2003, the tenth anniversary of the date on which Northwest had issued the Preferred Stock (the "Put Date"), holders could put their shares to Northwest. On or before the first day of the Put Exercise Period, Northwest had to choose between alternative means of

² IAM members gave up wages and benefits worth about \$ 340 million. The motion papers do not indicate how much IBT members conceded.

performance: it could elect “either (i) to repurchase [the Preferred Stock] for either cash equal to the Put Price [a per-share price derived from a stated formula] or shares of [Northwest’s] Class A Voting Common Stock [with a worth] equal to the Put Price,” or (ii) permit the holders to choose whether to (A) convert the Preferred Stock into Northwest common stock, and also receive additional cash, or (B) have a set number of shares of Class A Voting Common Stock sold on the market on holder’s behalf, and receive the sales price plus additional cash. Henceforth, Northwest’s option to repurchase the Preferred Stock will be referred to as the “Repurchase Option,” and its option to permit the holders to choose other alternatives will be referred to as the “Alternative Option.” Northwest was also required to publicly announce its chosen Option when or before the Put Exercise Period began, and repurchase on or before October 30, 2003 (the “Put Payment Date.”) Agreement § 3.5(a).

As further consideration for their members’ concessions, IAM, IBT, and ALPA were entitled to each appoint one director to Northwest’s board of directors (the “Board”), and the Agreements provided that Northwest could only elect certain repurchase options if at least two of the three union-controlled directors consented. Agreements §§ 3.5(c) & (d), 5.1. Henceforth, the union-controlled directors shall be referred to as the “Series C Directors.” Their consent was needed if the Board chose

either (i) not to repurchase all of the [Preferred Stock which had been put to Northwest] either (A) with cash pursuant to Section 3.5(a)(i) or (B) pursuant to the procedures set forth in Section 3.5(a)(ii), but instead to repurchase such [Preferred Stock] with shares of Class A Voting Common Stock pursuant to Section 3.5(a)(i), or (ii) not to repurchase any of the [Preferred Stock] in accordance with the requirements of Section 3.5(a)

Agreement § 3.5(c).

Another provision, Section 3.5(d), addressed Northwest's obligations if "on the Put Date [Northwest's] board of directors decides not to repurchase all of the [Preferred Stock that had been put to it]" under the procedures set forth in Section 3.5(a). In that case, on the Put Date and at the end of each calendar quarter thereafter, Northwest had to use its "Available Cash", broadly meaning its net profits, to repurchase the outstanding Preferred Stock *pro rata* among the holders. However, a partial repurchase with Available Cash was excused if Northwest was "prohibited from making such repurchase under Delaware law or any loan agreement or other instrument to which it is a party or is subject." The Board could only decline to repurchase Preferred Stock with Available Cash if a majority of the Series C Directors consented.

Finally, the Agreement provided that, if Northwest had failed to repurchase all of the Preferred Stock by a set date, (1) the outstanding Preferred Stock would accrue a quarterly dividend of at least 12% and (2) the number of Series C Directors would increase by three or more. Agreement § 3.5(e).

Election by defendant – On June 3, 2003, Northwest issued a press release announcing its election pursuant to Section 3.5(a) of the Agreements. Northwest began by interpreting its contractual obligations:

The terms of the [Preferred Stock] establish the process that the Company is required to go through to determine how and when the [Preferred Stock] will be repurchased. The process requires the Company to choose the form of payment it intends to use to repurchase the [Preferred Stock]. The Company is also required to make a separate decision as to whether the Company will repurchase the [Preferred Stock].

Northwest next stated that it had elected to use "cash, rather than shares of its common stock" for the repurchase, but suggested that it was not obligated to buy the Preferred Stock on the Put Date:

The decision announced today does not mean that the [Preferred Stock] will be repurchased by the Company later this year. Consummation of the repurchase is subject to, among other things, compliance with corporate law requirements applicable to the Company. A decision regarding repurchase of the [Preferred Stock] will be made by the Company's Board of Directors on August 1, 2003.

Thereafter, the Trustees exercised the Put Right with respect to all of the outstanding Preferred Stock held in behalf of IAM and IBT members, with an aggregate repurchase price (as of the Put Date) of about \$ 226 million.

On July 29, 2003, the Board met to consider the repurchase. The minutes reflect that the Board reviewed (1) a report about Northwest's finances that independent consultants had prepared and (2) the opinion of its outside legal counsel that, if the Board could not conclude that Northwest had "adequate surplus" to repurchase the Preferred Stock, counsel could not advise the Board that the repurchase complied with Delaware law. The Board resolved that, based upon those findings, it "is not able to conclude that it would be lawful under Delaware law for the Company to repurchase [the Preferred Stock] at this time." The Board deemed its resolution to be effective as of August 1, 2003. Two of the three Series C Directors voted against the resolutions; the rest of the Board directors voted for it. This lawsuit ensued.

Statute – The parties agree that the Board's general reference to "Delaware law" in the July 2003 resolutions only pertains to Section 160 of the Delaware General Corporation Law ("Section 160"), which Northwest claims prohibited it from purchasing the Preferred Stock. In relevant part, Section 160 provides as follows:

Every corporation may purchase . . . or otherwise acquire . . . its own shares; provided, however, that no corporation shall . . . [p]urchase or redeem its own shares of capital stock for cash or other property when the capital of the corporation is impaired or when such purchase or redemption would cause any impairment of the capital of the corporation Nothing in this subsection shall

invalidate or otherwise affect a note, debenture or other obligation of a corporation given by it as consideration for its acquisition by purchase, redemption or exchange of its shares of stock if at the time such note, debenture or obligation was delivered by the corporation its capital was not then impaired or did not thereby become impaired.

Del. Code. Ann. tit. 8 § 160(a), 160(a)(1). The last quoted sentence, which was added to the statute in 1974, shall be referred to as the “1974 Amendment.”

Motions – Moving for summary judgment on their breach of contract claims,³ plaintiffs argue that Section 160 would only bar Northwest from paying cash for the Preferred Stock if its capital was impaired in 1993, when it executed the Agreements. According to the plaintiffs, Northwest’s current finances are irrelevant. They further contend that Section 160 was only intended to protect a corporation’s creditors, and accordingly Northwest cannot invoke it to avoid the repurchase. In the alternative, plaintiffs argue that, even if Section 160 barred a cash repurchase on the Put Date, under the Agreements Northwest was obliged to buy the Preferred Stock with common stock. Finally, plaintiffs contend that Northwest breached the Agreements by failing to procure the Series C Directors’ consent at the Board meeting.

In opposition, Northwest first claims that the Agreements do not govern the parties’ rights and obligations; the “operative contract”, according to Northwest, is the Certificate of Designations for the Preferred Stock that Northwest filed with the Secretary of State of Delaware when it issued the new shares (the “Certificate”). The Certificate incorporates most of the terms

³The motions are designated differently but are alike in substance. IAM moves for “partial” summary judgment on its claim for breach of contract. IBT moves for summary judgment for the amount Northwest owes “in accordance with” its obligation under its Agreement to repurchase the Preferred Stock, and notes that IAM moves “on the same or similar grounds.”

of the Put Right set forth in the Agreements, but omits any provisions requiring Northwest to obtain the Series C Directors' consent to certain actions.

Addressing Section 160, Northwest argues that the appropriate date for measuring impairment is 2003, when Northwest was obliged to repurchase the Preferred Stock, and not 1993, when the obligation was created. Northwest adds that once the Board had elected to repurchase with cash, it was committed to that choice, and “[t]he mechanics of the [P]ut [R]ight, set forth in the [Certificate], do not permit the Board to retrace its steps and make a different election if it determines that [Northwest] is unable to engage in a complete repurchase.” Finally, Northwest contends that these motions are premature because more discovery is needed.

Conclusion – A threshold issue that Northwest raises is whether the Agreements or the Certificate governs the parties' contractual relationship. The Agreements control. The Certificate did not create any rights and obligations among the parties; rather, the Agreements obligated Northwest to file the Certificate before it issued the Preferred Stock in compliance with Section 151 of the Delaware General Corporation Law. Agreements § 3.8(d). The Certificate omits the Agreement provisions requiring Northwest to obtain the Series C Directors' consent, but the Northwest Bylaws contain those provisions. Bylaws, art. VII, § 6(a).

Plaintiffs are entitled to summary judgment for Northwest's breach of those Agreements. Northwest's conduct constitutes a breach even if it properly invoked Section 160 as a defense.⁴

⁴Plaintiffs' argument that under Section 160, Northwest's finances should be measured for capital impairment as of 1993, not 2003, is unpersuasive. A corporation's impairment is measured when it purchases its stock, not when it contracts to purchase the stock in the future. *See Kohls v. Duthie*, 791 A.D.2d 772, 784-85 (Del. Ch. 2000). The 1974 Amendment, which carves out a limited exception where a corporation acquires its own stock by issuing debt to the seller, does not apply here because the Preferred Stock shares are equity, not debt.

Northwest breached Section 3.5(c)(ii) when, over the objection of two Series C Directors, the Board resolved not to repurchase any of the Preferred Stock on the Put Date. That decision required the consent of the majority of Series C Directors.

Northwest could not avoid repurchase by first electing to pay cash and then claiming that cash payments would be illegal under Section 160. Section 160 only prohibits a corporation from purchasing its stock for cash or other property; it would not apply if Northwest had repurchased the Preferred Stock with common stock. Northwest misinterprets section 3.5(a) of the Agreements as providing Northwest three distinct alternatives: (1) the Repurchase Option using cash, *or* (2) the Repurchase Option using common stock, *or* (3) the Alternative Option. On its face, however, section 3.5(a) provides Northwest with only two alternatives, namely the Repurchase Option, designated as sub-section “3.5(a)(i)”, and the Alternative Option, designated as sub-section “3.5(a)(ii)”. Significantly, the Alternative Option offers two sub-options, which are designated as sub-sub-sections “3.5(a)(ii)(A)” and “3.5(a)(ii)(B)”; in contrast, the Repurchase Option has no subdivisions. Once it chose the Repurchase Option, Northwest was obligated to proceed with the transaction. If Northwest could not or would not use cash, it had to use common stock.⁵ *See generally Yankton Sioux Tribe of Indians*, 272 U.S. 351, 358 (1922) (“where promises are in the alternative, the fact that one of them . . . becomes impossible of performance does not . . . relieve the promisor from performing the other.”)

⁵To repurchase with common stock, Northwest needed the consent of two of the Series C Directors. Agreement § 3.5(c). That requirement has no bearing on these motions, however, because Northwest did not take any steps towards repurchasing with common stock before it breached the Agreements.

Northwest fails to show how further discovery could adduce any evidence that would defeat these summary judgment motions. Accordingly, its application for their deferment is denied.

In sum, Northwest is found liable to plaintiffs on their claims for breach of the Agreements. As plaintiffs acknowledge, their damages for breach of contract must be determined at trial.

Settle order. The parties are directed to appear on March 29, 2005 at 9:30 a.m. for a status conference.

Dated: March 22, 2005

Enter:



Helen E. Freedman, J.S.C.