

AMR CORP  
Form 10-K  
February 20, 2008

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United States  
Securities and Exchange Commission  
Washington, D.C. 20549

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Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 2007

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 1-8400  
AMR Corporation  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

75-1825172  
(IRS Employer  
Identification Number)

4333 Amon Carter Blvd.  
Fort Worth, Texas 76155  
(Address of principal executive offices, including zip code)

(817) 963-1234  
(Registrant's telephone number, including area code)

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Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, \$1 par value per share	New York Stock Exchange
9.00% Debentures due 2016	New York Stock Exchange
7.875% Public Income Notes due 2039	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:  
None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

Act.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2007, was approximately \$6.5 billion. As of February 13, 2008, 249,410,640 shares of the registrant's common stock were outstanding.

#### DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain information from the Proxy Statement for the Annual Meeting of Stockholders to be held May 21, 2008.

PART I

ITEM 1. BUSINESS

AMR Corporation (AMR or the Company) was incorporated in October 1982. AMR's operations fall almost entirely in the airline industry. AMR's principal subsidiary, American Airlines, Inc. (American), was founded in 1934. American is the largest scheduled passenger airline in the world in terms of available seat miles and revenue passenger miles. At the end of 2007, American provided scheduled jet service to approximately 170 destinations throughout North America, the Caribbean, Latin America, Europe and Asia. American is also one of the largest scheduled air freight carriers in the world, providing a wide range of freight and mail services to shippers throughout its system onboard American's passenger fleet.

AMR Eagle Holding Corporation (AMR Eagle), a wholly-owned subsidiary of AMR, owns two regional airlines which do business as "American Eagle" -- American Eagle Airlines, Inc. and Executive Airlines, Inc. (Executive) (collectively, the American Eagle® carriers). American also contracts with two independently owned regional airlines, which do business as "American Connection" (the American Connection® carriers). The American Eagle carriers and the American Connection carriers provide connecting service from eight of American's high-traffic cities to smaller markets throughout the United States, Canada, Mexico and the Caribbean.

AMR Eagle currently operates a fleet of 294 aircraft. The AMR Eagle fleet is operated to feed passenger traffic to American pursuant to a capacity purchase agreement between American and AMR Eagle under which American receives all passenger revenue from flights and pays AMR Eagle a fee for each flight. In July 2007, the capacity purchase agreement was amended to reflect what the Company believes are current market rates received by other regional carriers for similar flying. Amounts paid to AMR Eagle under the capacity purchase agreement are for various operating expenses of AMR Eagle, such as crew expenses, maintenance and aircraft ownership, some of which are calculated based on specific operating statistics (e.g. block hours, departures) and others of which are fixed monthly amounts. As of December 31, 2007, AMR Eagle averaged over 1,700 daily departures, offering scheduled passenger service to over 150 destinations in North America, Mexico and the Caribbean. On a separate company basis, AMR Eagle reported \$2.3 billion in revenue and \$114 million of income before income taxes in 2007. However, AMR Eagle's historical financial information is not indicative of the AMR Eagle's future results of operations, financial position and cash flows if AMR Eagle had been a stand-alone entity.

As discussed in the Recent Events section of this Item 1., the Company plans to divest AMR Eagle in 2008. Material modifications could be made to the business and operations of AMR Eagle, and to the capacity purchase agreement between American and AMR Eagle, prior to any such divestiture.

American Beacon Advisors, Inc. (American Beacon), a wholly-owned subsidiary of AMR, is responsible for the investment and oversight of assets of American's U.S. employee benefit plans, as well as AMR's short-term investments. It also serves as the investment manager of the American Beacon Funds, a family of mutual funds with both institutional and retail shareholders, and provides customized fixed income portfolio management services. American Beacon's average assets under management for 2007 was \$65 billion, an increase of 27 percent from 2006 and are almost evenly split between equities and fixed income investments. American Beacon has been particularly successful in growing its third party business, as average third-party assets under management increased by approximately 39 percent in 2007. Third-party assets under management accounted for \$37 billion of average assets under management and \$90 million of 2007 gross revenue. For 2007, on a separate company basis, American Beacon's gross revenue was \$101 million and income before income taxes was approximately \$48 million, both of which increased approximately 40 percent over 2006.

Recent Events

The Company recorded net earnings of \$504 million in 2007, its second consecutive annual profit and a \$273 million increase over 2006. Improved results reflected an increase in operating revenue of \$372 million, or 1.6 percent on 2.3 percent less capacity, partially offset by higher fuel prices and increases in certain other costs. American's passenger revenues increased 2.1 percent despite a capacity (available seat mile) decrease of 2.4 percent. While passenger yield showed significant year-over-year improvement as American implemented fare increases to partially offset the continuing rise in the cost of fuel, passenger yield remains low by historical standards.

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The average price per gallon of fuel the Company paid increased 27.9 cents from 2005 to 2006 and 11.7 cents from 2006 to 2007. These price increases negatively impacted fuel expense by \$787 million and \$268 million in 2006 and 2007, respectively, as compared to the respective prior years. Continuing high fuel prices, additional increases in the price of fuel, and/or disruptions in the supply of fuel would further adversely affect the Company's financial condition and its results of operations.

AMR continues to take steps to strengthen its balance sheet and in January 2007, issued 13 million shares of common stock for net proceeds of \$497 million. The Company reduced long-term debt and capital lease obligations (including current maturities) by \$2.3 billion during the year and ended the year with \$4.5 billion in unrestricted cash and short-term investments and \$428 million in restricted cash and short-term investments.

The Company's ability to remain profitable, reach acceptable profit levels and its ability to continue to fund its obligations on an ongoing basis will depend on a number of factors, many of which are largely beyond the Company's control. Certain risk factors that affect the Company's business and financial results are discussed in the Risk Factors listed in Item 1A. In addition, four of the Company's largest domestic competitors and several smaller carriers have filed for bankruptcy in the last several years and have used this process to significantly reduce contractual labor and other costs. In order to remain competitive and to improve its financial condition, the Company must continue to take steps to generate additional revenues and to reduce its costs. Although the Company has a number of initiatives underway to address its cost and revenue challenges, the ultimate success of these initiatives is not known at this time and cannot be assured.

In October 2007, the Company announced that it was conducting a review of its strategic assets. The purpose of the review is to determine whether there exists the potential for unlocking additional stockholder value with respect to one or more of the Company's strategic assets through some type of separation transaction. For further information regarding the strategic asset review, see Item 1A. Risk Factors.

On November 28, 2007, the Company announced that it plans to divest AMR Eagle (American Eagle Airlines, Inc., and Executive Airlines, Inc.), its wholly-owned regional carrier. American Eagle Airlines, Inc. feeds American Airlines hubs throughout North America, and its affiliate, Executive Airlines, Inc., carries the American Eagle name throughout the Bahamas and the Caribbean from bases in Miami and San Juan, Puerto Rico. AMR believes that a divestiture of AMR Eagle is in the long-term best interests of the Company and its shareholders.

The divestiture of AMR Eagle is intended to provide it with the structure, incentives and opportunities to win new business and provide new opportunities for AMR Eagle's employees. The Company also believes that the divestiture will enable American to focus on its mainline business, while ensuring the Company's continued access to cost-competitive regional feed. Once the two airlines are separated, it is expected that, subject to market considerations, AMR Eagle will perform flying on behalf of American pursuant to an air services agreement under which AMR Eagle will continue to provide American with regional flying of a scope and quality comparable to that provided prior to the separation and on terms that reflect the current market for those services.

The Company continues to evaluate the form of the divestiture, which may include a spin-off to AMR shareholders, a sale to a third party, or some other form of separation from AMR. The Company expects to complete the divestiture in 2008; however, the completion of any transaction and its timing will depend on a number of factors, including general economic, industry and financial market conditions, as well as the ultimate form of the divestiture. The impact on AMR of divesting AMR Eagle is not currently quantifiable due to these uncertainties and the potential restructuring of assets, liabilities and the capacity purchase agreement between American and AMR Eagle. In addition, AMR Eagle's historical financial information is not indicative of AMR Eagle's future results of operations, financial position and cash flows as a stand-alone entity.

## Competition

**Domestic Air Transportation** The domestic airline industry is fiercely competitive. Currently, any U.S. air carrier deemed fit by the U.S. Department of Transportation (DOT) is free to operate scheduled passenger service between any two points within the U.S. and its possessions. Most major air carriers have developed hub-and-spoke systems and schedule patterns in an effort to maximize the revenue potential of their service. American operates five hubs: Dallas/Fort Worth (DFW), Chicago O'Hare, Miami, St. Louis and San Juan, Puerto Rico. United Air Lines (United) also has a hub operation at Chicago O'Hare.

The American Eagle® carriers increase the number of markets the Company serves by providing connections at American's hubs and certain other major airports -- Boston, Los Angeles, Raleigh/Durham and New York's LaGuardia (LaGuardia) and John F. Kennedy International (JFK) Airports. The American Connection® carriers provide connecting service to American through St. Louis. American's competitors also own or have marketing agreements with regional carriers which provide similar services at their major hubs and other locations.

On most of its domestic non-stop routes, the Company faces competing service from at least one, and sometimes more than one, domestic airline including: AirTran Airways (Air Tran), Alaska Airlines (Alaska), ATA Airlines, Continental Airlines (Continental), Delta Air Lines (Delta), Frontier Airlines, JetBlue Airways (JetBlue), Northwest Airlines (Northwest), Southwest Airlines (Southwest), United, US Airways, Virgin America Airlines and their affiliated regional carriers. Competition is even greater between cities that require a connection, where the major airlines compete via their respective hubs. In addition, the Company faces competition on some of its connecting routes from carriers operating point-to-point service on such routes. The Company also competes with all-cargo and charter carriers and, particularly on shorter segments, ground and rail transportation. On all of its routes, pricing decisions are affected, in large part, by the need to meet competition from other airlines.

The Company must also compete with carriers that have recently reorganized under the protection of Chapter 11 of the U.S. Bankruptcy Code (Chapter 11). It is possible that one or more other competitors may seek to reorganize in or out of Chapter 11. Successful reorganizations present the Company with competitors with significantly lower operating costs derived from renegotiated labor, supply and financing contracts.

**International Air Transportation** In addition to its extensive domestic service, the Company provides international service to the Caribbean, Canada, Latin America, Europe and Asia. The Company's operating revenues from foreign operations were approximately 37 percent of the Company's total operating revenues in 2007, and 37 and 36 percent of the Company's total operating revenues in 2006 and 2005, respectively. Additional information about the Company's foreign operations is included in Note 14 to the consolidated financial statements.

In providing international air transportation, the Company competes with foreign investor-owned carriers, foreign state-owned carriers and U.S. airlines that have been granted authority to provide scheduled passenger and cargo service between the U.S. and various overseas locations. In general, carriers that have the greatest ability to seamlessly connect passengers to and from markets beyond the nonstop city pair have a competitive advantage. In some cases, however, foreign governments limit U.S. air carriers' rights to carry passengers beyond designated gateway cities in foreign countries. To improve access to each other's markets, various U.S. and foreign air carriers - including American - have established marketing relationships with other airlines and rail companies. American currently has marketing relationships with Aer Lingus, Air Pacific, Air Tahiti Nui, Alaska Airlines, British Airways, Brussels Airlines, Cathay Pacific, China Eastern Airlines, Dragonair, Deutsche Bahn German Rail, EL AL, EVA Air, Finnair, Gulf Air, Hawaiian Airlines, Iberia, Japan Airlines, LAN (includes LAN Airlines, LAN Argentina, LAN Ecuador and LAN Peru), Malév Hungarian Airlines, Mexicana, Qantas Airways, Royal Jordanian, SNCF French Rail, and Turkish Airlines.

American is also a founding member of the oneworld alliance, which includes British Airways, Cathay Pacific, Finnair, Lan Airlines, Iberia, Qantas, Japan Airlines, Malev Hungarian, Dragonair, and Royal Jordanian. The

oneworld alliance links the networks of the member carriers to enhance customer service and smooth connections to the destinations served by the alliance, including linking the carriers' frequent flyer programs and access to the carriers' airport lounge facilities. Several of American's major competitors are members of marketing/operational alliances that enjoy antitrust immunity. American and British Airways, the largest members of the oneworld alliance, are restricted in their relationship because they lack antitrust immunity. They are, therefore, at a competitive disadvantage vis-à-vis other alliances that have antitrust immunity.

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**Price Competition** The airline industry is characterized by substantial and intense price competition. Fare discounting by competitors has historically had a negative effect on the Company's financial results because the Company is generally required to match competitors' fares, as failing to match would provide even less revenue due to customers' price sensitivity.

In recent years, a number of low-cost carriers (LCCs) have entered the domestic market. Several major airlines, including the Company, have implemented efforts to lower their costs since lower cost structures enable airlines to offer lower fares. In addition, several air carriers have recently reorganized under Chapter 11, including United, Delta, US Airways and Northwest Airlines. These cost reduction efforts and bankruptcy reorganizations have allowed carriers to decrease operating costs. In the past, lower cost structures have generally resulted in fare reductions. If fare reductions are not offset by increases in passenger traffic, changes in the mix of traffic that improve yields (passenger revenue per passenger mile) and/or cost reductions, the Company's operating results will be negatively impacted.

### Regulation

**General** The Airline Deregulation Act of 1978, as amended, eliminated most domestic economic regulation of passenger and freight transportation. However, the DOT and the Federal Aviation Administration (FAA) still exercise certain regulatory authority over air carriers. The DOT maintains jurisdiction over the approval of international codeshare agreements, international route authorities and certain consumer protection and competition matters, such as advertising, denied boarding compensation and baggage liability.

The FAA regulates flying operations generally, including establishing standards for personnel, aircraft and certain security measures. As part of that oversight, the FAA has implemented a number of requirements that the Company has incorporated and is incorporating into its maintenance programs. The Company is progressing toward the completion of over 180 airworthiness directives including Boeing fuel tank safety directives, Boeing 757 and Boeing 767 pylon improvements, McDonnell Douglas MD-80 horizontal stabilizer, cargo door and aft pressure bulkhead improvements, Boeing 737 horizontal stabilizer actuator and digital flight recorder improvements and Airbus A300 structural improvements. Based on its current implementation schedule, the Company expects to be in compliance with the applicable requirements within the required time periods.

The Department of Justice (DOJ) has jurisdiction over airline antitrust matters. The U.S. Postal Service has jurisdiction over certain aspects of the transportation of mail and related services. Labor relations in the air transportation industry are regulated under the Railway Labor Act, which vests in the National Mediation Board certain regulatory functions with respect to disputes between airlines and labor unions relating to union representation and collective bargaining agreements.

On December 21, 2007, a New York federal judge dismissed the Air Transport Association's ("ATA") challenge to a recently enacted New York law requiring airlines to provide certain services to onboard passengers whose flights are delayed on the ground prior to takeoff for more than three hours. The ATA plans to appeal the ruling. The law became effective in New York on January 1, 2008. In addition, legislation similar to the New York law has been proposed in Congress and several state legislatures. Legislation of this type requires airlines to pay compensation to passengers for delayed or cancelled flights and delayed, damaged, or lost luggage; sets limits on how long delayed flights can remain on the tarmac without returning to the gate; and presents numerous other service issues. The Company expects that the requirement of such services in New York and elsewhere could adversely impact the Company, but the magnitude of that impact cannot currently be determined.

**International** International air transportation is subject to extensive government regulation. The Company's operating authority in international markets is subject to aviation agreements between the U.S. and the respective countries or governmental authorities (such as the European Union), and in some cases, fares and schedules require the approval of the DOT and/or the relevant foreign governments. Moreover, alliances with international carriers may be subject to the jurisdiction and regulations of various foreign agencies. Bilateral agreements between the U.S. and various foreign governments of countries served by the Company are periodically subject to renegotiation. Changes in U.S. or foreign government aviation policies could result in the alteration or termination of such agreements, diminish the value of route authorities, or otherwise adversely affect the Company's international operations. In addition, at some foreign airports, an air carrier needs slots (landing and take-off authorizations) before the air carrier can introduce new service or increase existing service. The availability of such slots is not assured and the inability of the Company to obtain and retain needed slots could therefore inhibit its efforts to compete in certain international markets.

In April 2007, the United States and the European Union approved an "open skies" air services agreement that provides airlines from the United States and EU member states open access to each other's markets, with freedom of pricing and unlimited rights to fly beyond the United States and any airport in the EU including London's Heathrow Airport. The provisions of the agreement will take effect on March 30, 2008. Under the agreement, every U.S. and EU airline is authorized to operate between airports in the United States and Heathrow. Notwithstanding the open skies agreement, Heathrow is a slot-controlled airport. Only three airlines besides American were previously allowed to provide that Heathrow service. The agreement will result in the Company facing increased competition in serving Heathrow to the extent that additional carriers are able to obtain necessary slots and terminal facilities which could have an adverse impact on the Company. In addition, the Company will face additional competition in European markets. However, the Company believes that American and the other carriers who currently have existing authorities and the related slots and facilities will continue to hold an advantage after the advent of open skies. See Item 1A, Risk Factors, and Note 11 to the consolidated financial statements for additional information.

**Security** In November 2001, the Aviation and Transportation Security Act (ATSA) was enacted in the United States. The ATSA created a new government agency, the Transportation Security Administration (TSA), which is part of the Department of Homeland Security and is responsible for aviation security. The ATSA mandates that the TSA provide for the screening of all passengers and property, including U.S. mail, cargo, carry-on and checked baggage, and other articles that will be carried aboard a passenger aircraft. The ATSA also provides for security in flight decks of aircraft and requires federal air marshals to be present on certain flights.

Effective February 1, 2002, the ATSA imposed a \$2.50 per enplanement security service fee, which is being collected by the air carriers and submitted to the government to pay for these enhanced security measures. Additionally, air carriers are annually required to submit to the government an amount equal to what the air carriers paid for screening passengers and property in 2000. In recent years, President Bush has sought to increase both of these fees under spending proposals for the Department of Homeland Security. American and other carriers have announced their opposition to these proposals as there is no assurance that any increase in fees could be passed on to customers.

**Airline Fares** Airlines are permitted to establish their own domestic fares without governmental regulation. The DOT maintains authority over certain international fares, rates and charges, but applies this authority on a limited basis. In addition, international fares and rates are sometimes subject to the jurisdiction of the governments of the foreign countries which the Company serves. While air carriers are required to file and adhere to international fare and rate tariffs, substantial commissions, fare overrides and discounts to travel agents, brokers and wholesalers characterize many international markets.

**Airport Access** Historically, the FAA designated JFK, LaGuardia, and Washington Reagan airports as high-density traffic airports. The high-density rule limits the number of Instrument Flight Rule operations - take-offs and landings - permitted per hour and requires that a "take-off/landing slot right" support each operation. In April 2000, the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (Air 21 Act) was enacted. It eliminated slot

restrictions at JFK and LaGuardia airports effective January 1, 2007; slot restrictions remain in effect at Washington Reagan.

Although slot restrictions were eliminated at JFK in January 2007, on December 19, 2007, the United States transportation secretary announced an agreement had been reached between the Department of Transportation (“DOT”) and domestic airlines to ease congestion at JFK by shifting the timing of certain flights. As a result, the DOT does not currently expect to order a reduction in the number of flights per hour or to reimplement and auction landing slots at JFK. The shifting of timing of flights has not caused a significant impact to flights to or from JFK.

In order to remedy congestion at LaGuardia that was exacerbated by the elimination of slot restrictions, the FAA placed caps on total operations, and required carriers at LaGuardia to hold operating authorizations. In addition, the FAA has proposed rules for carriers operating at LaGuardia that would fundamentally change the manner in which operating authorizations are held and distributed at that airport. The Company, along with other carriers and interested parties, filed comments with the FAA seeking changes in the proposed rules, which remain pending. The proposed rules, as currently drafted, could require the Company to change the routes and service it currently operates at LaGuardia, which could adversely impact the Company.

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Under the high-density rule, still in effect at Washington Reagan Airport, the FAA permits the purchasing, selling, leasing or transferring of slots, except those slots designated as international, and essential air service slots. Trading of any domestic slot is permitted subject to certain parameters. The FAA's proposed rules for carriers operating at LaGuardia, described above, also contemplate certain restrictions. Some foreign airports, including London Heathrow, a major European destination for American, also have slot allocations. Most foreign authorities do not officially recognize the purchasing, selling or leasing of slots.

In 2006, the FAA issued an order requiring carriers to hold arrival authorizations to land during certain hours at Chicago O'Hare. The FAA's O'Hare order places some limits on the ability to buy and sell arrival authorizations. The Company has not experienced any significant adverse impact from this order. In addition, the DOT is considering imposing a schedule reduction order at Newark airport, which could include slot controls at that airport. The Company could be adversely affected if such an order is imposed.

Although the Company is constrained by slots, it currently has sufficient slot authorizations to operate its existing flights. However, there is no assurance that the Company will be able to obtain slots in the future to expand its operations or change its schedules because, among other factors, slot allocations are subject to changes in government policies.

On October 13, 2006, the Wright Amendment Reform Act of 2006 (the Act) was signed into law by the President. The Act is based on an agreement by the cities of Dallas and Fort Worth, Texas, DFW International Airport, Southwest, and the Company to modify the Wright Amendment, which authorizes certain flight operations at Dallas Love Field within limited geographic areas. Among other things, the Act eventually eliminates domestic geographic restrictions on operations while limiting the maximum number of gates at Love Field. The Company believes the Act is a pragmatic resolution of the issues related to the Wright Amendment and the use of Love Field.

**Environmental Matters** The Company is subject to various laws and government regulations concerning environmental matters and employee safety and health in the U.S. and other countries. U.S. federal laws that have a particular impact on the Company include the Airport Noise and Capacity Act of 1990 (ANCA), the Clean Air Act, the Resource Conservation and Recovery Act, the Clean Water Act, the Safe Drinking Water Act, and the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or the Superfund Act). Certain operations of the Company are also subject to the oversight of the Occupational Safety and Health Administration (OSHA) concerning employee safety and health matters. The U.S. Environmental Protection Agency (EPA), OSHA, and other federal agencies have been authorized to promulgate regulations that have an impact on the Company's operations. In addition to these federal activities, various states have been delegated certain authorities under the aforementioned federal statutes. Many state and local governments have adopted environmental and employee safety and health laws and regulations, some of which are similar to or stricter than federal requirements.

The ANCA recognizes the rights of airport operators with noise problems to implement local noise abatement programs so long as they do not interfere unreasonably with interstate or foreign commerce or the national air transportation system. Authorities in several cities have promulgated aircraft noise reduction programs, including the imposition of nighttime curfews. The ANCA generally requires FAA approval of local noise restrictions on aircraft. While the Company has had sufficient scheduling flexibility to accommodate local noise restrictions imposed to date, the Company's operations could be adversely affected if locally-imposed regulations become more restrictive or widespread.

Many aspects of the Company's operations are subject to increasingly stringent environmental regulations. Concerns about climate change and greenhouse gas emissions, in particular, may result in the imposition of additional regulation. For example, the European Commission is currently seeking to impose emissions controls on all flights coming into Europe. Such regulatory action by the U.S. or foreign governments in the future may adversely affect the Company's business and financial results.

American is a named potentially responsible party (PRP) at the former Operating Industries, Inc. Landfill in Monterrey Park, CA (OII). American is participating with a number of other PRPs in a Steering Committee that have entered into a series of partial consent decrees with EPA and the State of California which address specific aspects of investigation and cleanup at OII. American's alleged volumetric contributions at OII are small when compared with those of other PRPs, and American expects that any future payments will be immaterial.

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American also has been named as a PRP for soil contamination at the Double Eagle Superfund Site in Oklahoma City, OK (Double Eagle). American's alleged volumetric contributions are small when compared with those of other PRPs. American is participating with a number of other PRPs at Double Eagle in a Joint Defense Group that is currently conducting settlement negotiations with the EPA and state officials. The group is seeking a settlement on behalf of its members that will enable American to resolve its past and present liabilities at Double Eagle in exchange for a one-time, lump-sum settlement payment. American expects that its payment will be immaterial.

American, along with most other tenants at the San Francisco International Airport (SFIA), has been ordered by the California Regional Water Quality Control Board to engage in various studies of potential environmental contamination at the airport and to undertake remedial measures, if necessary. In 1997, the SFIA pursued a cost recovery action in the U.S. District Court of Northern California against certain airport tenants to recover past and future costs associated with historic airport contamination. American entered an initial settlement for accrued past costs in 2000. In 2004, American resolved its liability for all remaining past and future costs. Based on SFIA's cost projections, the value of American's second settlement is immaterial and is payable over a 30 year period.

In 1999, American was ordered by the New York State Department of Environmental Conservation (NYSDEC) to conduct remediation of environmental contamination located at Terminals 8 and 9 at JFK. In 2004, American entered a Consent Order with NYSDEC for the remediation of a JFK off-terminal hangar facility. American expects that the projected costs associated with the completion of the JFK remediation will be immaterial.

In 1996, American and Executive, along with other tenants at the Luis Munoz Marin International Airport in San Juan, Puerto Rico (SJU) were notified by the SJU Port Authority that it considered them potentially responsible for environmental contamination at the airport. In 2003, the SJU Port Authority requested that American, among other airport tenants, fund an ongoing subsurface investigation and site assessment. American denied liability for the related costs. No further action has been taken against American or Executive.

Pursuant to an Administrative Order on Consent entered into with NYSDEC, American Eagle is implementing a final remedy to address contamination at an inactive hazardous waste site in Poughkeepsie, New York. The costs of this final remedy are immaterial.

The Company does not expect these matters, individually or collectively, to have a material adverse impact on the Company. See Note 4 to the consolidated financial statements for additional information on accruals related to environmental issues.

#### Labor

The airline business is labor intensive. Wages, salaries and benefits represented approximately 31 percent of the Company's consolidated operating expenses for the year ended December 31, 2007. The average full-time equivalent number of employees of the Company's subsidiaries for the year ended December 31, 2007 was 85,500.

The majority of these employees are represented by labor unions and covered by collective bargaining agreements. Relations with such labor organizations are governed by the Railway Labor Act (RLA). Under this act, the collective bargaining agreements among the Company's subsidiaries and these organizations generally do not expire but instead become amendable as of a stated date. If either party wishes to modify the terms of any such agreement, it must notify the other party in the manner agreed to by the parties. Under the RLA, after receipt of such notice, the parties must meet for direct negotiations, and if no agreement is reached, either party may request the National Mediation Board (NMB) to appoint a federal mediator. The RLA prescribes no set timetable for the direct negotiation and mediation process. It is not unusual for those processes to last for many months, and even for a few years. If no agreement is reached in mediation, the NMB in its discretion may declare at some time that an impasse exists, and if an impasse is declared, the NMB proffers binding arbitration to the parties. Either party may decline to submit to arbitration. If arbitration is rejected by either party, a 30-day "cooling off" period commences. During that

period (or after), a Presidential Emergency Board (PEB) may be established, which examines the parties' positions and recommends a solution. The PEB process lasts for 30 days and is followed by another "cooling off" period of 30 days. At the end of a "cooling off" period, unless an agreement is reached or action is taken by Congress, the labor organization may strike and the airline may resort to "self-help", including the imposition of any or all of its proposed amendments and the hiring of new employees to replace any striking workers.

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In April 2003, American reached agreements (the Labor Agreements) with its three major unions - the Allied Pilots Association (the APA) which represents American's pilots, the Transport Workers Union of America (AFL-CIO) (the TWU), which represents seven different employee groups, and the Association of Professional Flight Attendants (the APFA), which represents American's flight attendants. The Labor Agreements substantially moderated the labor costs associated with the employees represented by the unions. In conjunction with the Labor Agreements, American also implemented various changes in the pay plans and benefits for non-unionized personnel, including officers and other management (the Management Reductions). While the Labor Agreements do not become amendable until 2008, they do allow the parties to begin contract discussions in or after 2006. In 2006, American and the APA commenced negotiations under the RLA. In early 2008, the APA asked that the NMB appoint a mediator. In response, the NMB noted that it is required to docket all facially valid mediation applications. The NMB also expressed an interest in exploring with the parties alternative methods of narrowing the issues prior to entering formal mediation in light of the fact that as of January 29, 2008, no issues had been agreed upon between the parties. Also in 2006, American and the TWU commenced negotiations with respect only to dispatchers, one of the seven groups at American represented by the TWU. In November 2007, American and the TWU commenced negotiations under the RLA with respect to the other employee groups represented by the TWU. The negotiations between American and the APA and TWU employees are still in their early stages. It is anticipated that negotiations between American and the APFA will commence in the first half of 2008.

The Air Line Pilots Association (ALPA), which represents American Eagle pilots, reached agreement with American Eagle effective September 1, 1997, to have all of the pilots of the American Eagle® carriers (currently American Eagle Airlines, Inc. and Executive Airlines, Inc.) covered by a single contract. This agreement lasts until October 31, 2013. The agreement provides to the parties the right to seek limited changes in 2000, 2004, 2008 and 2012. If the parties are unable to agree on the limited changes, the agreement provides that any issues would be resolved by interest arbitration, without the exercise of self-help (such as a strike). ALPA and American Eagle negotiated a tentative agreement in 2000, but that agreement failed in ratification. Thereafter, the parties participated in interest arbitration. The interest arbitration panel determined the limited changes that should be made and these changes were appropriately effected. In 2004, the parties successfully negotiated limited changes that became effective on January 1, 2005. The quadrennial process described above is scheduled to occur in 2008.

The Association of Flight Attendants (AFA) represents the flight attendants of the American Eagle carriers. The current agreement between the American Eagle carriers and the AFA is amendable on October 27, 2009; however, the parties have agreed that contract openers may be exchanged 90 days prior to that date.

The other union employees at the American Eagle carriers are covered by separate agreements with the TWU. The agreements between the American Eagle carriers and the TWU were amendable beginning on October 1, 2007. Negotiations commenced in that month and the parties have reached a tentative agreement on a number of articles. Negotiations are ongoing.

#### Fuel

The Company's operations and financial results are significantly affected by the availability and price of jet fuel. The Company's fuel costs and consumption for the years 2005 through 2007 were:

Year	Gallons Consumed (in millions)	Total Cost (in millions)	Average Cost Per Gallon (in cents)	Percent of AMR's Operating Expenses
2005	3,237	\$ 5,615	173.5	27.0%

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2006	3,178	6,402	201.4	29.8
2007	3,130	6,670	213.1	30.4

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The impact of fuel price changes on the Company and its competitors depends on various factors, including hedging strategies. The Company has a fuel hedging program in which it enters into jet fuel and heating oil hedging contracts to dampen the impact of the volatility of jet fuel prices. During 2007, 2006 and 2005, the Company's fuel hedging program reduced the Company's fuel expense by approximately \$239 million, \$97 million and \$64 million, respectively. As of January 2008, the Company had hedged, with option contracts, primarily heating oil collars and call options, approximately 24 percent of its estimated 2008 fuel requirements. The consumption hedged for 2008 is capped at an average price of approximately \$2.31 per gallon of jet fuel excluding taxes and transportation costs. A deterioration of the Company's financial position could negatively affect the Company's ability to hedge fuel in the future. See the Risk Factors under Item 1A for additional information regarding fuel.

Additional information regarding the Company's fuel program is also included in Item 7(A) – Quantitative and Qualitative Disclosures about Market Risk, Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 7 to the consolidated financial statements.

#### Frequent Flyer Program

American established the AAdvantage frequent flyer program (AAdvantage) to develop passenger loyalty by offering awards to travelers for their continued patronage. The Company believes that the AAdvantage program is one of its competitive strengths. AAdvantage benefits from a growing base of approximately sixty million members with desirable demographics who have demonstrated a strong willingness to collect AAdvantage miles over other loyalty program incentives and are generally disposed to adjusting their purchasing behavior in order to earn additional AAdvantage miles. AAdvantage members earn mileage credits by flying on American, American Eagle, and the American Connection carriers or by using services of other participants in the AAdvantage program. Mileage credits can be redeemed for free, discounted or upgraded travel on American, American Eagle or other participating airlines, or for other awards. Once a member accrues sufficient mileage for an award, the member may book award travel. Most travel awards are subject to capacity controlled seating. A member's mileage credit does not expire provided that member has any type of qualifying activity at least once every 18 months.

American sells mileage credits and related services to other participants in the AAdvantage program. There are over 1,000 program participants, including a leading credit card issuer, hotels, car rental companies and other products and services companies in the AAdvantage program. The Company believes that program participants benefit from the sustained purchasing behavior of AAdvantage members, which translates into a recurring stream of revenues for AAdvantage. Under its agreements with AAdvantage members and program participants, the Company reserves the right to change the AAdvantage program at any time without notice, and may end the program with six months notice. As of December 31, 2007, AAdvantage had approximately 60 million total members, and 613 billion outstanding award miles. During 2007, AAdvantage issued approximately 200 billion miles, of which approximately one-half were sold to program participants. See Critical Accounting Policies and Estimates under Item 7 for more information on AAdvantage.

#### Other Matters

**Seasonality and Other Factors** The Company's results of operations for any interim period are not necessarily indicative of those for the entire year, since the air transportation business is subject to seasonal fluctuations. Higher demand for air travel has traditionally resulted in more favorable operating and financial results for the second and third quarters of the year than for the first and fourth quarters. Fears of terrorism or war, fare initiatives, fluctuations in fuel prices, labor actions, weather and other factors could impact this seasonal pattern. Unaudited quarterly financial data for the two-year period ended December 31, 2007 is included in Note 15 to the consolidated financial statements. In addition, the results of operations in the air transportation business have also significantly fluctuated in the past in response to general economic conditions.

No material part of the business of AMR and its subsidiaries is dependent upon a single customer or very few customers. Consequently, the loss of the Company's largest few customers would not have a materially adverse effect upon the Company.

**Insurance** The Company carries insurance for public liability, passenger liability, property damage and all-risk coverage for damage to its aircraft.

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As a result of the terrorist attacks of September 11, 2001 (the Terrorist Attacks), aviation insurers significantly reduced the amount of insurance coverage available to commercial air carriers for liability to persons other than employees or passengers for claims resulting from acts of terrorism, war or similar events (war-risk coverage). At the same time, these insurers significantly increased the premiums for aviation insurance in general.

The U.S. government has agreed to provide commercial war-risk insurance for U.S. based airlines until August 31, 2008, covering losses to employees, passengers, third parties and aircraft. If the U.S. government does not extend the policy beyond August 31, 2008, or if the U.S. government at anytime thereafter ceases to provide such insurance, or reduces the coverage provided by such insurance, the Company will attempt to purchase similar coverage with narrower scope from commercial insurers at an additional cost. To the extent this coverage is not available at commercially reasonable rates, the Company would be adversely affected. While the price of commercial insurance has declined since the premium increases immediately after the Terrorist Attacks, in the event commercial insurance carriers further reduce the amount of insurance coverage available to the Company, or significantly increase its cost, the Company would be adversely affected.

**Other Government Matters** In time of war or during a national emergency or defense oriented situation, American and other air carriers can be required to provide airlift services to the Air Mobility Command under the Civil Reserve Air Fleet program. In the event the Company has to provide a substantial number of aircraft and crew to the Air Mobility Command, its operations could be adversely impacted.

**Available Information** The Company makes its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 available free of charge under the Investor Relations page on its website, [www.aa.com](http://www.aa.com), as soon as reasonably practicable after such reports are electronically filed with the Securities and Exchange Commission. In addition, the Company's code of ethics, which applies to all employees of the Company, including the Company's Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Controller, is posted under the Investor Relations page on its website, [www.aa.com](http://www.aa.com). The Company intends to disclose any amendments to the code of ethics, or waivers of the code of ethics on behalf of the CEO, CFO or Controller, under the Investor Relations page on the Company's website, [www.aa.com](http://www.aa.com). The charters for the AMR Board of Directors' standing committees (the Audit, Compensation, Diversity and Nominating/Corporate Governance Committees), as well as the Board of Directors' Governance Policies (the Governance Policies), are likewise available on the Company's website, [www.aa.com](http://www.aa.com). Upon request, copies of the charters or the Governance Policies are available at no cost. Information on the Company's website is not incorporated into or otherwise made a part of this Report.

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## ITEM 1A. RISK FACTORS

Our ability to become consistently profitable and our ability to continue to fund our obligations on an ongoing basis will depend on a number of risk factors, many of which are largely beyond our control. Some of the factors that may have a negative impact on us are described below:

As a result of significant losses in recent years, our financial condition has been materially weakened.

We incurred significant losses in recent prior years: \$857 million in 2005, \$751 million in 2004, \$1.2 billion in 2003, \$3.5 billion in 2002 and \$1.8 billion in 2001. As a result, our financial condition was materially weakened, and although we earned a profit in 2007 and 2006, we remain vulnerable both to unexpected events (such as additional terrorist attacks or a sudden spike in jet fuel prices) and to general declines in the operating environment (such as that resulting from a recession or significant increased competition).

Our initiatives to generate additional revenues and to reduce our costs may not be adequate or successful.

As we seek to improve our financial condition, we must continue to take steps to generate additional revenues and to reduce our costs. Although we have a number of initiatives underway to address our cost and revenue challenges, some of these initiatives involve changes to our business which we may be unable to implement. In addition, we expect that, as time goes on, it will be progressively more difficult to identify and implement significant revenue enhancement and cost savings initiatives. The adequacy and ultimate success of our initiatives to generate additional revenues and reduce our costs are not known at this time and cannot be assured. Moreover, whether our initiatives will be adequate or successful depends in large measure on factors beyond our control, notably the overall industry environment, including passenger demand, yield and industry capacity growth, and fuel prices. Given the competitive challenges we face and other factors, such as high fuel prices, that are beyond our control, we must continue to aggressively pursue profit improvement initiatives to achieve long-term success.

Our business is affected by many changing economic and other conditions beyond our control, and our results of operations tend to be volatile and fluctuate due to seasonality.

Our business and our results of operations are affected by many changing economic and other conditions beyond our control, including among others:

- actual or potential changes in international, national, regional and local economic, business and financial conditions, including recession, inflation and higher interest rates, war, terrorist attacks or political instability;
  - changes in consumer preferences, perceptions, spending patterns or demographic trends;
  - changes in the competitive environment due to industry consolidation and other factors;
    - actual or potential disruptions to the air traffic control system;
  - increases in costs of safety, security and environmental measures;
    - outbreaks of diseases that affect travel behavior; and
    - weather and natural disasters.

As a result, our results of operations tend to be volatile and subject to rapid and unexpected change. In addition, due to generally greater demand for air travel during the summer, our revenues in the second and third quarters of the year tend to be stronger than revenues in the first and fourth quarters of the year.

Our indebtedness and other obligations are substantial and could adversely affect our business and liquidity.

We have and will continue to have a significant amount of indebtedness and obligations to make future payments on aircraft equipment and property leases, and a high proportion of debt to equity capital. We may incur substantial additional debt, including secured debt, and lease obligations in the future. We also have substantial pension funding obligations. Our substantial indebtedness and other obligations could have important consequences. For example, they could:

- limit our ability to obtain additional financing for working capital, capital expenditures, acquisitions and general corporate purposes, or adversely affect the terms on which such financing could be obtained;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness and other obligations, thereby reducing the funds available for other purposes;
  - make us more vulnerable to economic downturns;
- limit our ability to withstand competitive pressures and reduce our flexibility in responding to changing business and economic conditions; or
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate.

We may be unable to comply with our financial covenants.

American has a secured bank credit facility which consists of an undrawn \$255 million revolving credit facility with a final maturity on June 17, 2009, and a fully drawn \$440 million term loan facility, with a final maturity on December 17, 2010 (the Revolving Facility and the Term Loan Facility, respectively, and collectively, the Credit Facility). The Credit Facility contains a liquidity covenant and a ratio of cash flow to fixed charges covenant. We complied with these covenants as of December 31, 2007 and expect to be able to continue to comply with these covenants. However, given fuel prices that are high by historical standards and the volatility of fuel prices and revenues, it is difficult to assess whether we will, in fact, be able to continue to comply with these covenants, and there are no assurances that we will be able to do so. Failure to comply with these covenants would result in a default under the Credit Facility which - - if we did not take steps to obtain a waiver of, or otherwise mitigate, the default - - could result in a default under a significant amount of our other debt and lease obligations, and otherwise have a material adverse impact on us.

We are being adversely affected by increases in fuel prices, and we would be adversely affected by disruptions in the supply of fuel.

Our results are very significantly affected by the price and availability of jet fuel, which are in turn affected by a number of factors beyond our control. Fuel prices are volatile, increased significantly in 2007, and remain very high by historical standards.

Due to the competitive nature of the airline industry, we may not be able to pass on increased fuel prices to customers