10-K 1 d10k.htm FORM 10-K

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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, 2010

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number	Exact Name of Registrant as Specified in its Charter, Principal Office Address and Telephone Number	State of Incorporation	I.R.S. Employer Identification No
001-06033	**United Continental Holdings, Inc.** 77 W. Wacker Drive Chicago, Illinois 60601 (312) 997-8000	Delaware	36-2675207
001-11355	**United Air Lines, Inc.** 77 W. Wacker Drive Chicago, Illinois 60601 (312) 997-8000	Delaware	36-2675206
001-10323	**Continental Airlines, Inc.** 1600 Smith Street, Dept. HQSEO Houston, Texas 77002 (713) 324-2950	Delaware	74-2099724

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

	Title of Each Class	Name of Each Exchange on Which Registered
United Continental Holdings, Inc.	Common Stock, $0.01 par value	New York Stock Exchange
United Air Lines, Inc.	None	None
Continental Airlines, Inc.	None	None

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

United Continental Holdings, Inc.	None	United Air Lines, Inc.	None
Continental Airlines, Inc.	None		

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

United Continental Holdings, Inc.	Yes ☒ No ☐	United Air Lines, Inc.	Yes ☒ No ☐
Continental Airlines, Inc.	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.

United Continental Holdings, Inc.	Yes ☐ No ☒	United Air Lines, Inc.	Yes ☐ No ☒
Continental Airlines, Inc.	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.

United Continental Holdings, Inc.	Yes ☒ No ☐	United Air Lines, Inc.	Yes ☒ No ☐
Continental Airlines, Inc.	Yes ☒ No ☐		

Table of Contents

30 years. Residual values are estimated based on historical experience with regard to the sale of both aircraft and spare parts and are established in conjunction with the estimated useful lives of the related fleets. Residual values are based on current dollars when the aircraft are acquired and typically reflect asset values that have not reached the end of their physical life. Both depreciable lives and residual values are revised periodically to recognize changes in the Company's fleet plan and other relevant information. A one year increase in the average depreciable life of UAL's flight equipment would reduce annual depreciation expense on flight equipment by approximately $36 million.

Benefit Accounting. United's obligations with respect to defined benefit pension plans were substantially eliminated in 2006 as most of the United defined benefit plans were assumed by the PBGC as part of UAL Corporation's emergence from Chapter 11 bankruptcy protection. UAL's pension obligations increased significantly in 2010 due to UAL's assumption of Continental obligations in the Merger. Under applicable accounting guidance, pension expense is recognized on an accrual basis over employees' approximate service periods. UAL only began recognizing the impact of Continental's plans in its financial statements beginning on October 1, 2010.

UAL's plans' under-funded status was $1.5 billion at December 31, 2010, of which $1.4 billion is attributed to Continental's plans. Funding requirements for tax-qualified defined benefit pension plans are determined by government regulations. We estimate that our minimum funding requirements for the Continental plans during calendar year 2011 is approximately $126 million. The fair value of the plans' assets was $1.9 billion at December 31, 2010, of which $1.7 billion is attributed to assets of Continental's plans.

The following discussion relates only to the Continental plans, as the United plans are not significant to UAL's total obligations.

When calculating pension expense for 2011, Continental assumed that its plans' assets would generate a long-term rate of return of 7.75%. The expected long-term rate of return assumption was developed based on historical experience and input from the trustee managing the plans' assets. The expected long-term rate of return on plan assets is based on a target allocation of assets, which is based on a goal of earning the highest rate of return while maintaining risk at acceptable levels. Our projected long-term rate of return is slightly higher than some market indices due to the active management of our plans' assets, and is supported by the historical returns on our plans' assets. The plans strive to have assets sufficiently diversified so that adverse or unexpected results from one security class will not have an unduly detrimental impact on the entire portfolio. We regularly review actual asset allocation and the pension plans' investments are periodically rebalanced to the targeted allocation when considered appropriate.

The defined benefit pension plans' assets consist primarily of equity and fixed-income securities held through common collective trusts. Equity securities include investments in large-cap and small-cap companies. Fixed-income securities include corporate bonds of companies in diversified industries and asset and mortgage-backed securities. Investments in equity securities and fixed-income securities are commingled funds valued at the unit of participation value of shares held by the plans' trusts. The private equity funds invest primarily in common stock of companies in diversified industries and in buyout, venture capital and special situation funds. Investments in private equity funds are valued at the net asset value of shares held by the plans' trusts at year end. The allocation of assets was as follows at December 31, 2010:

	Percent of Total	Expected Long-Term Rate of Return
Equity security funds:		
U.S. companies	50%	8%
International companies	21	8
Fixed-income securities	20	5
Private equity funds	9	10

Table of Contents

Pension expense increases as the expected rate of return on plan assets decreases. When calculating pension expense for 2011, we will assume that our plans' assets will generate a weighted-average long-term rate of return of 7.75%. Lowering the expected long-term rate of return on plan assets by an additional 50 basis points (from 7.75% to 7.25%) would increase UAL's estimated 2011 pension expense by approximately $8 million.

Future pension obligations for the Continental plans were discounted using a weighted average rate of 5.52% at December 31, 2010. UAL determines the appropriate discount rate for each of its plans based on current rates on high quality corporate bonds that would generate the cash flow necessary to pay plan benefits when due. This approach can result in different discount rates for different plans, depending on each plan's projected benefit payments. The pension liability and future pension expense both increase as the discount rate is reduced. Lowering the discount rate by 50 basis points (from 5.52% to 5.02%) would increase the pension liability at December 31, 2010 by approximately $290 million and increase the estimated 2011 pension expense by approximately $36 million.

Future changes in plan asset returns, plan provisions, assumed discount rates, pension funding law and various other factors related to the participants in our pension plans will impact our future pension expense and liabilities. We cannot predict with certainty what these factors will be in the future.

Other Postretirement Benefit Accounting. United's postretirement plan provides certain health care benefits, primarily in the U.S., to retirees and eligible dependents, as well as certain life insurance benefits to certain retirees reflected as "Other Benefits." Continental's retiree medical programs permit retirees who meet certain age and service requirements to continue medical coverage between retirement and Medicare eligibility. Eligible employees are required to pay a portion of the costs of their retiree medical benefits, which in some cases may be offset by accumulated unused sick time at the time of their retirement. Plan benefits are subject to co-payments, deductibles and other limits as described in the plans.

The Company accounts for other postretirement benefits by recognizing the difference between plan assets and obligations, or the plan's funded status, in its financial statements. Under GAAP, other postretirement benefit expense is recognized on an accrual basis over employees' approximate service periods and is generally calculated independently of funding decisions or requirements. The Company has not been required to pre-fund its current and future plan obligations, which has resulted in a significant net obligation, as discussed below.

UAL's benefit obligation was $2.5 billion and $2.1 billion for the other postretirement benefit plans at December 31, 2010 and 2009, respectively. The year-over-year increase is due to Continental plan obligations assumed by UAL in the Merger, as well as changes in the assumptions used to value the obligation for United's plan, such as the decrease in the discount rate.

The calculation of other postretirement benefit expense and obligations requires the use of a number of assumptions, including the assumed discount rate for measuring future payment obligations and the health care cost trend rate. UAL determines the appropriate discount rate for each of its plans based on current rates on high quality corporate bonds that would generate the cash flow necessary to pay plan benefits when due. UAL's weighted average discount rate to determine its benefit obligations as of December 31, 2010 was 5.13%, as compared to 5.69% for December 31, 2009. The health care cost trend rate assumed by United and Continental for 2010 was 8.5% and 7.5%, respectively, as compared to assumed trend rates for 2011 of 8.0% and 7.5%, respectively. A 1.0% increase/(decrease) in assumed health care trend rates would increase/(decrease) UAL's total service and interest cost for the year ended December 31, 2010 by $20 million/($16 million), respectively. Detailed information regarding the Company's other postretirement plans, including key assumptions, is included in Note 9 to the financial statements in Item 8 of this report.

Actuarial gains or losses are triggered by changes in assumptions or experience that differ from the original assumptions. Under the applicable accounting standards, those gains and losses are not required to be recognized currently as other postretirement expense, but instead may be deferred as part of accumulated other comprehensive

Table of Contents

income and amortized into expense over the average remaining service life of the covered active employees. The Company's accounting policy is to not apply the corridor approach available under applicable GAAP with respect to amortization of amounts included in accumulated other comprehensive income. Under the corridor approach, amortization of any gain or loss in accumulated other comprehensive income is required only if, at the beginning of the year, the accumulated gain or loss exceeds 10% of the greater of the benefit obligation or the fair value of assets. If amortization is required, the minimum amount outside the corridor divided by the average remaining service period of active employees is recognized as expense. The corridor approach is intended to reduce volatility of amounts recorded in pension expense each year. Since the Company has elected not to apply the corridor approach, all gains and losses in accumulated other comprehensive income are amortized to expense over the remaining years of service of the covered active employees. At December 31, 2010 and 2009, UAL had unrecognized actuarial gains of $24 million and $155 million, respectively, recorded in accumulated other comprehensive income for its other postretirement benefit plans.

Business Combination Measurements. In accordance with applicable accounting standards, UAL estimated the fair value of Continental's assets and liabilities as of the closing date of the Merger, October 1, 2010. These fair value measurements did not result in gains or losses, but were instead an input to the calculation of goodwill related to the excess of purchase price over the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed from Continental in the Merger. Additional changes in the fair values of these assets and liabilities from the current estimated values, as well as changes in other assumptions, could significantly impact the reported value of goodwill.

The fair values of the assets acquired and liabilities assumed were determined using the market, income and cost approaches. The fair value measurements were primarily based on significant inputs that are not observable in the market other than for derivative financial instruments and certain long-term debt assumed in the Merger. The market approach, which indicates value for a subject asset based on available market pricing for comparable assets, was utilized to estimate the fair value of Continental's aircraft and operating leases. The market approach used by the Company included prices and other relevant information generated by market transactions involving comparable assets, as well as pricing guides and other sources. We considered the current market for the aircraft, the maintenance condition of the aircraft and the expected proceeds from the sale of the assets, among other factors. We also utilized the market approach to value certain intangible assets such as airport take-off and landing slots when sufficient market information was available. The income approach was primarily used to value intangible assets, including the frequent flyer database, international route authorities, alliances, the Continental logo and tradename, and certain airport take-off and landing slots. The income approach indicates value for a subject asset based on the present value of cash flows projected to be generated by the asset. Projected cash flows are discounted at a required market rate of return that reflects the relative risk of achieving the cash flows and the time value of money. The cost approach, which estimates value by determining the current cost of replacing an asset with another of equivalent economic utility, was used, as appropriate, for certain assets for which the market and income approaches could not be applied due to the nature of the asset. The cost to replace a given asset reflects the estimated reproduction or replacement cost for the asset, less an allowance for loss in value due to depreciation.

The fair value of Continental's pension and postretirement plans was determined by measuring the plans funded status as of the Merger closing date. Any excess projected benefit obligation over the fair value of plan assets was recognized as a liability. One of the significant assumptions in determining the projected benefit obligation is the discount rate. We determined the appropriate discount rate for each of the plans based on current rates on high quality corporate bonds that would generate the cash flow necessary to pay plan benefits when due, which resulted in a discount rate of 5.2% for pension plans and 4.6% for postretirement plans. Other significant assumptions include the healthcare cost trend rate, retirement age, and mortality assumptions. These assumptions are discussed further in Note 9 to the financial statements in Item 8.