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Labor and Employment Committee

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If the Bankruptcy Process Takes Away Employees' Wages, Medical, Retiree and Other Benefits to Save Costs, Who Gets the Value?

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Corporate chapter 11 debtors have long used the bankruptcy process to not only restructure their institutional and vendor debt and obligations, but also to reduce their obligations to current and retired employees. These obligations include current wages and salaries, pension contributions, and payments for medical, retiree and other benefits. Debtors argue that the extraction of this value is crucial to such a debtor's recovery, a but-for piece of the reorganization puzzle.

In several recent cases, however, the debtors have taken the value from employees and redistributed that value to other holders of general unsecured claims, and even old equity. Arguably, this approach does not further the goals of chapter 11.

In the *Hostess* cases, for example, the debtors chose to continue operating while conducting liquidation under the protection of chapter 11. The Bankruptcy Code requires a debtor to pay its post-petition operating expenses in full. While Hostess did pay some operating expenses, it cherry-picked which post-petition expenses to pay, and in these cases chose not to satisfy all their employee obligations and not to make pension contributions for much of the pendency of the chapter 11 cases.

This is in line with a trend of cases where debtors, to maximize secured lender recoveries in liquidation scenarios, are being permitted to choose to pay only the "important" post-bankruptcy filing administrative expenses—allowing, among other expenses, pension and benefit claims to grow during the pendency of the cases. That value is then arguably captured in the sale or plan of reorganization process and ultimately redistributed to other creditors.

In another example, the debtors in the *American Airlines* bankruptcy extracted significant concessions from the employees early in the case only to seek to distribute that value to other general unsecured creditors and even old equity at the end of the case. A few months after it commenced its bankruptcy case, American Airlines initiated an aggressive process to modify collective bargaining agreements and non-union employee agreements to save more than $1 billion in labor costs. There was no debtor-in-possession financing that required any labor concessions, no threat of pending liquidation, or any other emergency triggering an immediate need for Bankruptcy Code § 1113 or other employee-related relief. The company asserted, however, that the concessions were necessary to achieve a successful stand-alone business plan, even though it was far from clear that American Airlines would emerge from bankruptcy as a stand-alone entity.

Generally, chapter 11 provides a forum for the various constituencies with an interest in the debtor to come together to negotiate and formulate a business plan to enable the debtor to reorganize, or to liquidate the debtor's assets to maximize recoveries. The debtor's eventual capital structure and business plan negotiations should evolve with the input of all of the debtor's constituencies, including labor, and should be premised on the ultimate business plan that will be embodied in a plan of reorganization. Employees should not be asked to negotiate first in a vacuum against a straw business plan model. Ultimately, each constituency should measure its treatment against the treatment afforded other creditors in the context of the priorities established by the Bankruptcy Code.

In *American Airlines*, the debtors focused on employee concessions first and extracted real reductions marked against a stand-alone business plan, only to abandon its stand-alone "business plan" when negotiations with all constituencies led to the negotiation of a proposed merger with U.S. Airlines—the same result that American Airlines rejected at the beginning of the case. The resulting proposed merger may result in a distribution to all other general unsecured creditors of value equal to the full amount of their claims, and may even yield a small recovery to old equity.

Compelling the court to make a § 1113 determination on the basis of a hypothetical business plan, as was done in *American Airlines*, runs contrary to the fundamental principles of the Bankruptcy Code. This process allows a debtor to extract concessions from one constituency and reallocate that value for the benefit of another, and arguably violates the

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fundamental principle of shared sacrifice that is embodied in § 1113 of the Bankruptcy Code. Where a collective bargaining agreement is modified, either pursuant to a court order or by agreement, in the face of the § 1113 process, or pension, benefit or other employee concessions reduce costs, query whether it is fundamentally unfair to permit unsecured creditors to receive payment in full or to provide for any recovery to old equity, unless and until the full value given up under affected collective bargaining agreements is returned to the represented employees that made the sacrifice.