University of Miami Law School
University of Miami School of Law Institutional Repository

Articles | Faculty and Deans

Winter 2015

Labor Activism in Bankruptcy

Andrew B. Dawson

Follow this and additional works at: https://repository.law.miami.edu/fac_articles

Part of the Bankruptcy Law Commons, and the Labor and Employment Law Commons

Labor Activism in Bankruptcy

by

*Andrew B. Dawson**

This article analyzes the role of labor unions in corporate reorganizations and argues that labor union participation can improve corporate governance in the bankruptcy context. Generally, when a unionized corporation seeks to reorganize in bankruptcy, it does so with an eye towards obtaining concessions from its labor unions. The Bankruptcy Code permits corporate debtors to reject their collective bargaining agreements and to impose reduced wages and benefits, thus placing labor unions in a position of bargaining over concessions in bankruptcy. Such concession bargaining is vitally important to the labor union and to the debtor's reorganization efforts; however, the focus on concession bargaining overlooks the more activist role labor unions can, and do, play in corporate bankruptcy governance.

Labor unions have long played an important governance role when a corporation has suffered financial distress and sought protection under the Bankruptcy Code. This was true during the struggles of Pan Am Airlines in the late 1980s, and it was true in the more recent struggles of American Airlines. Current bankruptcy practice, characterized by a competition among creditors for control of the distressed corporation, has created an environment in which such labor participation is increasingly likely to occur. Further, labor participation in the current dynamics of Chapter 11 reorganizations may be especially important for corporate governance in this setting. Labor unions, with their inside information as to the corporation's practices and their unique perspective of managerial conduct, may improve decision making in the bankruptcy context by providing greater information about the bankrupt firm. In the competitive market for corporate control, such information may be a valuable currency that can help improve outcomes in Chapter 11 cases.

If labor union participation can improve upon bankruptcy governance, it is worthwhile to consider whether in an era of ever-decreasing unionization the bankruptcy laws could be changed in order to provide representation to non-unionized employees. While such committees are already permissible under cur-

*Associate Professor, University of Miami School of Law. I would like to thank Sergio Campos, Francis Hill, Felix Mormann, Dennis Lynch, Chrystin Ondersma, Elliott Manning, Cesar Rosado, Steven R. Schwartz, William H. Widen, the participants at the 2013 LatCrit Conference, and my colleagues at the University of Miami faculty workshop for helpful comments or discussions. In addition, thanks to Kayleigh McEnany, Evan Stroman, Samuel Winikoff, and Dan Wolfe for excellent research assistance. Any errors are my own.

rent bankruptcy law, they are rarely used, in part, because of their perceived costs. The value contributed by labor union participation, however, suggests that these costs should be reconsidered in light of the benefits such committees can provide.

INTRODUCTION

Labor unions have received considerable attention in several recent high profile bankruptcies, from the corporate reorganizations of American Airlines and Hostess Bakeries to the municipal bankruptcy of the city of Detroit. Popular media has either blamed labor unions for their employers' financial distress or expressed dismay when bankruptcy law is used as a "union busting" procedure.[1] The academic literature in this area has focused on the appropriate legal standard for determining whether a debtor should be permitted to reject its collective bargaining agreements in bankruptcy and on determining the consequences of rejection.[2] These discussions have focused principally on concession bargaining: should corporate debtors be able to use bankruptcy as a lever to obtain concessions from labor unions? That is, these discussions cast labor unions as concession bargaining agents in bankruptcy.

Missing from this discussion is the role labor unions have played in developing and negotiating for a reorganization plan for their employers. Labor unions have shaped corporate reorganization plans by playing the role of activist stakeholder in addition to, or instead of, their traditional role of concession bargaining agent. For example, the labor union representing the bakers in Hostess Bakeries effectively forced the company to forego a stand-alone reorganization and instead liquidate the business, and the pilots' union pushed American Airlines away from a stand-alone reorganization and towards a merger with US Airways.[3]

Labor unions' roles as activist stakeholder and concession bargaining agent are interrelated, as illustrated in the American Airlines bankruptcy in Part II *infra*, in which the pilots' union ultimately made concessions to the

[1] *See, e.g.*, Michael Brownfield, *Big Labor Drags American Airlines into Bankruptcy*, THE DAILY SIGNAL (November 29, 2011), http://www.dailysignal.com/2011/11/29/big-labor-drugs-american-airlines-into-bankruptcy; Jordan Weissman, *Who's to Blame for the Hostess Bankruptcy: Wall Street, Unions, or Carbs?*, THE ATLANTIC (Nov. 16, 2012, 6:02 PM), *available at* http://www.theatlantic.com/business/archive/2012/11/whos-to-blame-for-the-hostess-bankruptcy-wall-street-unions-or-carbs/265357.

[2] *See, e.g.*, Christopher D. Cameron, *How "Necessary" Became the Mother of Rejection: An Empirical Look at the Fate of Collective Bargaining Agreements on the Tenth Anniversary of Bankruptcy Code Section 1113*, 34 SANTA CLARA L. REV. 841, 869 (1994); Marc S. Kirschner, Willis J. Goldsmith, Lawrence P. Gottesman, Deena B. Jenab, & Jay G. Swardenski, *Tossing the Coin Under Section 1113: Heads or Tails, the Union Wins*, 23 SETON HALL L. REV. 1534-35 (1993); Michael St. Patrick Baxter, *Is There a Claim for Damages from the Rejection of a Collective Bargaining Agreement Under Section 1113 of the Bankruptcy Code?*, 12 BANK. DEV. J. 703, 721-22 (1993).

[3] *See infra* section II.

airline as part of its strategy with the creditors to push the airline towards a merger. This article distinguishes these two roles analytically, "unbundling" labor union's stakeholder activism from the collective bargaining role.[4] Disaggregating these functions facilitates evaluation of labor unions' activist role ("labor union activism") separate from their role in collective bargaining. It further helps begin the conversation for considering the potential role of non-unionized employees in bankruptcy, a much larger topic that is worth considering given the declining unionization rate of American workers.

Labor union activism in bankruptcy is not a new phenomenon, but current corporate reorganization practice potentially makes labor participation increasingly an important factor in bankruptcy decision making. Labor unions played a role in the reorganizations of Pan Am and Frontier Airlines in the 1980s just as they played a role in the recent reorganization of American Airlines.[5] Recent corporate reorganization practice, however, has created governance dynamics in bankruptcy that create both greater opportunities and greater incentives for labor unions to participate in corporate decision making in the Chapter 11 context.

As Professors Ayotte and Morrison have argued based on their empirical examination of corporate reorganizations, bankruptcy governance has become characterized by the competition for control among various creditor groups.[6] Creditor competition has turned corporate reorganization into a forum for market-based solutions to financial distress.[7] This creditor competition can make labor unions' interests—already vulnerable given the Bankruptcy Code authority for corporate debtors to reject collective bargaining agreements[8]—even more vulnerable, as creditor groups may target labor costs in order to

---

[4]The concept of "unbundling" representation from collective bargaining is based on Benjamin I. Sachs's article *The Unbundled Union: Politics Without Collective Bargaining*, 123 YALE L. J. 148, 182 (2013), in which he discusses the unbundling of the collective bargaining function of labor unions from their political representation function.

[5]*See* Katherine Van Wezel Stone, *Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities*, 55 U. CHI. L. REV. 73, 75-76 (1988).

[6]*See* Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511 (2009) and discussion *infra* in section I.A; *see also* Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 473 (2011) ("The goals of the corporation and its new set of creditors can and often do conflict. In addition, intercreditor conflict can develop as creditors compete for control of the corporation's restructuring. Consequently, the corporation's Chapter 11 bankruptcy case can become a battleground for resolving conflict rather than a neutral site for building consensus.").

[7]Jonathan C. Lipson & Christopher M. DiVirgilio, *Controlling the Market for Information in Reorganization*, 18 AM. BANKR. INST. L. REV. 647, 654 (2010) ("The marketization of business failure has been driven largely by two phenomena: (1) the growth of secondary markets for claims against distressed firms, and (2) the growth of large, private pools of capital that purchase these claims, or other interests in, or assets of, troubled companies.") (footnote omitted).

[8]11 U.S.C. § 1113 provides for the rejection of collective bargaining agreements, discussed in greater detail *infra* in section II.

maximize returns on their claims against the debtor.[9]

At the same time, in this marketplace for corporate control of the distressed firm, information about the firm is a valuable commodity,[10] and labor unions may have information about the firm that other stakeholders and interested parties may lack. Labor unions, consequently, can play a significant role in current corporate bankruptcy dynamics.

This article argues that this information-sharing function from labor unions has the potential to improve bankruptcy governance. That is, by sharing information about the distressed firm, labor union participation in corporate reorganizations may make it more likely that bankruptcy will maximize returns to creditors. Currently, corporate reorganizations have been criticized for facilitating asset fire sales that benefit no one other than the secured creditors.[11] These sales have been criticized as being procedurally unfair[12], as distorting resource allocation decisions[13], and as failing to maximize the value of the assets.[14] Even though bankruptcy asset sales have the potential to maximize a debtor's assets by enabling the debtor to sell the assets free of all claims and interests, these asset sales have been shown to yield below market returns.[15]

The ideal solution to improving bankruptcy governance may be through amendments to the Bankruptcy Code, such as by creating an unbiased "case facilitator," as suggested by Michelle Harner.[16] Labor union activism, how-

[9]*See, e.g.*, David A. Skeel, Jr., *Employees, Pensions, and Governance in Chapter 11*, 82 WASH. U. L. Q. 1469, 1481 (2004) (discussing role of controlling creditor in pushing the debtor to seek concessions from labor unions and citing the first US Airways bankruptcy as an example).

[10]Lipson & DiVirgilio, *supra* note 7, at 655 ("Like all markets, the market for control of distressed firms depends on two things: money and information.").

[11]Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11*, 2013 U. ILL. L. REV. 103, 105 (2013) ("One shot that those senior secured lenders call repeatedly is to sell the firm's assets, lock, stock, and barrel, in the incipient stages of the case.").

[12]*Id.* at 143 (arguing that a secured creditor's right to credit bid at such sales turns bankruptcy into little more than a foreclosure sale).

[13]Ayotte & Morrison, *supra* note 6, at 511 ("We also find that bargaining between secured and unsecured creditors can distort the reorganization process. A Chapter 11 case is significantly more likely to result in a sale if secured lenders are oversecured, consistent with a secured creditor-driven fire-sale bias. A sale is much less likely when these lenders are undersecured or when the firm has no secured debt at all. Our results suggest that the advent of creditor control has not eliminated the fundamental inefficiency of the bankruptcy process: resource allocation questions (whether to sell or reorganize a firm) are ultimately confounded with distributional questions (how much each creditor will receive) due to conflict among creditor classes.").

[14]Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 4 (2007) (presenting empirical support for argument "that creditors and shareholders can more than double their recoveries by reorganizing large public companies instead of selling them").

[15]Anne M. Anderson & Yung-Yu Ma, *Acquisitions in Bankruptcy: 363 Sales Versus Plan Sales and the Existence of Fire Sales*, 22 AM. BANKR. INST. L. REV. 1, 17 (2014).

[16]Harner, *supra* note 6, at 475 ("This Article suggests an alternative approach for preserving estate value in the Chapter 11 context: a third-party neutral appointed by the court to participate in the process. The Article refers to this neutral as a 'case facilitator.'").

ever, may be a second-best solution in the absence of legislative reform. Labor union activism has the potential to provide a valuable counterbalance to creditor control. Labor unions tend to hold a long position in the debtor-employer, and therefore would likely favor rehabilitation over an asset sale. In addition, labor unions may be able to contribute information that would help evaluate the decision to sell as well as the sale value.

Labor union activism will likely impose some costs, as labor unions are likely biased towards reorganization, even when reorganization may not be in the interest of all creditors.[17] Labor union activism, according to some, may also impose costs as labor unions may seek to impose a plan of reorganization that fails to recognize changing economic realities.[18] And from an allocative efficiency standpoint, bankruptcy governance should be in the hands of the residual claimants, i.e., those stakeholders who stand to reap the marginal gain and to suffer the marginal loss of bankruptcy investment decisions.[19] While scholars struggle to identify which creditors share these attributes, it is highly unlikely labor unions would ever be the residual claimants.

Ultimately, though, because labor union activism operates through Chapter 11's marketplace for corporate control, it will be the market that determines whether the benefits of labor union activism outweigh their costs. This, again, is not a perfect solution to current bankruptcy governance problems. Labor unions introduce their own bias into the reorganization proceeding, and with the decline of unionization in this country, labor union presence in corporate reorganizations is likewise declining. Nonetheless, it is the hope of this article to separate the activist-type role of labor unions from the traditional bargaining role. Perhaps by separating activism from traditional bargaining, it will be possible to imagine a role for non-unionized employees to play an activist role through committee representation in Chapter 11.

This article begins in Part I by situating labor union activism within the dynamics of corporate governance in Chapter 11 reorganizations. This first part of the paper describes the traditional concession bargaining role of labor

---

[17]Harvey R. Miller, Michele J. Meises & Christopher Marcus, *The State of the Unions in Reorganization and Restructuring Cases*, 15 AM. BANKR. INST. L. REV. 465, 483 (2007) (arguing that granting a rejection damage claim to labor unions would make reorganization more difficult because "[t]he objectives of the union and those of other creditors may be adverse and prejudice the prospects of reorganization.").

[18]*Id.* at 497 ("Unfortunately, many labor representatives are caught in a time warp and believe that the economy still is operating in the economic climate of the 1950s and 1960s."); *see also* Hon. William T. Bodoh & Beth A. Buchanan, *Ignored Consequences-The Conflicting Policies of Labor Law and Business Reorganization and Its Impact on Organized Labor*, 15 AM. BANKR. INST. L. REV. 395, 413 (2007) (observing that "[i]n the end, a union's effort in forestalling a debtor's reorganization is a hollow victory if the debtor's reorganizing efforts ultimately fail" and then collecting cases at note 89).

[19]*See* Ayotte & Morrison, *supra* note 6, at 539 (concluding that creditor conflict can result in a misallocation of resources because it puts resource allocation decisions in the hands of non-residual claimants).

unions in bankruptcy. It then considers how creditor competition in Chapter 11 governance has affected this concession bargaining, with a particular focus on the prominence of creditor-driven asset fire sales. This first part concludes by considering how this creditor competition and resultant market place for corporate control can enable labor unions to impact the reorganization process.

Part II of the paper illustrates these dynamics through three case studies, the first two of Hostess Bakeries as it made its way through bankruptcy first in 2004 and then again in 2012, only three years after emerging from its first attempted reorganization. The third case study is that of American Airlines, which filed for bankruptcy protection in 2011. The airline filed bankruptcy in an attempt to cut labor costs and emerge as a stand-alone entity. It emerged from bankruptcy by merging with US Airways, in part due to the influence of the airline pilots' labor union.

Part III evaluates labor participation from a bankruptcy policy perspective. Even though bankruptcy policy can be readily reduced to a simple statement that bankruptcy law should preserve a debtor's going concern value and maximize the value of its assets, in practice this statement poses significant difficulties, as these two goals may be in direct tension. Furthermore, evaluating whether a particular reorganization maximizes the value of assets requires a comparison with a hypothetical valuation of alternative courses of action. Valuation problems make it difficult, if not impossible to determine whether any particular course of action is value maximizing. Nonetheless, this section urges that the current market for corporate control can provide a market-based means of ensuring assets are put to their most efficient use. This market for corporate control, however, depends in part on creditors' access to information about the corporation. Labor union participation can potentially provide additional information to the reorganization process in order to improve chances that the reorganization plan will in fact maximize the debtor's assets. Whether labor union participation will perform this role is market-driven—labor unions can effect change only to the extent that other creditors place a value on the information unions can provide.

Part IV then briefly considers whether, in an era of very low (and declining) unionization, bankruptcy governance may be improved by the appointment of a committee to represent non-unionized workers. Such committees already are permissible under the Bankruptcy Code, but when they are appointed, they are generally viewed as a litigation vehicle to determine employee claims against the debtor's estate. An employee committee could, in theory, be appointed to serve the functions that have been performed by labor unions: represent employees' ongoing interest in their employer and provide a means for employees to "sell" their information value to other creditors. While there would be costs and complexities in appointing an employee

committee for this purpose, this article suggests that it is worth considering the use of such an employee committee in some cases in order to improve bankruptcy governance. Part V then concludes.

I. LABOR UNIONS: CONCESSION BARGAINING AND ACTIVISM

Current scholarship and media attention on unionized workers in bankruptcy have focused on the employer's ability to use bankruptcy law to cut wages and benefits. The Bankruptcy Code gives debtors a powerful tool not available otherwise: debtors can reject their unexpired collective bargaining agreements.[20] Collective bargaining agreements are contract-like agreements between an employer and a group of employees that have elected to be collectively represented. The National Labor Relations Act requires that employers and employee representatives bargain "with respect to wages, hours, and other terms and conditions of employment . . . but such obligations does not compel either party to agree to a proposal or require the making of a concession."[21] Under the Railway Labor Act, this duty to bargain is even higher, as carriers and employees have a duty "to exert every reasonable effort to make and maintain agreements concerning rates of pay, rules, and working conditions, and to settle all disputes."[22]

Even though labor laws do not require the parties to enter collective bargaining agreements, once the parties enter an agreement they are not allowed to modify it while in effect. To deviate from the collective bargaining agreement is to commit an unfair labor practice.[23]

Bankruptcy law provides a way around this through § 1113, which provides that a debtor may reject a collective bargaining agreement.[24] The debtor must satisfy several procedural requirements, such as giving a proposal to the unions listing desired modifications to the collective bargaining agreement, meeting with the union, and providing the union with sufficient information to evaluate the proposal.[25] If the union rejects the proposal, the court can authorize the debtor to reject the collective bargaining agreement if it finds that the union's rejection was without cause and that the proposed modifications are necessary for the debtor to reorganize.[26]

While this process in theory provides for a bargaining role for labor unions in corporate reorganizations, it restricts that bargaining role to the nar-

[20] 11 U.S.C. § 1113 (2004).
[21] 29 U.S.C. § 158(d) (2006).
[22] 45 U.S.C. § 152 (2006).
[23] 29 U.S.C. § 158(a)(1), (a)(5) (2006).
[24] 11 U.S.C. § 1113 (2004).
[25] *Id.* § 1113(b) (2004).
[26] *Id.* § 1113(c) (2004).

row range of labor law's mandatory bargaining subjects, that is, wages and benefits.[27] It does not open the door to the union negotiating over whether the debtor should seek to reorganize its balance sheet, sell divisions of the corporation, or merge in bankruptcy.

Private employers (and even municipalities now, as seen in the bankruptcy filings of Detroit and Stockton, California) have invoked the power to reject collective bargaining agreements as a central part of their reorganization strategy. Bankruptcy professionals have dubbed such cases as "labor transformation cases."[28]

Most of the academic literature in this area has focused on labor unions' role in participating in concession bargaining under § 1113, evaluating whether bankruptcy law adequately protects labor law policies in bankruptcy or whether § 1113's standards make it too inviting for a debtor to file a "labor transformation case."

Some have argued that this power to reject is an important one to maximize returns to creditors and to preserve jobs for employees. They have further argued that labor unions retain sufficient negotiation leverage in bankruptcy through their right to strike (although that right has been called into question for airline bankruptcies under the Railway Labor Act[29]).[30]

Others have argued that the power to reject has turned bankruptcy from a vehicle for corporate rehabilitation into a tool for busting unions. Labor unions for years have sought to amend the Bankruptcy Code provisions deal-

---

[27]Donald R. Korobkin, *Employee Interests in Bankruptcy*, 4 AM. BANKR. INST. L. REV. 5, 29 (1996) ("Furthermore, the influence of a union is generally limited to subjects covered by the collective bargaining agreement. Fundamental business policy remains securely within the zone of 'managerial prerogative.' As a consequence, even employees represented by a union may have only a marginal voice on many of the debtor's most important decisions."); *see also* James Friedman, *Keeping Big Issues Off the Table: The Supreme Court on Entrepreneurial Discretion and the Duty to Bargain*, 37 ME. L. REV. 223 (1985) (regarding distinction between mandatory and non-mandatory subjects of bargaining under labor laws).

[28]Babette A. Ceccotti, *Lost in Transformation: The Disappearance of Labor Policies in Applying Section 1113 of the Bankruptcy Code*, 15 AM. BANKR. INST. L. REV. 415, 417 (2007) ("How, then, to explain the wave of bankruptcy cases targeting significant reductions in labor costs, pension funding, and retiree health obligations that has surged through the airline industry, the steel industry, auto supply and other heavily unionized industries in recent years? Restructuring professionals have denominated these cases 'labor transformation' bankruptcies. They have in common the strategic use of bankruptcy to bring about broad changes to a business, largely through substantial cost-cutting, to address conditions that are ascribed to fundamental industry change.") (footnotes omitted).

[29]*See Nw. Airlines Corp. v. Ass'n of Flight Attendants-CWA (In re Nw. Airlines Corp.)*, 483 F.3d 160, 164 (2d Cir. 2007); Richard M. Seltzer & Thomas N. Ciantra, *The Return of Government by Injunction in Airline Bankruptcies*, 15 Am. Bankr. Inst. L. Rev. 499, 500 (2007).

[30]Miller, Meises & Marcus, *supra* note 17, at 495 ("As Delphi and similar cases demonstrate, despite a potentially favorable result from a rejection motion for the DIP, unions still possess a powerful ability to cripple a debtor's business and possibly prejudice the debtor's customers. The threat and power to strike can be overwhelming. Consequently, it is hard to conclude that the power of organized labor has substantially diminished in the chapter 11 context.") (footnote omitted).

ing with collective bargaining agreements in order to remove the incentive for debtors to commence labor transformation cases.

For purposes of this article, it is not necessary to evaluate the merits of these arguments. It is enough to note that a bankruptcy filing places labor union interests at risk. Labor unions can oppose any motion to reject a collective bargaining agreement, but this involves expensive litigation. Furthermore, empirically, debtors' rejection motions are always successful in the end.[31] Indeed, labor unions' interests may be placed at further risk due to creditor control in bankruptcy. As discussed in Part A below, creditors may exert greater control over a corporation that is suffering financial distress or that has filed bankruptcy. This control, as discussed in Part B, can increase the chances that a debtor will use bankruptcy to target labor costs.

Part B below concludes by examining how the concessionary bargaining framework creates incentives for labor unions to play a role beyond that of concession bargaining. It further considers how creditor control creates opportunities for labor unions to play more of an active role in plan negotiations.

A. Creditor Control and Competition

When corporate debtors suffer financial distress and file bankruptcy, creditors are able to exercise increased control over corporate decision making.[32] Institutional lenders may exert control either by lending money to the corporation or by acquiring debts owed by the corporation.

For those institutional lenders that lend new money to a company, control over the corporation comes in the form of extensive loan covenants in the loan agreement that may "cover[ ] everything from minimum cash receipts to timely delivery of audited financial statements."[33] These covenants "serve as trip wires for the lender's right to accelerate and enforce or to intervene in

---

[31]Andrew B. Dawson, *Collective Bargaining Agreements in Corporate Reorganizations*, 84 Am. Bankr. L.J. 103, 117 (2010) (reporting results of empirical study of all large publicly traded corporations filed between 2001-2007, finding that debtors were able to reject collective bargaining agreements in every litigated motion. Delta Airlines was the sole case in which a court denied a motion, but with leave to amend. The motion was ultimately granted).

[32]Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. Pa. L. Rev. 1209, 1231 (2006) ("The desire of a lender to gain control when a business becomes financially distressed should come as no surprise. Much of the literature on corporate governance is aimed at reducing agency costs when times are good. In that situation, managers may have an incentive to pursue private benefits rather than maximize shareholder wealth. Things change when distress occurs. Distress often foreshadows the replacement of managers and directors. They know that they are in the end game. Final-period problems tend to reduce the efficacy of controls designed to bind managers over the long term. Left unchecked, managers are even more likely to put their interests ahead of those of the company. Lenders thus institute a new set of controls in order to protect their interests.") (footnotes omitted); Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. Rev. 115, 120 (2009).

[33]Baird & Rasmussen, *supra* note 32, at 1211; Tung, *supra* note 32, at 125.

the borrower's decisions,"[34] giving the lender "de facto control rights—such as replacing the CEO of a company—that shareholders of a public company simply do not have."[35] Empirical studies suggest that lenders frequently exercise these control rights, as it has been found that CEOs were replaced in up to seventy percent of corporations that ended up filing for bankruptcy.[36]

Likewise, institutional lenders may acquire the debts of a financially troubled company in an effort to exert control over the company by influencing management or by acquiring the company.[37] These lenders may acquire a financially troubled corporation's bonds, notes, and even trade debt from lenders, bondholders, and suppliers who may prefer to avoid the costs associated with the debtor's default. Those institutional lenders that acquire such debts are referred to as distressed debt investors. Some of these investors may simply be purchasing debts at a discounted rate with the goal of realizing gains from a successful turnaround.[38] Others may look to use their debt holdings to influence management or to exchange their claims for equity through a restructuring.[39]

If the debtor seeks protection under Chapter 11 of the Bankruptcy Code, institutional lenders may exert even greater control in corporate governance by providing financing for the debtor's reorganization.[40] Frequently, large corporate debtors require additional financing to carry on their business during the reorganization, to pay the restructuring professionals, and to assure counterparties that the debtor will be able to pay the debts it incurs during the bankruptcy. The lenders who extend this bankruptcy financing—commonly referred to as debtor-in-possession (or DIP) financing—may exert control over the debtor and the reorganization process through loan covenants, similar to the control institutional lenders may exercise outside the bankruptcy context.[41] In bankruptcy, these covenants may require the debtor to

---

[34]George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CAL. L. REV. 1073, 1093 (1995).

[35]Baird & Rasmussen, *supra* note 32, at 1211; Tung, *supra* note 32, at 125.

[36]Ayotte & Morrison, *supra* note 6, at 522 (reporting that seventy percent of CEOs were replaced within the two years preceding the bankruptcy, a number they believe underestimates CEO turnover because they did not examine turnover during the reorganization process.); Ethan S. Bernstein, *All's Fair in Love, War & Bankruptcy: Corporate Governance Implications of CEO Turnover in Financial Distress*, 11 STAN. J.L. BUS. & FIN. 298 (2006).

[37]Michelle M. Harner, *The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing*, 77 FORDHAM L. REV. 703, 709 (2008).

[38]*Id.* at 715.

[39]*Id.* at 716.

[40]David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917 (2003).

[41]*Id.*

appoint a chief restructuring officer, to adhere to a line item budget,[42] to sell assets by a target date, or to obtain concessions from its labor unions.[43] Default can accelerate the loan and force the debtor into liquidation.

While DIP financing covenants are similar to those covenants by which institutional lenders can exert "de facto control rights" outside bankruptcy,[44] the DIP financing covenants can provide even greater control rights than would be available outside of bankruptcy.[45] For instance, the DIP lender can exert even greater control over the process of selling the debtor's assets.[46]

Distressed debt investors likewise may be able to assert even greater control in the bankruptcy process. By acquiring claims in bankruptcy, these investors acquire both the distribution rights from those claims as well as the governance rights. Creditors' governance rights include the ability to vote on the debtor's plan of reorganization,[47] object to non-ordinary course business decisions,[48] and to move to replace management with a trustee.[49] In addition, creditors may exert influence over the reorganization through representation on a statutory committee, the most frequent type being the unsecured creditors' committee. The unsecured creditors' committee, generally consisting of the seven largest unsecured claimholders, is empowered to monitor the debtor in bankruptcy and to participate in plan negotiations.

While many creditors may not exercise these governance rights, perhaps because the benefits of monitoring the debtor do not justify the expense, distressed debt investors have both the incentive and the sophistication to participate in bankruptcy governance. They may acquire sufficient claims to influence the plan negotiations through membership on the unsecured creditors' committee, through objecting to the debtor's reorganization decisions, or

---

[42]Ayotte & Morrison, *supra* note 6, at 525 (reporting that seventy-two percent of loans examined imposed specific line-item budgets).

[43]*See* Skeel, *supra* note 9, at 1481 n.66 (2004) ("The principal lender in the first U.S. Airways bankruptcy explicitly threatened to force a liquidation unless employees made substantial concessions. The cash-flow requirements in United's DIP financing agreement were also designed with wage concessions in mind."); *see also Hostess II* bankruptcy filing, discussed *infra* in Part II.

[44]Baird & Rasmussen, *supra* note 32, at 1211; Tung, *supra* note 32, at 125.

[45]David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905, 1929 (2004) (describing lock up agreements that are permissible in bankruptcy but not under state corporate law: "outside of bankruptcy, if the managers of a company walked into court with an agreement that transferred control over its board of directors and promised thirty-six percent of the company's stock to a Bidder, without any input from the company's shareholders, the court's most likely response would be, 'nice try.' In the corporate law context, courts are skeptical of stock lock-ups that commit a significant portion of a company's stock to a favored bidder, since the lock-up may exclude other bidders from making a higher bid for the company.").

[46]*Id.*

[47]11 U.S.C. § 1126 (2004).

[48]11 U.S.C. § 1109 (2004).

[49]11 U.S.C. § 1103 (2004).

through seeking to appoint a trustee to replace management.[50] The end goal may be to increase their distribution rights, to receive equity in the reorganized entity in exchange for their claims, or to direct the sale of corporate assets.

With bankruptcy governance being driven by DIP lenders and distressed debt investors, corporate reorganizations have come to be characterized by creditor competition for control.[51] This conflict frequently concerns asset sales in bankruptcy, in which DIP lenders may prefer a quick sale of the debtor's assets while unsecured creditors prefer a traditional reorganization.[52] As Ayotte and Morrison demonstrated, the conflict frequently arises because the DIP lenders (and secured lenders generally) may prefer a quick sale of assets, particularly when their collateral value exceeds the amount of the secured indebtedness; meanwhile, unsecured creditors (including distressed debt investors who have purchased bonds and trade debt) are more likely to oppose sales in that scenario.[53]

Asset sales in bankruptcy have come under increased scrutiny from commentators.[54] Such sales may be a valuable means of maximizing value for creditors. Bankruptcy law permits such sales to be made free and clear of any claims or interests in the assets, thus allowing the purchaser to avoid the possibility of successor liability.[55] While in theory this should maximize the value of the assets, empirical evidence demonstrates that asset sales in bankruptcy do not maximize the value of assets.[56] Not only are such sales inefficient in many cases, but they also permit debtors to effectuate a restructuring through a sales procedure that lacks the statutory protections that creditors

---

[50]Michelle M. Harner, *Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*, 16 AM. BANKR. INST. L. REV. 69, 84 (2008) (reporting that 65.5% of the firms surveyed said they have used "a company's distressed debt to try to influence board or management decisions at the company").

[51]Harner, *supra* note 6, at 478 ("Self-dealing and control contests in corporate restructurings are becoming commonplace. As a result, conflicts and costly disputes are on the rise, and the problems associated with information asymmetry are intensifying."); Lipson & DiVirgilio, *supra* note 7, at 654 ("The marketization of business failure has been driven largely by two phenomena: (1) the growth of secondary debt markets for claims against distressed firms, and (2) the growth of large, private pools of capital that purchase these claims, or other interests in, or assets of, troubled companies."); Ayotte & Morrison, *supra* note 6, at 511.

[52]*See* LoPucki & Doherty, *supra* note 14, at 36-37 (summarizing the literature regarding diverging interests of DIP lenders and the estate: "As Kenneth Ayotte, David Skeel, Douglas Baird, Robert Rasmussen, Harvey R. Miller, Shai Waisman, and others have noted, DIP lenders also have incentives with respect to section 363 sales that conflict with those of the estate.").

[53]Ayotte & Morrison, *supra* note 6, at 534.

[54]*See, e.g.*, LoPucki & Doherty, *supra* note 14; Tabb, *supra* note 11; Anderson & Ma, *supra* note 15.

[55]11 U.S.C. § 363(f) (2004).

[56]LoPucki & Doherty, *supra* note 14, at 3-4 (finding that asset sales "yielded less than half as much value as reorganization."); Anderson & Ma, *supra* note 15, at 3 ("Compared with plan sales, section 363 sales are also associated with significantly lower sales prices.").

would receive in a traditional reorganization.[57] As the Second Circuit Court of Appeals expressed in Chrysler's reorganization, courts have recognized the concern "that a quick, plenary sale of assets outside the ordinary course of business risked circumventing key features of the Chapter 11 process, which afford debt and equity holders the opportunity to vote on a proposed plan of reorganization after receiving meaningful information."[58]

B. Creditor Control's Impact on Labor Unions

Creditor control can directly threaten workers' interests as creditors may demand that management exercise its statutory right to reject its collective bargaining agreements with its unionized workers.[59] Collective bargaining agreements set forth the terms and conditions of employment between management and the unionized workers and create a "law of the shop" that may govern all aspects of that relationship. Outside of bankruptcy, a debtor commits an unfair labor practice if it fails to comply with the agreement.[60] Inside of bankruptcy, a debtor may reject these agreements and then impose new terms on those agreements without committing an unfair labor practice.[61] Creditors may directly insist on the debtor rejecting its collective bargaining agreements by making it an event of default to fail to do so. Creditors can also indirectly reach this result by imposing a budget on the debtor that practically requires new labor terms.[62]

Creditors can also insist on asset sales that can lead to the loss of jobs. Further, because purchasers are not bound by the seller's collective bargaining agreements, sales can effectively terminate the workers' collective bargaining agreements.[63]

While creditor control may threaten worker interests, the competition also presents opportunities for workers to find alliances within the competition. Chapter 11 dynamics open up opportunities for labor to exert influence on bankruptcy governance in at least two ways. First, a vulnerable management may be more willing to work with labor in order to avoid disruptions

---

[57]Mark J. Roe & David A. Skeel, Jr., *Assessing the Chrysler Bankruptcy*, 108 Mich. L. Rev. 727, 734 (2010) ("A complex sale, however, can determine priorities and terms that the Code is structured to determine under § 1129, and is not structured to determine under § 363.").

[58]*In re Chrysler LLC*, 576 F.3d 108, 114 (2d Cir. 2009), *cert. granted, vacated sub nom. Indiana State Police Pension Trust v. Chrysler LLC*, 558 U.S. 1087 (2009).

[59]Skeel, *supra* note 9, at 1481 n.66 ("The principal lender in the first U.S. Airways bankruptcy explicitly threatened to force a liquidation unless employees made substantial concessions. The cash-flow requirements in United's DIP financing agreement were also designed with wage concessions in mind.").

[60]29 U.S.C. § 158(a)(1) & (a)(5) (2004).

[61]*N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984). Even though *Bildisco* was overruled in part by the enactment of § 1113 of the Bankruptcy Code, this proposition remains true provided that the debtor comply with the procedural requirements of § 1113.

[62]*Id.*

[63]*N.L.R.B. v. Burns Int'l Sec. Servs. Inc.*, 406 U.S. 272, 281-82 (1972).

that could invite greater creditor control. While it is widely recognized that a union's right to strike is largely toothless since employers have the right to replace striking workers,[64] a strike or threat of one may have more bite in times of financial distress. The employer may not be able to withstand a labor interruption of even short duration in such times. Further, a strike or labor unrest may trigger an event of default under a loan, raising the stakes in a threatened work stoppage. At the same time, the threat of disrupting the firm provides the union with leverage only to the extent that those in control of the corporation prefer to avoid liquidation. As mentioned above, that may not be the case when control is exercised by a creditor who stands to completely recover its claim in a liquidation.[65]

Second, credit dynamics change labor relations by adding bargaining partners other than existing management. Labor may bargain with senior and junior lenders, who may look to an alliance with labor as a way to obtain greater control over the Chapter 11 case, as well as other distressed investors or third parties interested in acquiring a stake in the debtor.

Labor has at least two bargaining chips in these negotiations. Labor may offer concessions to a party that seeks to acquire the corporation. For example, labor may agree to waive its right to strike or may agree to wage and benefits cuts. In this way, labor concessions serve the function of a capital infusion through debt forgiveness.

In addition, labor can provide valuable insight into the firm's internal operations. As recognized in the corporate governance literature, workers perform a monitoring function in identifying managerial slack.[66] With their experience working in the corporation, workers have a perspective on internal operations that is available to few, if any, other stakeholders. For example, workers may be privy to defects in internal production procedures—something that may be unobservable from outside the corporation. Labor unions, bargaining on behalf of these workers, can offer this perspective and experience to other stakeholders and potential purchasers who may lack the monitoring power but who have the power to use that monitoring knowledge.[67]

---

[64]Craig Becker, *"Better Than A Strike": Protecting New Forms of Collective Work Stoppages Under the National Labor Relations Act*, 61 U. CHI. L. REV. 351, 353-54 (1994) ("The right to strike has been gutted by the federal courts and the National Labor Relations Board (NLRB).").

[65]*See* Skeel, *supra* note 4.

[66]Michael C. Harper, *Reconciling Collective Bargaining with Employee Supervision of Management*, 137 U. PA. L. REV. 1, 17-18 (1988); Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 299 (1998); Triantis & Daniels, *supra* note 34, at 1077.

[67]*See* Harper, *supra* note 66, at 16-17 (arguing that employee representatives can serve this function for shareholders outside the bankruptcy context: "Finally, just as employee representatives can serve as a conduit of information about the firm to unions, they also serve as a source of information to shareholder representatives about employee interests, concerns, and needs.").

The following section provides case studies of the Chapter 11 reorganizations of Hostess Bakeries and AMR Corp., the parent company of American Airlines. These cases illustrate the creditor competition dynamics, how such dynamics can target worker interests, and how labor has responded.

II. CASE STUDIES

This section examines the corporate reorganizations of Hostess Bakeries (which filed first in 2004 as Interstate Bakeries Corporation and then again in 2012 as Hostess Bakeries) and American Airlines. These cases illustrate the governance dynamics described above as well as the strategies pursued by labor unions to participate in the bankruptcy governance.

A. Hostess I

When Hostess[68] filed bankruptcy in 2004, it did so with the stated objectives "to make significant progress on the operational initiatives" and "to restructure [its] debt to levels commensurate with [its] cash flow generating capability and industry norms."[69] Three years into the reorganization process, however, Hostess had made little to no progress. In early 2007, Hostess installed a new CEO charged with creating a new business plan to lead the company out of bankruptcy.[70] As part of that plan, Hostess contemplated overhauling its product distribution structure, which would require major concessions from delivery systems employees, who were represented by the International Brotherhood of Teamsters. It would also require financing to fund the new business plan. In the summer of 2007, Hostess found a potential source of debt and equity financing from Silver Point Capital to fund the new business plan, conditioned on, among other things, Hostess' obtaining concessions from its labor unions. Hostess was able to do so from one of its major labor unions—the Bakery, Confectionary, Tobacco Workers & Grain Millers International Unions (the Bakers)—but not from the International Brotherhood of Teamsters. The Teamsters, in fact, declared that bargaining with Hostess had reached a dead end and that it would no longer negotiate with management.[71]

Around this time, Yucaipa Companies LLC, a hedge fund specializing in turning around distressed firms, expressed interest in proposing its own plan

---

[68]Interstate Bakeries Corporation, referred to as "Hostess" for simplicity.

[69]Declaration of Ronald B. Hutchison in Support of Chapter 11 Petitions and First Day Motions at 17, *In re Interstate Bakeries Corp.*, Case No. 04-45814 (Bankr. W.D. Mo., Sept. 22. 2004), Doc. 7 [hereinafter *Hostess I*].

[70]Disclosure Statement at 5, *Hostess I*, Case 04-45814, Doc 10133.

[71]*Teamsters Break Off Negotiations With Interstate Bakeries Corporation*, Press Release issued by the International Brotherhood of Teamsters, Sept. 16, 2007, http://www.teamster.org/content/teamsters-break-negotiations-interstate-bakeries-corporation.

of reorganization.[72] The Teamsters agreed to work exclusively with Yucaipa in formulating a plan that would involve an industry competitor, Bimbo Bakeries.[73] Yucaipa sought permission to access Hostess's records to conduct due diligence for such a plan; however, Hostess refused access, based in part on its discomfort with Yucaipa's undisclosed agreement with the Teamsters.[74] Finally, on the eve of the court hearing date for approval of the Silver Point Capital commitment letter, Hostess agreed to sign a confidentiality agreement to provide Yucaipa with access to information for four weeks.[75]

In November of 2007, the court approved the terms of the Silver Point Capital commitment letter, even though the Teamsters argued that a key condition precedent would never materialize, as they would never agree to a deal with management.[76] Meanwhile, the clock was ticking on Yucaipa's access to its diligence materials. During this four week window, Hostess and the official committee of unsecured creditors kept Yucaipa busy. Hostess and the committee filed a Rule 2004 motion and served subpoenas on Yucaipa and Bimbo demanding disclosure of the terms of their arrangement with the Teamsters, which motion the court denied.[77] Hostess also unsuccessfully moved to expedite that deadline, arguing that the Teamster's exclusivity agreement with Yucaipa was interfering with Hostess's ability to confirm a plan of reorganization.[78]

---

[72]*Yucaipa Joins Bid to Buy Twinkies Maker*, L.A. TIMES, Nov. 3, 2007, *available at* http://articles.latimes.com/2007/nov/03/business/fi-burkle3.

[73]The Yucaipa Companies, LLC's (A) Objection to Motion for Authorization to Enter Into Exit Facility Commitment Letter and Related Relief, (B) Opposition to Continuation and/or Extension of the Debtors' Exclusive Periods Within Which to File and Solicit Acceptance of a Plan and (C) Request for Order Compelling the Debtors to Enter Into Reasonable Confidentiality Agreement and Provide Access to Due Diligence at 4, *Hostess I*, Case 04-45814, Doc. 9680.

[74]*Id.*

[75]*See* Yucaipa Companies, LLC's Objection to Debtor's Motion for an Expedited Order Pursuant to 11 U.S.C. Section 105(d) Setting Deadline for the Yucaipa Companies, LLC and/or the International Brotherhood of Teamsters to File a Plan or Disclosure Statement at 7, *Hostess I*, Case No. 04-45814, Doc. 9923.

[76]Opposition of the International Brotherhood of Teamsters to (A) Continuation of and/or Further Extension of Exclusive Period; and (B) Motion for Authorization to Enter into Exit Facility Commitment Letter and Related Relief at 2, *Hostess I*, Case No. 04-45814, Doc. 9682 ("The Debtors apparently took the step of filing a motion seeking this Court's authorization to enter into exit facility financing under the unrealistic belief that they would meet the critical conditions of such financing, including one condition that the Debtors themselves made impossible, namely negotiating a national bargaining agreement with the International Brotherhood of Teamsters.").

[77]Motion of the Official Committee of Unsecured Creditors for an Order Pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure Directing the Production of Documents by Yucaipa Companies, LLC, Bimbo Bakeries, USA, BBU, Inc. and New Bakery, Inc. and the Examination of Witnesses [hereinafter Committee Discovery Motion]; *Hostess I*, Case No. 04-45814, Doc. 9803; Order Denying Committee Discovery Motion, *Hostess I*, Case No. 04-45814, Doc. 9849. .

[78]Motion for Order Regarding Setting Deadline for the Yucaipa Companies, LLC or the International Brother of Teamsters to File a Plan and Disclosure Statement at 5-6, *Hostess I*, Case No. 04-45814, Doc. 9919.

Ultimately, Yucaipa's diligence time expired without a formal proposal, and the Yucaipa/Teamsters/Bimbo alliance eventually dissolved.[79] True to their word, the Teamsters refused to bargain with management, and the Silver Point Capital commitment letter expired by its terms.

Ripplewood Holdings LLC, a private equity firm, then submitted a commitment letter to fund the debtor's emergence from Chapter 11 with an equity investment of $44.2 million and debt financing of $670 million, secured by liens on substantially all of Hostess's assets.[80]

As with the Silver Point commitment letter, the Ripplewood exit financing was conditioned on the debtor's obtaining concessions from the two main unions—the International Brotherhood of Teamsters[81] and the Bakery, Confectionary, Tobacco Workers and Grain Millers International Union.[82] The court approved the exit financing agreement on October 3, 2008,[83] and Hostess filed a motion to reject its collective bargaining agreements in February 2008.[84] Hostess was able to negotiate settlements with the Bakers union but was unable to do so with the Teamsters. Even though the Teamsters refused to bargain with management, they eventually bargained directly with Ripplewood, agreeing to the necessary concessions and receiving in return a seven percent equity interest in the emerging entity.[85]

---

[79]*Interstate Bakeries Bid Deadline Passes with No Yucaipa Plan*, KANSAS CITY BUS. J. (June 6, 2008), *available at* http://www.bizjournals.com/losangeles/stories/2008/01/14/daily27.html.

[80]Motion for Entry of an Order Pursuant to 11 U.S.C. §§ 105(a), 363(b), 364(c)(1), 503(b) and 507(a) Authorizing the Debtors to (I) Enter into Equity Commitment Letter and Related Agreements Including (A) Equity Commitment Fee Letter, (B) Revolving Facility Commitment Letter and Related Fee Letter, and (C) Term Loan Exit Facility Commitment Letter, and (II) Pay Certain Fees and Expenses Associated Therewith, *Hostess I*, Case No. 04-45814, Doc. 11287.

[81]Motion for Order Under 11 U.S.C. § 1113(c) Authorizing Rejection of Collective Bargaining Agreements at 7, *Hostess I*, Case No. 04-45814, Doc. 10304.

[82]Disclosure Statement at 6, *Hostess I*, Case No. 04-45814, Doc. 11334:

> A key component of the First Amended Plan was an exit facility commitment letter and related agreements for up to $400 million in exit financing (the 'Silver Point Commitment') with Silver Point Finance, LLC ('Silver Point'). The Silver Point Commitment was comprised of a $120 million senior secured revolving credit facility, a $60 million senior secured term loan facility and a $220 million letter of credit facility. The Silver Point Commitment contained various conditions to the commitments contemplated thereunder, including the ratification of amendments to the collective bargaining agreements governing the relationship between the Debtors and their unionized workforce necessary to implement the Business Plan and the condition that an order by the Bankruptcy Court confirming the First Amended Plan be entered no later than March 14, 2008.

[83]Order Pursuant to 11 U.S.C. § 105(a), 363(b), 364(c)(1), 503(b) and 507(a), Authorizing the Debtors to (I) Enter into Equity Commitment Letter and Related Agreements Including (A) Equity Commitment Fee Letter, (B) Revolving Facility Commitment Letter, and (C) Term Loan Exit Facility Commitment and (II) Pay Certain Fees and Expenses, *Hostess I*, Case No. 04-45814, Doc. 11367.

[84]Motion, *supra* note 81, *Hostess I*, Case No. 04-45814, Doc. 10304.

[85]Letter from Richard Volpe, Director, Bakery and Laundry Conference, to Teamster members em-

B. Hostess II

Hostess emerged from bankruptcy under new leadership and new labor agreements, but was saddled with even more secured debt than it had before the bankruptcy. After spending a remarkably long four and a half years in its first bankruptcy,[86] Hostess finally emerged. However, as many pointed out, the company's prospects were not bright as the exit finance plan left the debtors deeply indebted. The new investors paid $44.2 million in cash and borrowed $670 million, secured by Hostess's assets.[87] Thus, Hostess entered bankruptcy with approximately $650 million in secured debt and exited with $670 million in secured debt.

Saddled by these heavy post-emergence debt loads, Hostess filed a second bankruptcy a mere three years after emerging from its first case.[88] This time, the company stated that the objectives of the Chapter 11 proceeding were primarily about labor unions: the chief executive officer of Hostess stated that the "purpose and focus" of this second reorganization was to achieve for the Hostess companies "dramatic change to their labor agreements, with a corresponding material reduction in their cost structure and legacy pension and medical obligations, and a restructuring of their capital structure."[89] Hostess described the "threshold obstacle" to its reorganization effort as

> [A]n inflated cost structure that has put them at a profound competitive disadvantage. And that is so because the biggest component of the Debtors' costs — their obligations under collective bargaining agreements that cover nearly 15,000 active union employees — has never been meaningfully addressed. Nor have there been any significant modifications to union pension plan obligations or to the provisions in the collective bargaining agreements that limit the Debtors' opportunities to grow revenues. Hostess simply cannot emerge as a viable competitor unless they are relieved of significant financial commitments and arcane work rules imposed by their collective bargaining agreements.[90]

ployed by Interstate Bakeries Corporation (Oct. 1, 2008), *available at* http://bankrupt.com/misc/Teamsters_CBAModificationHighlights.pdf.

[86]According to the UCLA-LoPucki Business Bankruptcy Database, the mean duration of a large corporate reorganization is 675 days and the median duration 523 days. UCLA-LoPucki Bankruptcy Research Database, *available at* http://lopucki.law.ucla.edu. The 1,535 days of the first Hostess bankruptcy was in the ninetieth percentile of case duration. *Id.*

[87]*See* Disclosure Statement, *Hostess I*, Case No. 04-45814, Doc. 10133.

[88]*In re Old HB, Inc. (f/k/a Hostess Brands, Inc.), et al.*, Case No. 12-22052 (Bankr. S.D.N.Y. Jan. 11, 2012) [hereinafter *Hostess II*].

[89]Affidavit of Brian J. Driscoll in Support of First Day Motions and in Accordance with Local Bankruptcy Rule 1007-2 at 3, *Hostess II*, Doc. 3.

[90]*See* Debtor's Emergency Motion for Interim and Final Orders Pursuant to Sections 105, 363, 365,

Along with Hostess's bankruptcy petition, the company filed two motions that set the company on a path for litigation with its unions. First, it moved to schedule a hearing on the as-yet filed motions to reject its collective bargaining agreements.[91] This motion contemplated a fast-track process for § 1113, with a motion to be filed on or before January 25, 2012, responses due two weeks later, replies due two weeks after that, and a trial to start a week after that—that is, the debtor planned to file a motion on January 25 and start trial February 27.[92]

Second, Hostess filed a motion for interim approval of its DIP financing agreement, under which Silver Point Capital would lend $75,000,000 on a secured basis to fund Hostess's second reorganization.[93] That DIP loan agreement was conditioned on Hostess pursuing an expedited reorganization schedule, particularly with respect to obtaining labor concessions. In particular, the DIP agreement required that Hostess submit proposed modifications to its collective bargaining agreement within a day of the bankruptcy filing; that it move to reject its collective bargaining agreements within two weeks of the bankruptcy filing; and that it obtain relief from its collective bargaining agreements within 75 days of the bankruptcy filing.[94]

In accordance with this schedule, Hostess moved to reject its collective bargaining agreements with the International Brotherhood of Teamsters and the Bakery, Confectionary, Tobacco Workers and Grain Millers International union two weeks later, on January 25, 2012.[95] These two unions represented nearly ninety-two percent of the debtors' unionized workforce.[96] The proposed modifications to the Bakers' collective bargaining agreement sought to obtain $100 million in concessions.[97] Hostess argued that these concessions were necessary because the company was "experiencing a cash 'burn' of $2 million a week" and "[t]he Debtors' struggles are attributable almost exclusively to an inflated cost structure that has put them at a profound competitive disadvantage. And that is so because the biggest component of the Debtors' costs—their obligations under collective bargaining agreements that cover their nearly 15,000 active union employees—has never

and 503(c) of the Bankruptcy Code Approving Plan to Wind Down the Debtors' Business and for Other Relief [hereinafter Wind Down Motion] at 10, *Hostess II*, Doc. 1710 (quoting the Motion to Reject Collective Bargaining Agreements, *Hostess II*, Doc. 24).

[91]Motion for Scheduling Order in Connection with Motion to Reject Collective Bargaining Agreement, *Hostess II*, Doc. 24.

[92]*Id.* at 14-16.

[93]*Hostess II*, Doc. 36.

[94]Debtor's Motion for Interim and Final Orders Authorizing Debtors to Obtain Post Petition Financing, Use Cash Collateral and Provide Adequate Protection at 38, *Hostess II*, Doc. 36.

[95]Debtor's Motion to Reject Certain Collective Bargaining Agreements, *Hostess II*, Doc. 174.

[96]Debtor's Motion for Scheduling Order in Connection with Motion to Reject Certain Collective Bargaining Agreements at 8, *Hostess II*, Doc. 24.

[97]Response to Motion to Reject Certain Collective Bargaining Agreements at 3, *Hostess II*, Doc. 298.

been meaningfully addressed."[98]

The Bakers refused to participate in the § 1113 litigation, instead insisting that it remained open to negotiation as long as management was willing to address the company's capital structure and to ensure that the Bakers (1) would be compensated in future earnings on account of their concessions and (2) would have job security in the event the bakeries were sold to a third party.[99] The Bakers refused to participate in the litigation to reject their collective bargaining agreements, insisting that it would devote its efforts instead to addressing these three concerns and warning that the Bakers were willing to strike if management refused to engage in these issues, even though a strike would almost certainly push Hostess into liquidation.[100]

Management refused to engage the Bakers on these issues and, instead, pursued the motion to reject the Bakers' collective bargaining agreements. The court granted Hostess's motion to reject the Bakers collective bargaining agreements, meaning that the Bakers were left without a collective bargaining agreement in place.[101]

The Teamsters opposed the motion to reject the collective bargaining agreements. The bases for their objections were similar to the principles enunciated by the Bakers: Hostess's bargaining posture was inappropriate because Hostess "continues to reject outright the Union's proposals for a viable capital structure, adequate corporate protections, fair and equitable concessions by all parties, and continued participation in the multi-employer pension plans."[102]

---

[98]Debtor's Motion to Reject Certain Collective Bargaining Agreements at ¶¶ 7-9, *Hostess II*, Doc. 174.

[99]Response to Motion to Reject Certain Collective Bargaining Agreements at 3-4, *Hostess II*, Doc. 298 (listing four bargaining requirements: 1) that the emerging company will have a capital structure that would maximize the prospects of long-term survival of the company; 2) that the BCTGM-represented employees will receive meaningful return for their concessions in the form of real participation in any upside future of the company; 3) that the company commits to serious capital investment in its facilities; and 4) that any agreement provides some measure of job security for existing Hostess employees in the event the company sells its assets to third parties).

[100]*Id.* at 4 ("To maximize the possibility of a successful outcome, the BCTGM has concluded that, rather than expend its resources in litigation, it will devote its full time and attention to the only issue that matters - the negotiation of an acceptable agreement with the Debtors. The BCTGM believes that concentrated attention to negotiations will minimize the possibility of a strike, an event that, as the Debtors have represented, *see* Memorandum of Law in Support of Debtors' 1113/1114 Motion (Docket No. 175), at pp. 19-20, and the Committee of Unsecured Creditors has recognized, *see* Objection to Debtors' Motion to Obtain DIP Financing (Docket No. 231), at p. 3, would lead to liquidation of the Company.").

[101]Order (I) Granting Debtors' Motion to (A) Reject Certain Collective Bargaining Agreements and (B) Modify Certain Retiree Benefit Obligations Pursuant to Sections 1113(c) and 1114(g) of the Bankruptcy Code, as to the Bakery, Confectionary, Tobacco Workers and Grain Millers International Union Collective Bargaining Agreements Described Herein; and (II) Granting BCT's Motion to Dismiss the Debtors' 1113/1114 Motion as to the Terminated BCT Collective Bargaining Agreements Described Herein, *Hostess II*, Doc. 848.

[102]Objection of Interstate Brands Corp.—International Brotherhood of Teamsters National Negotiat-

The court denied Hostess's motion to reject the Teamsters' collective bargaining agreement, but with leave to amend.[103] Hostess and the Teamsters finally reached a settlement; however, Hostess still had to reach an accord with the Bakers.

Having rejected its collective bargaining agreements, Hostess was free to either negotiate a new collective bargaining agreement or to impose new terms on the old collective bargaining agreement.[104] When Hostess began implementing the modifications to these collective bargaining agreements in October 2012, the Bakers union began to strike.[105] The strikes disrupted operations and triggered default provisions in their bankruptcy financing (the Final DIP Order), thus prompting Hostess to file a motion proposing procedures to wind down the business.[106] At the hearing to discuss that motion, the parties agreed to mediation to attempt to resolve the strike and permit Hostess to reorganize.[107] Judge Drain expressed some hope that mediation might be effective, noting that the Bakers' points of contention were shared with the Teamsters, who had earlier settled their dispute with Hostess.[108] Expressing frustration and consternation with the Bakers' decision to strike, the Court noted that, even though it lacked power to enjoin the strike, that it did have the power to award "monetary claims against a union for an unlawful strike, or a strike that is basically improper, it contravenes another law."[109]

After the final mediation failed, the court approved the wind down procedures, and the Hostess assets were sold to various buyers.[110] These buyers have kept many of the old Hostess brands and bakeries running since then.

---

ing Committee to the Debtors' Motion to Reject Collective Bargaining Agreements Pursuant to Sections 1113 and 1114 of the Bankruptcy Code at 10, *Hostess II*, Doc. 408.

[103]Fifth Order Authorizing the Rejection of Certain Unexpired Leases and Executory Contracts and Setting Bar Date, *Hostess II*, Doc. 1064.

[104]The Bankruptcy Code simply gives the debtor in possession the right to reject collective bargaining agreements, but it does not define the consequences of such rejection. Courts have considered rejection to have a similar impact as bargaining to impasse under the National Labor Relations Act: at that point, the debtor may impose the terms of its last rejected proposal on the old collective bargaining agreement.

[105]Wind Down Motion at 16, *Hostess II*, Doc. 1710.

[106]*Id.* at 16-17.

[107]Transcript Regarding Hearing Held on Nov. 19, 2012, *Hostess II*, Doc. 2064.

[108]*Id.* at 17-18.

[109]*Id.* at 18-19.

[110]Final Order, Pursuant to Sections 105, 363, 365 and 503(c) of the Bankruptcy Code (A) Approving (I) A Plan to Wind Down the Debtors' Businesses, (II) The Sale of Certain Assets, (III) Going-Out-Of-Business Sales at the Debtors' Retail Stores, (IV) the Debtors' Use of Cash Collateral and Modifications to Final DIP Order, (V) An Employee Retention Plan, (VI) A Management Incentive Plan, (VII) Protections for Certain Employees Implementing the Winddown of The Debtors' Businesses, (VIII) The Use of Certain Third party Contractors and (IX) Procedures for the Expedited Rejection of Contracts and Leases; and (B) Authorizing the Debtors to Take any and all Actions Necessary to Implement the Winddown, *Hostess II*, Doc. 1871.

While the Bakers Union had assumed that the new owners would re-open the old factories and hire the old workers, so far the new owners have only re-hired twenty to twenty-five percent of the former workers, none of whom are unionized.[111] Whether or not the new employees will organize remains to be seen.

C. AMR

American Airlines (AMR) had flirted with bankruptcy for nearly 10 years before finally filing on November 29, 2011.[112] It had managed to avoid following every other legacy carrier into bankruptcy for so long in large part because of significant labor concessions from its unions in 2003, to the tune of $1.8 billion annually.[113]

AMR expressed its objective as restructuring its cost structure—including its labor costs—and to emerge as a stand-alone entity. AMR contended that it required further reductions in labor costs because each of its major competitors had gone through bankruptcy and lowered labor costs through that process, leaving AMR with the highest labor costs among the major network carriers.[114]

Even though AMR would be an attractive target for competitors, some analysts believed that AMR would be able to remain independent.[115] In part, this was because AMR went into bankruptcy with a record amount of cash reserves, enabling AMR to eschew DIP financing.[116] In the absence of a DIP lender, who as discussed above could exert significant leverage over AMR, it was believed that AMR would be better able to retain control through the Chapter 11 process.[117]

Other creditors, however, exerted significant control over the case, in particular the creditors' committee, the pilots' union, and the ad hoc committee of bondholders.[118] The unsecured creditors' committee—whose members

---

[111]Akane Otani, *Hostess Twinkies Return to Stores, But Unionized Jobs Disappear*, THE CHRISTIAN SCI. MONITOR, July 15, 2013, http://www.csmonitor.com/Business/2013/0715/Hostess-Twinkies-return-to-stores-but-unionized-jobs-disappear-video.

[112]*In re AMR Corp., et al.*, Case No. 11-15463 (Bankr. S.D.N.Y., Nov. 29, 2011).

[113]Affidavit of Isabella D. Goren Pursuant to Local Bankruptcy Rule 1007-2, *In re AMR*, Case No. 11-15463, Doc 4.

[114]*Id.* at ¶ 19.

[115]Mary Schlangenstein & Mary Jane Credeur, AMR Mutes Takeover Risk with Record $4.1 Billion Cash Entering Bankruptcy, BLOOMBERG, Dec. 5, 2011, *available at* http://www.bloomberg.com/news/2011-12-05/amr-mutes-takeover-risk-with-record-4-1-billion-bankruptcy-cash.html.

[116]*Id.*

[117]*Id.*

[118]Mike Spector & Susan Carey, *Attorney was AMR Deal Key*, WALL ST. J., Feb. 8, 2013, at C1 (reporting that the creditors' committee "filed an unusual 'mission statement' that declared, among other things, that the creditors committee's 'oversight responsibilities are highlighted and particularly essential' since the airline didn't have a bankruptcy loan requiring it to meet certain milestones."); Mike Spector &

included the Allied Pilots Association, the Transport Workers Union, and the Association of Professional Flight Attendants[119]—expressed its concerns early in the case "that the Debtors' reorganization cases are neither a labor transformation nor a debt recapitalization exercise; instead, transformation challenges surrounding revenue, city share, network, fleet, product, labor and capital structure must be creatively resolved."[120] The committee declared that it would take an extraordinarily active role in overseeing the Chapter 11 case in response to the absence of a DIP lender.[121]

An ad hoc committee of creditors consisting of several large claim holders, including Barclays, Goldman Sachs, and J.P. Morgan,[122] exerted significant influence, as they collectively held sufficient claims to block any plan of reorganization.[123] This group initially supported AMR's plan to emerge as an independent entity, and it offered to finance AMR's exit from bankruptcy. That exit financing, however, was contingent on the appointment of a new board of directors.[124]

The pilots' union was another influential group. They engaged in at least three lines of attack to derail AMR's reorganization plan. First, the pilots' union reached an agreement with US Airways, memorialized in a memorandum of understanding that "would serve as a framework for an agreement" if the airlines merged.[125] This unusual step was a public signal of the pilots' support for a merger, and it provided a means for other creditors to assess the viability and value of such a merger.

Second, the pilots negotiated with other creditors to push for the US

Matt Wirz, *Distressed Investors Circle AMR*, WALL ST. J., Oct. 12, 2012, at C1 (reporting that the ad hoc group of bondholders played an important role in plan negotiations due to its blocking position).

[119]*See* Appointment of Official Committee of Unsecured Creditors, *In re AMR Corp.*, Case No. 11-15463, Doc. 128 (listing the committee members, including Manufacturers and Traders Trust Company, Wilmington Trust Company, The Bank of New York Mellon, Pension Benefit Guaranty Corp., Hewlett-Packard Enterprise Services, LLC, and Boeing Capital Corporation, in addition to the three unions).

[120]Statement of the Official Committee of Unsecured Creditors Regarding Matters to be Heard on Dec. 22, 2011, at ¶ 5, *In re AMR Corp.*, Case No. 11-5463, Doc. 403.

[121]*Id.* at ¶ 7.

[122]Supplemental Verified Statement of the Ad Hoc Committee of AMR Corporation Creditors Pursuant to Federal Rule of Bankruptcy Procedure 2019, *In re AMR Corp.*, Case No. 11-15463, Doc. 5585 (listing Barclays Asset Management Group LLC, Goldman, Sachs & Co. (solely with respect to the Distressed Products Group), and J.P. Morgan Securities LLC).

[123]In order to confirm a plan of reorganization, the debtor must obtain the approval of each impaired class of creditors, unless the debtor can satisfy the requirements of 11 U.S.C. § 1129(b). 11 U.S.C. 1129(a)(8). A class has accepted a plan if at least two-thirds in dollar amount and one-half in number of claim holders have approved the plan. 11 U.S.C. 1126(c).

[124]Jack Nicas & Mike Spector, *Creditors Want New Board if AMR Stays Single*, WALL ST. J., Nov. 30, 2012, at B2.

[125]Scott Alwyn, *American Airlines Pilots Approve MOU for Agreements Under Merger*, REUTERS, Dec. 29, 2012, *available at* http://www.reuters.com/article/2012/12/30/us-american-airlines-pilots-idUSBRE8BT00N20121230 (quoting board of the Allied Pilots Association).

Airways merger.[126] The pilots eventually agreed to a new collective bargaining agreement with American Airlines at the urging of the creditors' committee, as such an agreement would allow other creditors to compare the stand-alone versus merger plans. They also received support from the powerful Ad Hoc Committee of AMR Creditors. After that committee expressed interest in funding a stand-alone plan of reorganization, it sent a letter to the pilots' union emphasizing that its "support for a stand-alone Plan of Reorganization for AMR will be conditioned, among other things, on that Plan providing for a new Board of Directors."[127] The pilots' union spokesman characterized the importance of this letter as follows: "Having a role in determining the right leadership and strategic plan for the company is of vital importance to our pilots, and we now have a commitment from this significant creditor group to help us pursue that goal."[128]

And third, the pilots' union engaged in more "classic" resistance to AMR's reorganization plan. They opposed AMR's motion to reject their collective bargaining agreements, hiring Wall Street legal and financial advisers to support their litigation efforts.[129] They conducted a strike vote—even though the bankruptcy court could enjoin such a strike once AMR rejected the collective bargaining agreement. And they purportedly engaged in a work slowdown,[130] using tactics known as "work-to-rule" in which pilots would report maintenance issues that would not normally be reported, even though they technically were required to do so.[131]

Ultimately, with the support of the bondholders, and following months of contentious labor relations and related deterioration in customer service, management abandoned its plan to emerge as a stand-alone carrier and ultimately merged with US Airways after receiving requisite approval from creditors, the court, and regulators.[132]

---

[126]Andrea Ahles, *Anatomy of a Merger: How American, US Airways Joined*, FORT WORTH STAR TELEGRAM, Feb. 17, 2003, http://www.star-telegram.com/2013/02/17/4626182/anatomy-of-a-merger-how-american.html (describing role of pilots' union in paving way for merger talks and in participating with the other creditors through the creditors' committee).

[127]Letter from Gerard Uzzi of Milbank, Tweed & McCloy on Behalf of the Ad Hoc Comm. of AMR Creditors to Keith Wilson, President of the APA (*available at* Terry Maxon, DALLAS MORNING NEWS AIRLINE BIZ BLOG (Nov. 24, 2012), http://aviationblog.dallasnews.com/2012/11/apa-weve-got-a-commitment-for-a-new-independent-amr-board-of-directors.html).

[128]Nicas & Spector, *supra* note 124.

[129]Steven Pearlstein, *Two Can Play the Airline Bankruptcy Game*, WASH. POST, April 28, 2012, http://www.washingtonpost.com/business/steven-pearlstein-two-can-play-the-airline-bankruptcy-game/2012/04/27/gIQAJ239nT_story.html.

[130]George Howell, *3rd American Airlines Flight in a Week Experiences Loose Seats*, CNN, Oct. 3, 2012, http://www.cnn.com/2012/10/03/travel/american-airlines-problem/

[131]*American Airlines' Bumpy Ride: Loose Seats, Smoky Cabins and Labor Disputes*, PBS NEWSHOUR, Oct. 3, 2012, http://www.pbs.org/newshour/bb/business/july-dec12/airlines_10-03.html

[132]The Bankruptcy Court approved AMR's plan of reorganization on October 21, 2013. *See In re AMR Corp.*, Case No. 11-15463, Doc 11402. The merger received regulatory approval in April 2014.

III. IMPLICATIONS FOR BANKRUPTCY LAW

As illustrated in the cases above, the struggle among creditors to control the corporate reorganization can directly threaten the interests of workers. The two attempted restructurings of Hostess provide examples of how controlling creditors may require the debtor to re-work its collective bargaining agreements as a condition to providing financing for the reorganization. And as seen in *Hostess II* and the AMR reorganization, adjusting labor costs may be the primary purpose of the bankruptcy filing.

Labor unions clearly had an important role in these cases as bargaining agents in the § 1113 rejection process. But these cases also show that this was not labor unions' only role. In fact, the Hostess bakers' union refused to even engage in the concession bargaining process, declining to oppose the motion to reject their collective bargaining agreement. Instead, they expressed their desire to negotiate over bankruptcy strategy. The AMR pilots did both—they engaged in concession bargaining while at the same time explored alliances to change the course of the bankruptcy proceedings.

With both of these debtors, the unions' arguments were unsuccessful at opposing the debtor's motion to reject the collective bargaining agreements, but they were successful in attracting the attention of other creditors. In AMR's case, the pilots' union's arguments were rejected by the court in the § 1113 litigation, but they were accepted by the bondholders and by AMR's merger partner. In *Hostess I*, although the agreement between the Teamsters and Yucaipa ultimately proved ineffective, the union was successful in finding a partner to attempt to solve what it identified as managerial slack. These cases, then, provide examples of how labor union activism in bankruptcy can impact bankruptcy governance.

There is good reason, then, to believe that labor unions can impact a corporate reorganization and potentially protect labor's interests in bankruptcy by forging alliances in the competition for control. But is this activism good for bankruptcy governance?

An evaluation of whether labor activism is good for bankruptcy governance is complicated because, as has long been recognized, "governance questions are inextricably bound up in the broader policy question of what goals Chapter 11 should seek to promote."[133] Corporate reorganization is designed to promote reorganization and to maximize returns to creditors.[134] At times,

---

See David McLaughlin & Andrew Zajac, *American Airlines-US Airways Merger Settlement Approved*, BLOOMBERG, April 26, 2014, http://www.bloomberg.com/news/2014-04-25/american-airlines-settlement-over-us-airways-merger-approved.html.

[133]Christopher W. Frost, *The Theory, Reality and Pragmatism of Corporate Governance in Bankruptcy Reorganizations*, 72 AM. BANKR. L.J. 103, 105 (1998).

[134]Harner, *supra* note 6, at 476 ("The primary goals of Chapter 11 are to rehabilitate corporate debtors and maximize recoveries to creditors.").

these goals may be consistent, as rehabilitating the debtor may be the best way to maximize creditor recoveries. At other times, though, maximizing creditor returns may require liquidating the firm.[135] Thus, from an outcome-based view of bankruptcy, it is difficult to assess whether labor activism is good for bankruptcy. In the AMR case, labor activism may have helped with both goals. In the Hostess cases, labor activism may have maximized returns to creditors (arguably) but did not promote reorganization.

From a process-oriented perspective, however, labor activism has the potential to improve bankruptcy governance. The potential added value from labor activism is primarily informational: it provides a means for workers to contribute to the reorganization by identifying managerial slack.

Yucaipa, the investment fund that partnered with the Teamsters in Hostess's first bankruptcy, has explained that one of the reasons it has sought alliances with unions is for their informational advantage: "cooperative union members provide 'phenomenal' information about potential deals and good business practices" as "[u]nion workers know more than anyone about 'the company, the management, the competitive environment and everything else' at their companies."[136]

Providing information does not assure that the process will properly balance bankruptcy's two policies, but it does provide the opportunity for improved governance in bankruptcy. As Anderson and Ma conclude in their empirical analysis comparing § 363 sale prices with prices obtained through a confirmed plan of reorganization, the lower sale prices through § 363 sales are not due to the speed of such sales or to the financial distress of the seller; rather, they conclude that the lower prices "appear to be associated with the diminished creditor negotiation leverage in 363 sales."[137]

This information does not necessarily promote reorganization or liquidation. Instead, it can improve creditor negotiations that can lead to maximizing asset value.

This basic argument that labor union's monitoring information can improve bankruptcy governance has a direct corollary in the corporate governance literature. Kenneth Dau-Schmidt, for instance, has argued that an alliance between capital and labor could greatly improve monitoring of management by combining shareholders' control rights with labor's inside infor-

---

[135]Frost, *supra* note 133, at 105 ("In general, we seem to expect that the process of rehabilitation will serve both the goals of maximizing the value of the business assets, thereby maximizing creditors' returns, and restoring businesses to health so that they can continue to provide benefits to employees and other noninvestor stakeholders. The problem is that meeting both of these goals is impossible when liquidation is the choice that maximizes the value of the business assets.").

[136]Joseph N. DiStefano, *Investor Who Works Well with Unions Ron Burkle is a Likely Bidder for The Inquirer*, PHILA. INQUIRER, Mar. 26, 2006, http://articles.philly.com/2006-03-26/business/25414666_1_yucaipa-spokesman-frank-quintero-inquirer-and-daily-news-biggest-unions.

[137]Anderson & Ma, *supra* note 15, at 17.

mation regarding the firm's operations.[138] That is, labor-stakeholder alliances can improve corporate governance outside of bankruptcy. Likewise, labor-stakeholder alliances, in which labor unions contribute their inside information into the market for corporate control, have the potential to improve governance in corporate reorganizations. This is especially true in those cases in which there is competition for creditor control, as "[t]he marketization of reorganization law has placed a greater premium on information."[139]

IV. EMPLOYEE COMMITTEES

Labor union participation in the competition for control cannot solve the inefficiencies in bankruptcy, but it can take steps to improving them. Issues such as asset sale procedures, the right to credit bid, and the propriety of breakup fees in bankruptcy are all important topics that must be addressed in the Bankruptcy Code in order to improve asset sales. Labor unions cannot solve these problems; however, they can provide information that can lessen the consequences of these problems. Further, labor unions not only have the ability to contribute, but as long-term investors they have the incentive to do so.

This final section of the paper considers whether the Bankruptcy Code can and should provide for an employee committee to provide such informational sharing.

Labor unions are an effective vehicle for providing information about the debtor-employer. For one, labor unions have experience and sophistication in the corporate reorganization process. In addition, labor unions have a history with both the particular debtor as well as with the industry. That is, they not only serve as the vehicle for packaging and delivering employees' insights as to internal operations, but labor unions also may provide additional knowledge as to the corporation and its industry.

At the same time, labor unions have traits that may limit their effectiveness. For one, there are agency costs inherent in labor unions, as the union may at times have interests that diverge from the workers.[140] For instance, a

---

[138]Kenneth G. Dau-Schmidt, *Promoting Employee Voice in the American Economy: A Call for Comprehensive Reform*, 94 MARQ. L. REV. 765, 802 (2011).

[139]*See* Lipson & DiVirgilio, *supra* note 7, at 695 (2010) (in presenting framework for evaluating schemes for the regulation of information in bankruptcy, the authors characterize the importance of information in the struggle for corporate control as follows: "We used to fight about more substantive matters in reorganization: cash collateral, adequate protection, exclusivity, and plan confirmation, to name a few. Today, we increasingly fight about information, or the rules that exist to control its flow. This is not surprising. The marketization of reorganization has placed a greater premium on information—especially about the company and its stakeholders.").

[140]*See* Richard A. Epstein, *Agency Costs, Employment Contracts, and Labor Unions*, *in* PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 127, 144 (John W. Pratt & Richard J. Zeckhauser eds., 1985) ("Generally speaking, successful unionization must simultaneously address two separate agency

union may prefer to see a company liquidate than to see it emerge by paying lower wages, as those lower wages might push down wages in other companies where the union represents workers.[141] The employees, however, may be willing to accept the lower wages in exchange for continued employment. Agency costs may arise as well due to conflicts between the national and local chapters.[142]

Probably the biggest limit on the effectiveness of labor unions is a practical one: fewer and fewer employees are members of labor unions. Only 6.7% of the private sector workforce was unionized in 2013,[143] and as private sector union representation declines, labor unions are less likely to play any role at all in corporate reorganizations.

This low unionization rate may be a consequence, in part, of the bankruptcies of large corporations. As firms have been able to use bankruptcy to reject their collective bargaining agreements and depress wages and benefits, employees have come to question the value of unionization.[144] As one firm reduces wages and benefits through bankruptcy, other firms in that industry likewise may depress wages throughout that firm's industry.[145] Indeed, this is what has happened in the airlines, as one airline's ability to reduce labor costs in bankruptcy has become a means to justify reducing wages among

---

problems. The firm has to worry about the abuses of its agents, the employees, while the employees have to worry about the abuses of their agents, the union representatives. If, moreover, some portion of the wage gains of the individual workers represents monopoly profits (including quasi-rents), the dangers of abuse by union leaders are even greater, since they have the constant opportunity of diverting some portion of the surplus (in payment for services rendered, as it were) without driving union members down to a competitive wage.")

[141]Steven Kropp, *Collective Bargaining in Bankruptcy: Toward an Analytical Framework for Section 1113*, 66 TEMP. L. REV. 697, 708 (1993) ("Workers and their unions recognize that unless an entire industry, or at least the entire competitive segment of the relevant labor market, is unionized, then the companies that are unionized generally will be disadvantaged. . . . Since a bankrupt company may be permitted to pay lower than union wages, it is probably better that some companies go out of business, rather than survive through bankruptcy and lead the entire industry to pay lower and lower wage rates.").

[142]Abigail Evans, *Cooperation or Co-Optation: When Does A Union Become Employer-Dominated Under Section 8(a)(2) of the National Labor Relations Act?*, 100 COLUM. L. REV. 1022, 1047 (2000) (describing local-national conflicts at Saturn: "Other conflicts arose not only between the union and Saturn management, but within the union internally. There is an inevitable conflict of interest between the local and the national UAW. The national has understandable difficulties representing the interests of all of GM's UAW workers, and not just the interests of the Saturn plant.").

[143]Economic News Release, Bureau of Labor Statistics, Union Members Survey (Jan. 24, 2014, 10:00 AM) available at http://www.bls.gov/news.release/union2.nr0.htm

[144]Ellen J. Dannin & Terry H. Wagar, *Lawless Law? The Subversion of the National Labor Relations Act*, 34 LOY. L.A. L. REV. 197, 211 (2001) ("Each time a union loses a site, it could be used to demonstrate the ineffectiveness of unions and the futility of collective bargaining.").

[145]Steven Kropp, *Collective Bargaining in Bankruptcy: Toward an Analytical Framework for Section 1113*, 66 TEMP. L. REV. 697, 708 (1993) ("To give a company in bankruptcy the opportunity to operate with cut-rate labor costs would put wages back into competition. It would also force competitors of the debtor company into bankruptcy. The result would be a general lowering of wages for all workers in the affected industry.").

competitors.[146]

It is possible that labor's participation in the competition for control may stem the decline in unionization by providing unions a way to protect their members' interests; however, it is unlikely that this would do much to increase unionization. Labor union decline is attributable to many factors other than bankruptcy laws, including changes in the modern workplace that "have rendered many features of existing labor regulation obsolete."[147]

Given this environment, it is worth considering how bankruptcy law might provide for the benefits of worker participation in bankruptcy governance without the intermediary of labor unions.[148]

In theory, the Bankruptcy Code already provides such a vehicle in the form of employee committees.[149] Just as the court may approve the appointment of a creditor committee and an equity committee, it may also approve the appointment of an employee committee.[150]

Some scholars have suggested that employee committees might be effective at improving returns for employees in bankruptcy and at protecting their interests, particularly when the reorganization is likely to entail mass layoffs.[151] These suggestions, though, have not generally considered the employee committee as a participant in governance matters.[152]

Currently, the Bankruptcy Code permits the formation of an employee

---

[146]*See, e.g.*, AMR's argument in favor of labor cost reductions in bankruptcy, discussed *supra* in notes 160-161 and accompanying text: "Unlike the other carriers, however, and with the cooperation of its employees, AMR was able to stave off bankruptcy by implementing hundreds of initiatives resulting, by the end of 2004, in annual cost reductions of approximately $4.1 billion. This included reaching consensual agreements with the labor unions and the non-union employees at American Airlines in the Spring of 2003, which reduced American Airlines' labor costs by approximately $1.8 billion per year. This gave AMR what was then perceived as an opportunity to return to prosperity and success with competitive costs. *Since that time, however, AMR's major competitors exited chapter 11 with dramatically improved balance sheets and dramatically reduced costs*, including labor costs that are significantly lower than AMR's labor costs." (emphasis added).

[147]*See, e.g.*, KATHERINE V. W. STONE, FROM WIDGETS TO DIGITS 124-25 (2004).

[148]In some ways, this section reflects that of labor scholars who have advocated for a labor law for non-unionized employees. *See, e.g.*, Michael H. Gottesman, *In Despair, Starting over: Imagining A Labor Law for Unorganized Workers*, 69 CHI.-KENT L. REV. 59 (1993).

[149]11 U.S.C. § 1102(a) ("[T]he United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.").

[150]*Id.*

[151]Skeel, *supra* note 9 at, 1472-3.

[152]Korobkin, *supra* note 27, at 29; Matthew L. Seror, *Analyzing the Inadequacies of Employee Protections in Bankruptcy*, 13 S. CAL. INTERDISC. L. J. 141, 164 (2003); Skeel, *supra* note 9, at 1482 ("Given that directors' hands are tied, and that they have only a limited ability to represent potentially vulnerable constituencies such as employees who may be laid off, should employees be given another representative to serve as a counterweight?"); *see also* Lynn M. LoPucki, *A Team Production Theory of Bankruptcy Reorganization*, 57 VAND. L. REV. 741, 772 (2004) (considering committee representation as serving to protect constituents' legal rights, not their team production rights (which loosely correspond to the informal rights discussed above)).

committee to serve as a fiduciary to employees. Such committees, however, are rare and, when formed, serve a narrow function. For example, in Enron's bankruptcy, an employee committee was formed for the limited purpose of investigating employee claims against Enron, principally severance payments allegedly owed.[153]

Employee committees might be effective at doing more than just protecting employees' formal rights. They may also provide the valuable monitoring information that labor unions currently provide. Such committees might actually be more effective at communicating with management than are labor unions, as it has been suggested that the collective bargaining process may actually deter management from seeking employee perspective on corporate decisions.[154] That is, an employee committee would provide a vehicle for employee representation "unbundled" from the collective bargaining process.[155]

Labor scholars have for decades complained that the NLRA's collective bargaining protections have prevented worker representatives from participating in corporate governance.[156] These scholars have argued that worker representation could improve workplace safety and operations, and that worker representation may provide valuable information to other stakeholders, particularly shareholders.[157] An employee committee in bankruptcy could likewise provide these benefits in the corporate reorganization process by providing worker representation outside of the collective bargaining process and outside the strictures of the National Labor Relations Act.

Despite the potential benefits of employee committees—benefits both to the employees' interests and to the reorganization process—employee committees are rare and, when formed, are narrowly focused, as discussed

---

[153]As described in the disclosure statement in that case, the employee committee was appointed "*for the limited purpose of investigating issues relating* to (a) continuation of health or other benefits for former employees of the Debtors, (b) the investigation of claims uniquely held by employees, as such, against the Debtors, (c) the treatment of employees' claims under any plan(s) of reorganization or liquidation, (d) possible WARN Act violations by the Debtors in discharging employees, (e) possible violation by the Debtors of state labor laws and certain provisions of ERISA, and (f) dissemination of non-confidential information relating to items (a) through (e) to employees, former employees, or groups thereof." Disclosure Statement for the Fifth Amended Joint Plan of Affiliated Debtors at 346, *In re Enron Corp.*, Case No. 01-16034, Doc. 15414.

[154]Harper, *supra* note 66, at 16-17.

[155]*See supra* note 4, attributing this "unbundling" concept to Benjamin I. Sachs.

[156]*See* Thomas A. Kochan, *Rethinking and Reframing U.S. Policy on Worker Voice and Representation*, 26 ABA J. LAB. & EMPL. L. 231, 242 (2011) (noting proposals to reform § 8(a)(2), including one proposal for promoting direct employee participation "to ensure that various employee involvement processes and/or advisory worker-employer task forces or committees are not prohibited by the § 8(a) (2) of the NLRA."); Katherine Van Wezel Stone, *supra* note 5, at 77; Michael C. Harper, *supra* note 66, at 9("However, the principle also prohibits management from influencing unions by placing union leaders in positions of divided responsibility on corporate boards or other management supervisory committees.").

[157]*Id.*

supra.[158] This may be due to the perceived costs and benefits of appointing an employee committee, both of which, I suggest, are poorly understood. The benefits, as mentioned above, are generally overlooked, as courts and commentators tend to view the benefits solely as providing employee protection. The costs, on the other hand, may be overestimated.

There are both direct and indirect costs of appointing an employee committee. The direct costs consist of paying professionals to represent the employee committee. As a statutory committee appointed by the United States Trustee, the employee committee may have its professional fees paid out of the bankruptcy estate.[159] Thus, the employee committee would create a greater financial burden on the bankruptcy estate, using money that would have been available for general unsecured creditors in order to pay professionals for the committee. These costs, while perhaps not capable of precise prediction *ex ante*, are at least familiar and understood.

The indirect costs of appointing an employee committee, on the other hand, are less clear. These costs arise from the threat that an additional committee may make obtaining approval of a plan of reorganization more difficult and costly. Perhaps the Bankruptcy Code's most pro-reorganization aspect is that it largely leaves management free to pursue reorganization efforts. To the extent an employee committee would constrain management, it may ultimately be making reorganization less likely.[160] A similar concern has been expressed about the appointment of special interest committees in bankruptcy generally.[161] Corporate reorganization theory is premised on a compulsory process that will leave creditors collectively better off than they would be if they each pursued individual collection efforts.[162] Special interest committees, in contrast, are means for creditors to pursue their own individual interests.[163]

There is certainly some truth underlying these concerns, as the introduction of yet another committee may create additional conflict in the bank-

[158] *See supra* note 153 and accompanying text.

[159] 11 U.S.C. § 1103(a) (2004) (permitting committee appointed under § 1102 to employ "one or more attorneys, accountants, or other agents, to represent or perform services for such committee."); 11 U.S.C. § 330(a) (2004) ("[T]he court may award to . . . a professional person employed under section . . . 1103 (A) reasonable compensation for actual, necessary services rendered by the . . . professional person . . . ; and (B) reimbursement for actual, necessary expenses.").

[160] Korobkin, *supra* note 27, at 31-32 ("The general absence of constraints on managerial decisionmaking reflects the legitimate concern that managers must be free to respond effectively to financial distress. Obviously, an effective response is in the interests of employees as a group. It would be entirely counterproductive to make managers directly accountable to employees if such accountability comes at the cost of effective reorganizations.") (footnote omitted).

[161] Mary Jo Wiggins, *Finance and Factionalism: The Uneasy Present (and Future) of Special Interest Committees in Corporate Reorganization Law*, 41 SAN DIEGO L. REV. 1373, 1382-83 (2004).

[162] *Id.*

[163] *Id.*

ruptcy process. It may well be that bankruptcy governance is more efficient with fewer cooks in the kitchen. Indeed, there have been arguments made that an independent management should have sole control over bankruptcy decisions (absent fraud or gross mismanagement) and that stakeholders should be limited to fighting over distributional issues.[164] Others have argued that strategic decisions should rest instead in the hands of the residual claimants.[165] Including management or other non-residual claimants in the decision-making process only leads to inefficient resource allocations.[166]

These concerns, however, are not specific to employee involvement; rather, these concerns arise from the creditor control dynamics of Chapter 11 bankruptcy in general. Management is not independent in operating the business through reorganization. As discussed *supra*, managerial discretion may be extremely limited due to restrictive loan covenants. In addition, managerial turnover both before and during bankruptcy suggests that management is not in fact independent at all but is instead installed to appease certain stakeholders. Likewise, even though it may be most efficient to allocate decision-making powers to residual claimants, these claimants are difficult (some say impossible) to identify.[167] Further, the competition for creditor control may make it highly unlikely that the theoretical residual claimant will have the power to control the reorganization decisions. Thus, even though there are valid theoretical reasons to be concerned about including an employee committee, these concerns are removed from current corporate reorganization practice. As discussed *supra*, there is reason to believe that employee committees may actually improve bankruptcy governance in this environment of creditor competition for control.

Even if the inclusion of employee committees generates greater costs, the benefits from employee committees may well outweigh those costs if the inclusion of employee representation would lead to improved bankruptcy governance. The analysis of labor union participation in bankruptcy governance suggests that employee representation might be similarly beneficial, provided that an employee committee can re-create the benefits that a labor union can provide.

Although an employee committee would mimic labor union representation to the extent it could provide a voice for employees, such a committee would necessarily have some major differences from a labor union. For one, there may be several labor unions representing the employees at a single corporation. Each of these bargaining units might further have divergent inter-

---

[164]LoPucki, *supra* note 152, at 772 .

[165]Ayotte & Morrison, *supra* note 6.

[166]*Id.*

[167]Lynn M. LoPucki, *The Myth of the Residual Owner: An Empirical Study*, 82 WASH. U. L.Q. 1341 (2004).

ests. For example, as discussed in the first Hostess reorganization, the proposed reorganization would place more of a burden on the truck drivers than on the bakers. Each group had its own union to advance its own interests. A single employee committee might be unable to be responsive to these individual concerns. In addition, the employee committee may lack the industry knowledge that a union may have. Perhaps most significantly, an employee committee will necessarily lack the bargaining leverage provided under the federal labor laws, bargaining leverage that the unions exercised in all three case studies in Part II *supra*.

Interest divergence within an employee committee is a problem only to the extent that they would prevent the committee from taking any action. That is, internal conflicts within the committee might hamper the committee's effectiveness. Similar concerns have been examined in the context of the statutory unsecured creditors' committee.[168] These concerns may well be misplaced, as the internal conflict within a committee can actually provide a forum in which those with divergent interests can bargain with one another. The result in the creditors' committee context, it has been argued, may be a compromise that will appeal to a majority of creditors.[169] Likewise, internal conflicts within an employee committee may lead to a richer representation of employee interests.

As far as the industry knowledge concern, an employee committee may be able to obtain such knowledge from professionals hired to represent the committee. For instance, attorneys and financial advisors with experience in a debtor's particular industry may be able to add a broader industry perspective to the employee committee. Such knowledge, of course, would come at a cost. Even if this were cost prohibitive, the employee committee would still be able to contribute firm-specific knowledge and insights, which alone could provide valuable monitoring information to the other stakeholders.

Finally, an employee committee would likely have less bargaining leverage than a labor union. A labor union can exert its rights under federal labor laws to influence bankruptcy governance, just as the Bakers union used the threat of a strike to pressure Hostess management. Likewise, the pilots' union in AMR's case had bargaining leverage because of restrictions on replacing pilots. Furthermore, labor unions have bargaining chips because they are large claimholders—they may have claims for unpaid dues, unpaid wages and benefits, and unfunded pension plans. They also have collective bargaining agreements that can cover all aspects of the employment relationship, to a much greater extent than an individual employment contract would. For ex-

[168]*See* Daniel J. Bussel, *Coalition-Building Through Bankruptcy Creditors' Committees*, 43 UCLA L. REV. 1547, 1550 (1995).

[169]*Id.*

ample, the collective bargaining agreement might restrain the employer from changing work schedules or from outsourcing work. All of these claims can be offered in the negotiations with the debtor, controlling creditor, and potential purchasers. The employee committee may be able to bargain regarding claims, but it will likely have less to offer in exchange. In part, this is because they don't have collective bargaining agreements. In part, this is also because their informal claims against their employers are not recognized as claims. Nonetheless, even with this diminished bargaining leverage, an employee committee would still have value to offer in the bankruptcy governance process. It could represent employee interests in the proceedings, e.g. by objecting to non-ordinary course of business decisions, as well as by providing insights into firm operations that may be valuable for evaluating a plan of reorganization or asset sale.

All of this suggests that any hesitation to the appointment of employee committees may be misguided, as an employee committee can provide value to a reorganization process that may justify the costs. There are surely practical concerns on the mechanics of such a committee, for example, in determining who would serve on the committee. There are also questions as to when such a committee should be formed at all. These are surely difficult questions and merit further consideration, but they are not questions that would be unique to an employee committee; rather, these are questions that arise whenever any committee is formed.[170] For example, a U.S. Trustee faces these issues when deciding whether to appoint an equity committee or a retirees' committee. This is not to say that the practical considerations are unimportant. The point is that in those cases in which there are large numbers of employees, an employee committee can provide a means for employees to monitor the bankruptcy process and to benefit bankruptcy governance.

V. CONCLUSION

Even though labor union participation in corporate reorganizations is largely considered to be through concession bargaining, labor unions have also played a role more akin to that of an activist investor. Labor unions have used their inside information on the firm's operations to garner alliances with other stakeholders to influence bankruptcy decision making.

This labor union activism may provide a partial solution to the problems in bankruptcy governance, specifically, the problem of creditor-driven asset fire sales. Labor union activism in bankruptcy is not likely the best solution

---

[170]Similar problems may arise in appointing a committee to represent retirees or equity holders. These problems are also similar to those faced when appointing the official committee of unsecured creditors, particularly in smaller cases in which it may be harder to find creditors that are willing to serve and that are representative of creditors generally. *See, e.g.*, Greg M. Zipes & Lisa L. Lambert, *Creditors' Committee Formation Dynamics: Issues in the Real World*, 77 AM. BANKR. L.J. 229 (2003).

to bankruptcy's governance problems; however, it has two main virtues. First, because labor unions are generally long-term investors in the corporate employer, labor union activism might provide a counterweight to the powerful creditors that push for quick asset sales in bankruptcy. Second, labor union activism operates within the current market for corporate control in Chapter 11 without the need for legislative changes to the Bankruptcy Code.

Finally, this paper suggests that the role of labor unions as information providers in bankruptcy might possibly be disaggregated from labor unions altogether. If employee committees could be created for this purpose—something that is theoretically already permissible but which poses practical difficulties—this might provide for information sharing in those cases in which the debtor has no unionized employees.