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Expert Analysis

In Great Recession, What Is Union's Role in Company Reorganization?


By **Steven D. Usdin**

And **Nella M. Bloom**

Presently, the weak economy—and job creation—are at the forefront in our minds. With the upcoming election, individuals and companies are questioning how to create and maintain jobs that will benefit Americans. In particular, labor unions are at the forefront of these debates. They must balance their efforts between protecting workers and maintaining jobs.

As seen in three current bankruptcy cases, employment issues—in particular, labor issues—have directed judicial outcomes, and may even determine the debtor's future. These three cases, each pending in the U.S. Bankruptcy Court for the Southern District of New York, are *In re Hawker Beechcraft*, Case No. 12-11873 (SMB); *In re AMR*, Case No. 11-15463 (SHL); and *In re Hostess Brands*, Case No. 12-22052 (RDD). In each of these cases, unions play an active role and prove their power to derail a debtor's reorganization goals, and perhaps whether the debtor can reorganize at all.

'Hawker Beechcraft'

In *In re Hawker Beechcraft,* a union prevented a debtor's redundant incentive plan for key employees. Hawker Beechcraft and its affiliates are manufacturers and servicers of aircraft. Approximately 45 percent of Hawker's work force is represented by the International Associations of Machinists and Aerospace Workers, AFL-CIO (IAM). Before the petition date, Hawker had laid off approximately 800 IAM-represented workers, closed several plants, and negotiated union concessions to the IAM's collective bargaining agreement. Also before the petition date, Hawker entered into a "Standalone Transaction" to convert its pre-petition debt to equity in the reorganized debtors.

Hawker proposed that, under the standalone transaction, eight insider key employees would be compensated by both a key employee retention plan (KERP) and a key employee incentive plan (KEIP). Hawker hired industry experts, who determined that a KEIP would allow the key employees to obtain benefits commensurate with benefits offered in similar companies.

STEVEN D. USDIN *is a shareholder at Flaster Greenberg, in its bankruptcy, financial restructuring and risk management practice group.* NELLA M. BLOOM *is an attorney at the firm. Both are based in the firm's Philadelphia office and can be reached at steven.usdin@flastergreenberg.com and nella.bloom@flastergreenberg.com.*

During the bankruptcy case, Hawker kept open its ability to sell the business. Hawker received a post-petition proposal from Superior Aviation Beijing Co. Ltd., a company primarily financed by the Chinese government, to perform an analysis of whether to bid on Hawker. If Superior were to enter into a transaction with Hawker, the key employees would still benefit from a KERP and a KEIP, but the KEIP was determined by the ultimate transaction price and the timing of the transaction—the higher the price, and the faster the transaction, the better the return for the key employees. The maximum KEIP benefit was proposed to be 200 percent of each key employee's base salary. However, Hawker could extend the dates by which certain goals had to be met, meaning that Hawker pay its key employees the maximum benefit even if the transaction was dragged out.

With recent layoffs and concessions in mind, as well as the fact that Superior would likely reject the collective bargaining agreements in place, the IAM objected to the KEIP. The IAM argued that the KEIP was a disguised retention plan designed to keep the key employees employed at Hawker, as opposed to an incentive program designed to hasten the sale process or increase the purchase price. Particularly in light of the fact that Hawker could extend the dates for enormous bonuses to be paid, the IAM argued that Hawker was discriminating against the workers and implementing bonus plans for executives, based on metrics other than performance.

Hawker, on the other hand, argued that the KEIP was a performance-based incentive plan, since it encouraged the key employees to assist with the administration of Hawker's estate, thus potentially increasing the purchase price for Hawker. Hawker also argued that it was uncertain whether the purchase goals could be met, and the KEIP thus rewarded the key employees' involvement in the sale process.

The court denied the implementation of the KEIP. It held that, while there were some incentive-based elements of the KEIP, the key employees would receive a bonus whether the standalone transaction occurred or if the Superior sale went forward, despite the fact that the standalone transaction did not require the key employees to perform any new duties. Therefore, the only true requirement for the key employee to receive a bonus was not to leave Hawker.

The union was not trying to protect its workers per se in arguing that the KEIP was meritless, since no bargaining agreements were directly implicated in the KEIP issue. Instead, the union argued for equitable treatment. The union and its constituents had made extreme concessions in the recent past, while Hawker proposed to pay eight insider employees for merely staying employed by Hawker. In the greater context of this Great Recession, the court's decision was a victory for Hawker employees and former employees.

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American Airlines

A union successfully prevented the rejection of a collective bargaining agreement. American Airlines, along with its holding company AMR and affiliates, filed for Chapter 11 protection in November, 2011. Approximately 70 percent of American's 65,000 active employees are represented by labor unions. American had been the only major airline without a prior bankruptcy, narrowly avoiding a filing in 2003 by taking measures including entering into consensual agreements with unions to reduce labor costs by approximately $1.8 billion. However, in the intervening years, other large carriers that reorganized and/or consolidated were able to obtain even larger union concessions. In 2011, American was the only major airline to fail to turn a profit, and had lost more than $10 billion since 2001.

American spends billions on salary and benefits annually. The company has high operating costs due to relatively generous salary and benefits to its employees. Its operating cost is among the highest in the country, though its productivity is relatively low. Its labor costs comprise a greater percentage of its overall operating costs than other comparable airlines, in part because pilots fly fewer hours per month, and take more sick leave, than pilots working in comparable airlines.

Post-petition, American proposed a six-year plan to improve profitability. Key to its plan was the reduction of labor costs. The company issued term sheets to its employees' unions, proposing measures that would cause a 20 percent reduction in costs from each labor group for an average annual savings of $1.25 billion. It then filed a motion pursuant to Section 1113 of the Bankruptcy Code seeking to reject nine collective bargaining agreements with three key unions.

The court held a three-week trial on the motion. It reviewed the Bankruptcy Code's requirements to reject a collective bargaining agreement, reviewing the standards of necessity, fair and equitable treatment for the union members, complete information to evaluate a proposal, good faith negotiations, and balancing the equities at issue. After the trial, all unions but one—the pilots' union—were able to productively continue negotiations with American. Since only the pilots' union had not come to an agreement, the motion was examined in light of the effect of the motion on that union.

Out of all unionized employees, the pilots were to take the hardest hit in American's business plan. The company proposed to reject the collective bargaining agreement, in particular to expand existing provisions regarding "codesharing" and pilot furloughs. "Codesharing" is a practice that allows regional or commuter carriers to operate smaller flights with non-union pilots in order to consolidate air travel to American's hubs. Current collective bargaining agreements limit codesharing to require that American use union pilots, and also provide that more senior pilots may voluntarily take furloughs designated for more junior pilots. American argued—and the court agreed—that without the rejection of the collective bargaining agreement, American cannot reorganize, nor can it sustain its status quo.

American proposed a dramatic increase in codesharing, which would allow it to expand its network under its six-year plan. The company argued that this type of codesharing was consistent with other large carriers' use of regional carriers during their reorganizations. The pilots' union argued that American could not show that unlimited codesharing was appropriate. The court held that, though American had established that some increase in codesharing was necessary to allow it to continue to compete in the marketplace, the company had not established that its proposed near-unlimited expansion of codesharing was necessary to its business plan.

American also proposed to eliminate the furlough provisions, arguing that if senior pilots were preparing to retire, the company would obtain no benefit from the senior pilots taking furloughs so that more junior pilots could continue to work. Additionally, it argued, current furlough provisions could cause a problem if an unforeseen catastrophic event occurred which necessitated the furlough of senior pilots. The pilots once more objected, arguing that American's proposed rejection of the collective bargaining agreement would eliminate all limits on pilot furloughs, and that a force majeure exception in the current collective bargaining agreement addressed the issue of an unforeseen catastrophic event. The court held that American sought to eliminate all contractual limits on furloughs for pilots, without showing that the elimination was necessary.

The pilots' union successfully protected its collective bargaining agreement against challenge by American. But the decision has also stymied American's reorganization, since it cannot reorganize with the agreement in place. Tens of thousands of jobs will be lost if American cannot successfully emerge from bankruptcy. Only time will tell if this decision is a victory or a loss for American and its employees.

'Hostess Brands'

Unions' disagreements with management in *In re Hostess Brands* may cause this baking star to supernova. Hostess and its affiliates are enmeshed in their second attempt at Chapter 11. The company filed its first bankruptcy case in 2004. As part of the reorganization in that case, unions made large concessions, causing thousands of union workers to lose their jobs while allowing for a labor cost savings of $110 million annually. Hostess also received a large equity infusion, and lenders agreed to allow it to continue operations by forgiving a sizeable amount of debt and allowing payment-in-kind loans instead. Hostess then implemented its business plan to innovate its product lines and increase its efficiency. The company also gave top executives large raises.

But the first reorganization also sowed the seeds of the current filing, increasing the debt of the company while fixed product costs (commodities and gasoline, for example) increased, and failing to adequately address its underlying retirement fund problems.

Hostess filed its current Chapter 11 case due to its unsustainable levels of debt, but also due to huge legacy costs from multi-employer pension plans and inflexible, unprofitable, and burdensome collective bargaining agreements. The company employs approximately 19,000 workers, 83 percent of whom are union members subject to 372 collective bargaining agreements. It also participates in 40 multi-employer pension plans, which are designed to pool retirement funds among similar types of employers. These pension plans are severely underfunded, since few employers join such plans and others have withdrawn from participation. As of the petition date, Hostess estimated that it was $2 billion in arrears to these pension plans.

Currently, the collective bargaining agreements governing Hostess' operations cause cumbersome, inefficient, and redundant operations. For example, under the agreements, sweets must be delivered separately from bread products, and the same individual cannot both drive the delivery truck and unload it, so a store may get two separate Hostess deliveries using four employees in a single day.

Additionally, the collective bargaining agreements require that Hostess employees make deliveries, but some potential customers (such as dollar stores, movie theaters, and vending machine operators) only allow their own employees to make such deliveries. Hostess moved to reject the collective bargaining agreements, and the court granted leave for Hostess to decide which—if any—to abrogate.

In order to stay in business, Hostess has requested that the labor unions make concessions—including streamlining deliveries, reducing wages, and reducing contributions to union-administered health and welfare plans. Some of these reductions would be temporary, and if Hostess survives and thrives, employees' compensation would increase after several years. Nonetheless, in light of the previous labor concessions and the large raises to executives paid before the current bankruptcy, the proposal has sparked the ire of union representatives. The two largest union players have refused to endorse the proposal, and at least one union is threatening to strike. Ballots to vote on the proposal were issued to union members on Aug. 25 and needed to be received by Sept. 14.

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It seems that only a miracle can save Hostess and its 19,000 employees. If the unions do not make the requested concessions, Hostess cannot continue to operate, and it is extremely unlikely that the unions' constituents will approve the measure without an endorsement from the unions. With no agreement in place, the unions may call for a strike, and Hostess may fail. In the unlikely event that the members do approve the measure, there is no guarantee that Hostess will thrive and that salaries will increase.

Conclusion

In Chapter 11 cases, unions can play an enormously important role. As in *Hawker Beechcraft*, unions can provide a moral compass to keep management in check. A union can also derail a debtor's chances of successful reorganization. American Airlines cannot reorganize without renegotiating the pilots' collective bargaining agreements; Hostess cannot reorganize without increasing its efficiency and sloughing off pension obligations. American and Hostess both run the risk of failing completely if unions and management cannot agree.

A union must carefully evaluate its endgame in a Chapter 11 case, and whether it is better to protect thousands of less desirable jobs, or risk throwing a debtor into a tailspin.