



Trajectory of Labor Relations Under Chapter 11

Eyal Z. Geva

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The Trajectory of Labor Relations Under Chapter 11

Eyal Z. Geva*

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ABSTRACT

Employees are the lost souls of bankruptcy regulations and Chapter 11 in particular. Although the reorganization of an industrial operation inevitably entails downsizing and labor force restructuring,

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when introduced, Chapter 11 did not address these issues directly. Because of the inevitable context of industrial disputes, however, since its enactment the regulations pertaining to employees under Chapter 11 have developed through legislation, judicial law-making, and business practices. This paper follows these developments, while adopting a wider perspective that addresses the issue of corporate control under Chapter 11's regulated bargaining environment. Against the backdrop of the determinants that establish the theoretical, practical, and institutional boundaries of Chapter 11, this paper explains these developments and assesses the future of employees under Chapter 11.

I. INTRODUCTION

At first glance, nothing in Chapter 11 of the Bankruptcy Code¹ requires a special discussion of the issue of company employees—Chapter 11 is simply a collective creditors' enforcement mechanism. Yet time and time again the issue of labor force restructuring, redundancies, plant relocation, and downsizing, have become the focal point of the Chapter 11 process. It is quite common, during a Chapter 11 procedure and before a reorganization² plan is approved, for the firm to sell entire divisions and shut down production lines. Since Chapter 11's enactment in 1978, heavily unionized industries throughout the country have triggered Chapter 11's automatic stay of proceedings³ strategically, in order to avoid or alter Collective Bargaining Agreements (CBAs) or retirees' pension plans.⁴ It was under Chapter 11 that the steel, airlines, car, and other heavily unionized industries, have annulled their existing CBAs or simply imposed upon their workforce new terms of employment. In some cases, under Chapter 11's protection, companies relocated their production lines abroad, prompting and supporting the de-industrialization phenomenon.⁵

1. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101, 92 Stat. 2549, 2549 (1978) (codified at 11 U.S.C. § 101 (2006)).

2. The terms corporate "reorganization" and "restructuring" throughout this paper are used interchangeably. When referring to "workouts," these are understood as pre-packaged bankruptcy reorganizations only, limited to small restructuring of debt and equity. See Kenneth M. Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425, 428 (2006).

3. Bankruptcy Reform Act of 1978, § 362 (codified at 11 U.S.C. § 362).

4. See KEVIN J. DELANEY, *STRATEGIC BANKRUPTCIES: HOW CORPORATIONS AND CREDITORS USE CHAPTER 11 TO THEIR ADVANTAGE* (2d ed. 1998) (regarding strategic bankruptcies). Some of the reasons to strategically choose Chapter 11 include gaining competitive advantage by trading under Chapter 11 or avoiding mass tort liabilities.

5. The reorganization of the steel corporations during the 1980s immediately comes to mind. A similar process of deindustrialization amongst the automobile suppliers has taken place during the years leading up to the 2008 credit crisis. In 2007, automobile suppliers such as Delphi Co., Tower Automotive Inc., Collins & Aikman Corp., Federal Mogul Corp., and Meridian Auto-

In other contexts, an employer may discharge an employee, or reduce wages, based on the simple explanation that the employer is undergoing reorganization, which is self-evident under Chapter 11.⁶ Unlike the non-bankruptcy context, however, Chapter 11 establishes a separate and designated regulated bargaining environment⁷ and envisions continuous operation, while assuming the cooperation of the employees. Because Chapter 11 reorganizations also assume the reduction of operation costs, including the costs of labor, the scene inevitably becomes a charged struggle. Within this context, the power conferred upon the firm's management, now the Debtor-In-Possession (DIP)⁸ over the firm's employees is determined by the boundaries of the firm's controlling rights.⁹ These, in turn, are established through participation rights in the preparation and approval process of the reorganization plan, as well as the basic characteristics and limits of DIP discretion. In other words, the position of the firm's controller, its rights, obligations, and natural alliances, as well as that of the firm's employees, determine the position of the firm's employees.

Since Congress introduced Chapter 11 in 1978, the regulations pertaining to this power relation have developed significantly. When introduced, nothing in Chapter 11 addressed either the issue of collective bargaining, or redundancies more generally. It was assumed that the general rules governing the contract of employment would apply within Chapter 11's domain as well. Nonetheless, the reality of

tive Systems Inc., all Michigan based companies, were all under Chapter 11. Production lines were shut and relocated abroad, mainly to Mexico. See BLUESTONE BARRY & HARRISON BENNETT, *THE DEINDUSTRIALIZATION OF AMERICA: PLANT CLOSINGS, COMMUNITY ABANDONMENT, AND THE DISMANTLING OF BASIC INDUSTRY* (1982) ("By deindustrialization is meant a widespread, systematic disinvestment in the nation's basic capacity.") See also Arthur S. Alderson, *Explaining Deindustrialization: Globalization, Failure, or Success?* 64 AM. SOC. REV. 701, 701 (establishing deindustrialization as a political choice, the authors find no linear regression between globalization and deindustrialization across 18 OECD nations during the 1968–1992 period).

6. Travis J. Ketterman, *The Impact of Employer's Bankruptcy on Employees*, 94 ILL. B.J. 304 (2006). Note, that under the Worker Adjustment and Retraining Notification Act, an employer with one hundred or more employees is required to give at least sixty days advance notice before the employer undertakes a "plant closing" or "mass layoffs." Worker Adjustment and Retraining Notification Act, §§ 2–5, Pub. L. No. 100-379, 102 Stat. 890, 890–94 (1988) (codified at 29 U.S.C. §§ 2101–04 (2006)).

7. See generally Kevin A. Kordana & Eric A. Posner, *A Positive Theory of Chapter 11*, 74 N.Y.U. L. REV. 161 (1999) (applying game theory to analyze the Chapter 11 bargaining environment).

8. 11 U.S.C. § 1107(a) (2000) (dictating rights, powers and duties of a debtor in possession).

9. See generally MARGARET M. BLAIR, *OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY* (1994) (adopting a wide definition of corporate control, one that takes into account the various legal and institutional constraints on the controller's autonomy).

continuously operating in a climate of financial distress required that bankruptcy courts deal with precisely these issues. While doing so, bankruptcy courts reshaped the boundaries of control by continuously extending managerial discretion and avoided empowering employees with a voice through any of the various procedural mechanisms of Chapter 11. In the context of collective bargaining, political pressure induced the enactment of §§ 1113 and 1114 of the Bankruptcy Code, which dealt with amending CBAs or retirees' pension plans and required judicial response. This response was shaped by the unique setting of a distressed firm, the theoretical and practical context of bankruptcy regulations, as well as the institutional and historical context in which federal bankruptcy courts operate. Ironically, trade unions supported §§ 1113 and 1114 and Congress designed the sections to protect employees by incorporating the non-bankruptcy collective bargaining regime.¹⁰ However, eventually, these rules only encouraged companies to choose to undergo Chapter 11 reorganizations for the purpose of rejecting existing CBAs and altering pension plans under their favorable court-made regime.¹¹

This Article reviews these developments while examining their origins and causes. Part II describes the theoretical and institutional setting in which Chapter 11 operates with respect to employee rights. As described in Part II, the goal of maximizing the firm's value, the desire to protect the firm as an organ on which various stakeholders depend, and the institutional context in which federal bankruptcy courts operate are the most significant factors in shaping Chapter 11's development and future.¹² As the basis for analyzing Chapter 11's development and future, the analysis provides a context that goes beyond the issue of the firm's employees to the more general context of corporate control. In Part III, this Article reviews the development of the regulations from the perspective of the relationship between the firm's employees and the DIP management. In Part IV, this Article examines the current state of Chapter 11 reorganizations. Emphasis is placed on the rise of secured creditors and DIP financiers, who in recent years have managed to exert increasing control. Although the

10. See *infra* Part III(B)(6).

11. See *infra* Part III(B)(6). See also DELANEY, *supra* note 4, at 82-125.

12. See BARRY M. MITNICK, *THE POLITICAL ECONOMY OF REGULATION: CREATING, DESIGNING, AND REMOVING REGULATORY FORMS* (1980) (regarding the development of regulations); ROBERT BALDWIN & MARTIN CAVE, *UNDERSTANDING REGULATION: THEORY, STRATEGY, AND PRACTICE* 32 (1999). As Baldwin suggests: "[I]t would be optimistic, even rash, to suggest that such [regulatory] theories can be synthesized so that reliable predictions can be made about all or most regulatory processes. Different theories exist at differing levels of generality and have varying applications and uses as explanatory tools." *Id.* at 32.

2009 employee-driven Chapter 11 restructurings of Chrysler and General Motors must be seen as exceptional cases, the historical, political, and economic conditions which allowed these reorganizations to take place still persist and may point in some important respects to the future of employees and Chapter 11 more generally. Part V discusses this future.

II. THE DETERMINANTS OF CHAPTER 11'S DEVELOPMENT

Before embarking upon a detailed review of the legal regime and its development since 1978, it is helpful to set the scene and identify the regulations' sources of influence. Together, these sources of influence establish the backdrop for understanding the basic logic and limits of the formal rules of Chapter 11, their subsequent interpretation by the courts, and the potential for employee participation in the Chapter 11 bargaining process. This setting accordingly places the discussion regarding employment rights within the larger issue of the firm's controlling rights during a Chapter 11 procedure. Only if we set the relevant legal developments within this larger setting of Chapter 11 can we make any valid assumptions regarding the future.

A. *Chapter 11 as a Value Maximization Creditor Enforcement Mechanism*

According to the dominant scholars' view, Chapter 11 and, more generally, the Bankruptcy Code should exclusively establish a compulsory collectivist arrangement that will maximize returns to creditors (the Creditor Wealth Maximization Model).¹³ This view of the logic and limits of the law is underpinned by an ideological vision regarding the role and limits of corporate law more generally. Thus, since the role of the law outside the bankruptcy realm is to maximize share value, within the bankruptcy realm, the role of the law remains incentivizing the maximization of value. The difference being that in bankruptcy, while shareholders are ousted from control, control shifts to the company creditors, providing the firm's residual claimants with the strongest incentive to maximize proceeds.¹⁴

Thus, bankruptcy procedures should come into play only when multiple withdrawal rights are triggered and when the exercise of these rights by individual investors is costly and interferes with the deploy-

13. THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 53, 212 (1986).

14. Katherine H. Daigle & Michael T. Maloney, *Residual Claims in Bankruptcy: An Agency Theory Explanation*, 37 J.L. & ECON. 157 (1994).

ment of the firm's assets.¹⁵ Such procedures will reduce strategic costs, enable administrative efficiency, and increase the value of the aggregate pool of assets by providing the possibility of liquidation, ongoing business activity, or corporate restructuring. An underlying assumption of this economic analysis of the law is that the compulsory procedure saves the multiplicity of collection costs if creditors were not obligated to act as a collective. Thus, the law fulfills a secondary role by reducing the risks associated with default to creditors, while minimizing credit costs so as to contribute to overall growth.¹⁶

Under economic analysis, no reference should be made to distributive concerns in bankruptcy. Thus, effect should be given only to existing pre-insolvency rights, and new rights should not be created.¹⁷ Importantly, the protection of employment is an issue of labor law outside the realm of bankruptcy regulations. As Baird put it: "Every investor in a firm bargains explicitly at the time he contributes assets to the firm for the power to extract his assets from the firm if events do not work out as planned."¹⁸ The establishment of new entitlements in the bankruptcy realm conflicts with the collectivization goal and serves as an incentive for a particular holder of rights to resort to bankruptcy to gain the advantages the scheme provides even when a bankruptcy proceeding is not in the collective interest of the investment group. It follows that keeping the firm in operation to protect non-creditors and other victims of corporate bankruptcy, such as employees, is not the role of the law.¹⁹ Instead, the central objective of the law is to maximize returns from assets, whether by reorganization or liquidation, without any moral value attached to either of these options; it is strictly a matter of reaching the best value that can be obtained on a dollar-equivalent basis.²⁰ Thus, this approach accepts the

15. Referred to as the "common pool problem." See Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 864 (1982).

16. See generally William H. Meckling, *Financial Markets, Default, and Bankruptcy: The Role of the State*, 41 LAW & CONTEMP. PROBS. 13 (1977); Fred J. Weston, *Some Economic Fundamentals for an Analysis of Bankruptcy*, 41 LAW & CONTEMP. PROBS. 47 (1977).

17. VANESSA FINCH, *CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES* 28 (2d ed., 2009); Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127, 131 (1986).

18. Baird, *supra* note 17, at 131.

19. JACKSON, *supra* note 13, at 25.

20. See Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 758 (2003) ("[W]e have a going-concern surplus (the thing the law of corporate reorganizations exists to preserve) only to the extent that there are assets that are worth more if located within an existing firm. If all the assets can be used as well elsewhere, the firm has no value as a going concern."); see also Charles W. Adams, *An Economic Justification for Corporate Reorganizations*, 20 HOFSTRA L. REV. 117, 133 (1991) ("[M]ost assets are probably not highly firm-specific, and so, most insolvent corporations will not have substantially greater going concern

assumption that in some cases, maximizing the value of the firm's assets must involve corporate restructuring and an opportunity to withhold claims, but this is connected to the need to maximize returns rather than safeguard employment.²¹ Accordingly, the goal of value maximization and the need to refrain from creating special legal rules within the bankruptcy realm undermine and contradict the establishment of special employee protections under Chapter 11.

With this background in mind, it is clear why the detailed rules of Chapter 11 provide creditors with strong controlling rights. Chapter 11 establishes a liquidation floor as the standard for approving a reorganization scheme²² and includes provisions such as the "cram down" provision²³ and the absolute priority rule.²⁴ Although the courts may have initially dealt with these provisions rather flexibly,²⁵ Congress designed the rules to assure that restructuring will take place only if it is likely to generate more income for creditors than liquidation.²⁶ Chapter 11 also established the doctrine of adequate protection,²⁷ which the courts have interpreted as requiring a debtor to provide "the most indubitable equivalence [to one's security interest]."²⁸ This doctrine was designed to guarantee that a restructuring plan would not disadvantage secured creditors. While courts did not compensate

than liquidation values and, consequently, will not be good candidates for an effective reorganization.").

21. See H.R. REP. NO. 595, at 220 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6179 ("[T]he premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap."); see also Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1991).

22. See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 1129(a)(7)(A)(ii), 92 Stat. 2549, 2636 (1978) (codified at 11 U.S.C. § 1129(a)(7)(A)(ii) (2006)) (stating that each creditor will receive at least as much as he will receive if the debtor was liquidated under Chapter 7). However, § 1129(a)(7)(A)(i) allows the court to confirm a plan if each member of the impaired class accepts it.

23. *Id.* § 1129(b) (codified at 11 U.S.C. § 1129(b)(1)).

24. *Id.* § 1129(a)(7)(A)(ii) (codified at 11 U.S.C. § 1129(a)(7)(A)(ii)) (indicating that under the absolute priority rule, no class of creditors will receive any value under a restructuring plan without the consent of the superior class of creditors according to the majority required in each class or if it is paid in full.).

25. Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285 (1990). This is no longer the case. See Lawrence A. Weiss & Vedran Capkun, *Bankruptcy Resolution: Priority of Claims with the Secured Creditor in Control* (Am. Law & Econ. Ass'n Annual Meeting, The Berkley Electronic Press, Working Paper, 2007).

26. Jack Friedman, *What Courts Do to Secured Creditors in Chapter 11 Cram Down*, 14 CARDOZO L. REV. 1495 (1993).

27. Bankruptcy Reform Act of 1978, § 361 (codified at 11 U.S.C. § 361 (2006)) (indicating that adequate protection has to be proven in order to justify the continuation of the automatic stay).

28. *Metropolitan Life Ins. Corp. v. Murel Holding Corp. (In re Murel Holding Co.)*, 75 F.2d 941, 942 (2d Cir. 1935) (Learned Hand, J.).

creditors for the time spent under Chapter 11,²⁹ the doctrine indicates a commitment towards the protection of credit. As this Article will show further below,³⁰ these legal mechanisms have paved the way to the increased ability of capital providers to dominate the procedure. Together with other legal rules and judicial doctrines, it is understood that a relation of dependency has been created between secured creditors and the DIP. This allows secured creditors to share control with the DIP and ultimately to dictate Chapter 11's business outcomes.

B. *Chapter 11 as a Mechanism for the Protection of Stakeholders*

In direct reaction to the abovementioned view of the law, the stakeholder view of bankruptcy regulations focuses on the importance of the multiplicity of parties and stakes that are at risk once the firm fails.³¹ Well connected to the more general ideological view of the role of corporate law outside the bankruptcy domain,³² proponents of this view argue that Creditors' Wealth Maximization fails to recognize the legitimate interest of many who are not defined as contract creditors, devalues business relationships that have not been formulated into contracts, fails to recognize other forms of contribution to the company, and neglects non-economic values of a moral, political, social, and personal kind.³³ Thus, instead of emphasizing private contractual rights and fixed claims, bankruptcy law should weigh the interests of the broad range of stakeholders affected by corporate distress. Professor Warren, the leading proponent of this approach, sees bankruptcy law with its "inadequate pie to divide and the looming discharge of unpaid debts"³⁴ as an attempt to reckon with a debtor's multiple defaults and to distribute the consequences among a number of different actors.³⁵ Thus, the redistribution of entitlements is, and ought to be, promoted so that on bankruptcy high priority claimants and the absolute priority rule will give way to other interest holders, including the community at large, in sharing the value of the bankrupt firm. This approach gives high value to distributional concerns:

29. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988).

30. See *infra* Part IV.

31. ROY M. GOODE, *PRINCIPLES OF CORPORATE INSOLVENCY LAW* 36-47 (2d ed. 1997).

32. See Merrick E. Dodd, *For Whom are Corporate Managers Trustees?* 45 HARV. L. REV. 1145 (1932) (articulating the basis for the stakeholder theory of the corporation); see also R. EDWARD FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* (1984).

33. Karen Gross, *Taking Community Interests into Account in Bankruptcy: An Essay*, 72 WASH. U. L.Q. 1031, 1031 (1994); Donald R. Korobkin, *Rehabilitation Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717 (1991); see also FINCH, *supra* note 17, at 40-43.

34. Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 785 (1987).

35. *Id.* at 789-93.

“bankruptcy is simply a federal scheme designed to distribute the costs among those at risk.”³⁶ Regarding employees, Warren stated that Chapter 11 has the important objective of maximizing the wealth of the debtor’s estate, but also of serving the distributional interests of many who are not “technically” creditors but have an interest in a business’ continued existence. This includes, for example, older employees who could not have retrained for another job:

By giving the debtor business an opportunity to reorganize, the bankruptcy scheme acknowledges the losses of those who have depended on the business and redistributes some of the risk of loss from the default. Even if dissolution is inevitable, the bankruptcy process allows for delay, which in turn gives time for all those relying on a business to accommodate the coming change.³⁷

In practice, the vision of the law as a mechanism for stakeholder protection is echoed within the direct and indirect legal mechanisms which together shape the Chapter 11 bargaining environment. For example, Congress provided many reasons, including the public interest and the protection of stakeholders, for the enactment of the 1978 Bankruptcy Code, the repeal of the New Deal Chandler Act,³⁸ and the re-introduction of an insider—the DIP—as facilitators of increased corporate restructuring.³⁹ The underlying assumption was that because of the management opportunity to retain control, more corporate reorganizations would take place. Similarly, the commencement of the “automatic stay” immediately after a Chapter 11 application is submitted⁴⁰ incentivizes the triggering of the bankruptcy procedure at an early stage of financial decline. Effectively the company, which can still trade under the control of the pre-bankruptcy management, becomes an anomalous legal creation with significant powers, which can enforce rights but cannot be asked to fully respect

36. *Id.* at 790.

37. *Id.* at 787–88.

38. The Chandler Act directed large-scale corporate reorganizations into Chapter 10 of the Code, imposing the appointment of a trustee, discharged the board and gave the SEC a strong oversight role. Bankruptcy Act, ch. 575, 52 Stat. 883 (1938).

39. See 124 CONG. REC. 32,392 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards) (regarding the interest of the “investment public, jobs and troubled businesses”); 124 CONG. REC. 33,990 (daily ed. Oct. 5, 1978) (per Sen. DeConcini). See H.R. REP. NO. 95-595, at 53–62 (Sep. 8, 1977), reprinted in 1978 U.S.C.C.A.N. 6014–23, for a discussion of the impact of bankruptcy on the community Bankruptcy Reform Act of 1978. See H.R. DOC. NO. 93-197 (Sep. 6, 1973) (regarding the “overriding community goals and values” in bankruptcy), for a discussion of the Bankruptcy Laws of the United States.

40. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 363, 92 Stat. 2549, 2549 (1978) (codified at 11 U.S.C. § 363 (2006)).

its obligations.⁴¹ The onus of lifting the stay of procedure, rather than justifying it, is on the company creditors. An underlining assumption is that the retention of control and the ease in which Chapter 11 can be triggered and sustained would protect a variety of stakeholders since it will increase the number of failing businesses undergoing reorganizations at an early stage.

Following the legislation, and while referring to the terminology Congress used when passing the Act, bankruptcy courts have taken the Act to contain an implicit policy of facilitating corporate reorganizations for the purpose of protecting the investing public and jobs, as well as addressing concerns about the impact of bankruptcy upon the community and the general public.⁴² In practice, this has meant that for the purpose of facilitating corporate reorganizations, courts have continuously widened this newfound managerial discretion. For example, allowing companies to routinely extend the stay of proceedings as well as the “exclusivity period” over and beyond the statutory six-month limit confers bargaining power onto the DIP.⁴³ Of course, the length of the moratorium and its scope, combined with managerial discretion, significantly circumvents the employees’ ability—unionized or not—to influence the outcome of the Chapter 11 negotiation process. As an example, between 1980 and 2012, the average duration of a large corporate non-pre-packaged Chapter 11 proceeding has been nearly two years.⁴⁴ During this time, employees are under pressure to agree to the very minimum proposed since firms can easily dispose of them. Courts further expand managerial discretion by allowing the

41. It has been suggested that Chapter 11 resembles an anti-takeover “poison pill” whereas transition in control can only take place through the court. See Bradley & Rosenzweig, *supra* note 21.

42. See *NLRB v. Bildisco*, 465 U.S. 513, 528 (1984) (“[T]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.”). The court went on and cited the views expressed by congress—the purpose of facilitating restructures—as the basis for such an interpretation of the law. *Id.*

43. Bankruptcy Reform Act of 1978, § 1121 (b), (c)(3) (codified at 11 U.S.C. § 1121(b), (c)(3)) (governing the exclusivity period, which currently grants the debtor a 120-day period to propose a reorganization plan, and an additional sixty day period to have its plan accepted). Only after the expiration of this 180-day period may creditors submit their own reorganization plan. *Id.* See also Kordana & Posner, *supra* note 7 (using game theory to model Chapter 11 bargaining).

44. Lynn M. LoPucki developed a bankruptcy research database of all public corporations undergoing bankruptcy reorganization in the USA. *Bankruptcy Research Database*, UCLA, available at <http://lopucki.law.ucla.edu/> [hereinafter *Bankruptcy Research Database*] (last visited Apr. 2, 2012). He regards large public corporations as such if the debtor’s assets exceed \$500 million. His database indicates that such restructurings took on average 697 days. *Id.* at http://lopucki.law.ucla.edu/tables_and_graphs/Average%20Case%20Duration%202001-2011.pdf.

DIP to shut down and sell business units practically at will.⁴⁵ Thus, although Congress designed the plan approval stage to allocate participation rights to creditor classes, through “pre-packs,” workouts, and ongoing Chapter 11 foreclosures, not much is left for the plan confirmation stage.⁴⁶

This increase in managerial discretion furthers the U.S.-centralized management model for corporate governance and control, but has been legitimized under the notion of increased stakeholder protection.⁴⁷ The assumption is that the increase in the number of corporate reorganizations will result in a reduction of unnecessary liquidations. However, from the perspective of the company employees, the stakeholder view of the company has another important consequence: in labor-management conflicts, this approach undermines the bilateral context in which the labor–capital conflict has been regulated since the New Deal, moving the conflict from a bilateral to a multilateral context.⁴⁸ In other words, outside the bankruptcy realm, Congress has regulated collective bargaining through laws that focus on the power relation between employees and management through collective bargaining, advance notice, and protections against unfair dismissals. Introducing the stakeholder model into the adjudication of labor disputes within the realm of bankruptcy undermines this bilateral context. Indirectly, it reduces the power of the firm’s employees, who now face multilateral interests and various stakeholders whose interests may or may not converge with their own. This problem will be further explored below after dealing with the issue of collective bargaining under Chapter 11.

45. See Bankruptcy Reform Act of 1978, § 363(b) (codified at 11 U.S.C. § 363(b)) (establishing the terms under which it is possible to sell the property of the estate outside the ordinary course of business. This section requires court authorization after notice and hearing.). Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1066 (2d Cir. 1983) (establishing the “sound business reason” requirement for approving a sale). *But see In re White Motor Credit Corp.*, 14 B.R. 584, 590 (Bankr. N.D. Ohio 1981) (requiring “Imminent Emergency”). See *infra* Part III(B)(4).

46. See *infra* Part IV.

47. See *supra* note 39.

48. See Richard L. Merrick, *The Bankruptcy Dynamics of Collective Bargaining Agreements*, 91 COM. L.J. 169, 188 (1986) (noting the conflict between employee interests and the purpose of the procedure. “[T]he bankruptcy’s court role is to balance the interests of all the adversaries and produce a fair and equitable result. Modifications of a collective bargaining agreement have bilateral significance, but that is relatively unimportant in the overall objective of bankruptcy.”). According to Stakeholder theory, the strategy of building alliances enables the company to counter antagonistic stakeholders and to escape a bilateral relationship in favour of a multilateral one. EDWARD R. FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* 135 (Cambridge Univ. Press 2010).

C. Chapter 11 and the Issue of Forum Shopping

The third determinant that needs to be addressed to understand the forces influencing Chapter 11's evolution is the tension that underpins the regulations and which stems from the existence of two separate political frameworks. While bankruptcy is federal law, when a labor-management conflict is at the core of the procedure, state law has been developed through judicial law making to expand managerial discretion and, subsequently, states have attracted the business of the big bankruptcy cases.

This phenomenon occurs because the bankruptcy venue provisions are quite flexible, permitting a troubled firm to file for bankruptcy in any district where it has its principal place of business, principal asset or domicile, or where an affiliated company filed for bankruptcy.⁴⁹ Effectively, this permits large public corporations, which have business all over the country, to file for bankruptcy anywhere they wish. Throughout the 1980s companies would routinely file their bankruptcy applications in New York, close to the big law firms and away from the production lines. By the early 1990s this had changed, and Delaware became the venue of choice for most large public corporate reorganizations.⁵⁰ Today Delaware is still the leading venue, with New York still a significant forum, and the rest of the U.S. bankruptcy courts trailing far behind.⁵¹

Professor LoPucki argues that the problem begins with judicial self-interest. According to LoPucki, the status that the power relating to managing the big cases confers goes beyond the courtroom to encompass finance, professional, and media circles. Managing the large cases provides bankruptcy judges with a high profile and status. Furthermore, as part of the local legal community, attracting big cases, LoPucki argues, is a form of debt payment to the community in which the judge adjudicates. As one judge noted anonymously:

It's an economic thing. A lot of money flows to Delaware because of these cases. It supports a cottage industry of local counsel. The money goes to everything from cabs, to the train station, to hotels.

49. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 102(a), 98 Stat. 333, 334 (1984) (codified at 28 U.S.C. § 1408 (2006)).

50. See generally Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 Nw. U. L. Rev. 1357 (2000) (attributing the rise of Delaware to the filing of the Eastern Airline Bankruptcy in March 1989). See also LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR THE BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* 49, 68 (Univ. Mich. Press 2005) (noting that in 1996, eighty-seven percent of all big cases were filed in Delaware, and from 1991-96, forty-one new big cases filing were made in Delaware compared with New York's fifteen).

51. LOPUCKI, *supra* note 50, at 245.

You can't get a hotel room there some nights, and who goes to Delaware? It's very important to them. You've got to look at all sides. As a visiting judge, you have to be sensitive to the local culture.⁵²

The rise of Delaware to prominence as the venue of choice for large corporate reorganizations has been controversial. Generally, some believe that while forum shopping is undisputed, it reflects the expertise and efficiency that the court of choice acquires through ongoing handling of bankruptcy procedures.⁵³ Furthermore, it is also believed that the stakes related to maintaining Delaware's position as the venue of choice incentivizes the preservation of their ongoing expertise, which has led to the "success" of the Delaware (and New York) bankruptcy courts in managing large corporate restructurings.⁵⁴ The repetitive role of the courts gives predictability to the procedure and attracts further big cases. During the 1990s, LoPucki and Kalin provided empirical support to undermine the merits of the "Delawarization" of Chapter 11 reorganizations. They found that Delaware-restructured corporations are likely to require a second bankruptcy filing.⁵⁵ Nonetheless, this was justified as an efficient "weeding out" process of the marginal and more difficult cases, which have the opportunity to realize that they do need a complex, lengthy, and expensive Chapter 11 restructuring after filing and implementing prepacks.⁵⁶ But those who explain and justify such phenomena, and those who criticize it, suggest that Delaware judges do not (or cannot) properly scrutinize the reorganization plans they confirm.⁵⁷

On the other hand, there are several objections to the rise of New York and Delaware as the venues of choice. First, the advantage of Delaware for the debtor is its inconvenient geographical location for small, local creditors that incorporated elsewhere; they find it difficult to challenge and participate in the procedure in Delaware. Most corporate debtors can file in Delaware because they or one of their affiliated companies incorporated in Delaware, and not because they have

52. *Id.* at 95.

53. David A. Skeel, Jr., *What's So Bad About Delaware?*, 54 VAND. L. REV. 309, 319 (2001); Rasmussen & Thomas, *supra* note 50, at 1385.

54. DAVID A. SKEEL, *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 132, 230 (2004); *see also* Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987, 1991-94 (2002).

55. *See* Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom"*, 54 VAND. L. REV. 231 (2001); *see also* Lynn M. LoPucki & Joseph W. Doherty, *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, 55 VAND. L. REV. 1933 (2002).

56. Robert K. Rasmussen & Randal S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 VAND. L. REV. 283, 288-89 (2001).

57. *Id.* *See also* LoPUCKI, *supra* note 50, at 240-43.

their actual production or ongoing businesses there. What is true for small, unsecured creditors is also true with respect to the company employees, who are not residents of Delaware. Even though they can hire a local representative, the court is far away from the avenues of influence and pressure that come with a lengthy bankruptcy procedure, ongoing downsizing, and the related social unrest. The second, closely related reason is that the rise of the Delaware bankruptcy court is due to its ability to develop a cozy relationship with the bankruptcy bar, the case setters, who bring the cases to Delaware. Thus, the lawyers representing the debtor are granted high (some may say excessive) fees, which incentivize them to come again.⁵⁸

Accordingly, the procedural leniency that bankruptcy courts established has been attractive to the DIP, allowing it to effectively retain control over the procedure and its outcomes. For example, waiver of interest rates on loans once a Chapter 11 procedure is triggered is treated differently in Boston than in Delaware (allowed in the latter). Exclusivity periods are extended routinely in Delaware and New York, up to three years on average,⁵⁹ usually ending only when the creditors agree to a plan. Before plan conformation, New York and Delaware courts generously and routinely grant Section 363 sales of material company assets, divisions, and sometimes the whole of the business or the company during this time. “Critical Vendor” orders, for example, allowing post-bankruptcy payments to particular non-secured creditors, are allowed in Delaware and in other courts that compete for the big cases, whereas in other, non-participating courts, it is not.⁶⁰ Delaware and New York routinely approve exemption from liability for the company’s directors. In both jurisdictions, it is certain that a trustee to the company would not be appointed even in the most controversial cases, such as WorldCom and Enron, both administered in New York. And lastly, Delaware and New York always approve pre-packaged bankruptcies, leading LoPucki to call these courts

58. Cf. LoPUCKI, *supra* note 50, at 128 (noting that in 2000 Delaware got forty-five of the seventy-nine cases filed nationally (fifty-seven percent) and awarded in these cases over \$700 million in professional fees and expenses). LoPucki discusses the waiver of fee caps and the routine approval rate of lawyer fee applications. *Id.* at 141–43.

59. See *Bankruptcy Research Database*, *supra* note 44.

60. See *In re Kmart Corp.*, 359 F.3d 866, 868 (7th Cir. 2004) (indicating an order to allocate \$300 million to critical vendors was described by the Chicago Bankruptcy Court as an “open-ended permission to pay any debt to any vendor [Kmart] deemed ‘critical’ in the exercise of unilateral discretion.”); see also LoPUCKI, *supra* note 50, at 132–35 (describing the Chicago Seventh Circuit decision to disallow such an order, together with the disapproval of exclusion of liability to the company directors, as the cause for the demise of Chicago as a venue of choice).

no more than “rubber stamp[s] for pre-packs.”⁶¹ All these, of course, confer significant bargaining power to the debtor *vis-à-vis* all its creditors, including its employees, inducing debtor-firms to choose these particular jurisdictions again.

Against the background of these separate avenues of influence, the law—both the basic mechanisms of Chapter 11 as well as *ex post* judicial law making—has shaped the trajectory in which Chapter 11 has developed. An ideological view regarding wealth maximization has embraced the economic benefits of allowing firms a second chance while vesting power with firm managers and creditors. This was combined and supported by a notion regarding stakeholder protection, also supportive of allowing failing firms a chance to reorganize their affairs while eliminating employee objections to corporate reorganizations. These dominant visions of bankruptcy law, combined with the institutional framework in which bankruptcy courts operate while competing over the big cases, influenced the development of the law, while continuously undermining employee protection.

III. THE PAST: CHAPTER 11, STRATEGIC BANKRUPTCIES, AND THE RESTRUCTURING OF THE LABOR FORCE

A. *Employees and the Making of Chapter 11*

Historically, nothing in the function of bankruptcy law required that the treatment of employees would be through a designated and separate procedure.⁶² In 1938, Congress introduced the Chandler Act,⁶³ establishing a new legal regime for the restructuring of large public corporations. Congress designed the Chandler Act with the objective of loosening the control of investment bankers (the issuers of corporate bonds) and insiders (the managerial elites, majority shareholders, and lawyers) over bankruptcy reorganizations, prevalent during the restructuring of the railroads.⁶⁴ In large corporate reorganizations, through Chapter 10 of the Code, the Chandler Act introduced the SEC (itself established in 1934)⁶⁵ and the courts as the government’s safeguards for the investment public interest (minority shareholders,

61. LoPucki, *supra* note 50, at 74 (noting that seventy-seven percent of cases in Delaware were “pre-packs.”).

62. The notion that employee rights should be no different in the out-of-bankruptcy context fits into the creditors’ wealth maximization model, according to which bankruptcy must exclusively respect pre-insolvency rights. See *supra* Part II(A).

63. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101, 92 Stat. 2549, 2549 (1978) (codified at 11 U.S.C. § 101 (2006)).

64. SKEEL, *supra* note 54, at 125.

65. See Securities Exchange Act of 1934, Pub. L. No. 73-291, § 4(a), 48 Stat. 881, 885 (1934) (codified at 15 U.S.C. § 78d (2006)).

but mostly debenture holders). It required strict adherence to the absolute priority rule, meaning that no class of creditors could retain any value under a restructuring plan if an upper class of creditors was not paid in full. By adhering to absolute priority, the Act targeted the ability of insiders to control bankruptcy procedures through equity receivership and other contractual arrangements. Through this control, bankers reorganized failing firms while re-issuing bonds to finance them anew and while allowing the previous management and particular connected shareholders to retain control. Accordingly, Congress designed the Chandler Act to break the alliance between bankers and managerial elites, and to protect the investing public.

Simultaneously, Congress dealt with and transformed collective labor legislation during the New Deal by introducing the Wagner Act⁶⁶ and other related institutions designed to enable collective bargaining and to advance a new compromise between labor and capital. This separation between the world of bankruptcy and that of labor legislation was maintained throughout the introduction of Chapter 11 in 1978. The subtle assumption—that bankruptcy is not the arena for labor legislation—was maintained throughout the legislation period and the “meta bargaining” that preceded it.⁶⁷ This separation explains, accordingly, the almost complete non-involvement of labor representatives during the legislative process of Chapter 11.⁶⁸

Ultimately, this lack of explicit labor related ideology in the formation stage of the legislation explains the fact that Chapter 11 was adopted through non-partisan voting with supporting majorities on both sides of the political realm: “the substance of bankruptcy law was not terribly political in terms of party ideology.”⁶⁹ A story relating to the signature of President Carter on the Bill in 1978 reveals the extent of the “non politicization” of Chapter 11’s enactment process:

[A]ccording to sources, perhaps apocryphal, the President called his long time colleague, Attorney-General Griffin Bell, from Camp David for advice minutes before midnight on the final day the bill could be signed into law. The President asked Bell what he should

66. National Labor Relations Act, Pub. L. No. 74-198, § 1, 49 Stat. 449, 449 (1935) (codified at 29 U.S.C. § 151 (2006)).

67. See BRUCE G. CARRUTHERS & TERENCE C. HALLIDAY, *RESCUING BUSINESS: THE MAKING OF CORPORATE BANKRUPTCY IN ENGLAND AND THE UNITED STATES* 15 (Clarendon Press 1998) (defining “meta bargaining” as negotiations over the system of property rights rather than property exchange).

68. See *id.* at 81, 83, 84, 87–88, 94–95, 97, 99–100 (mentioning the National Bankruptcy Conference and the National Conference of Bankruptcy Referees (both from within the legal profession), the Commercial Law League (composed of bankruptcy lawyers), the Judicial Conference of the United States and the finance industry).

69. *Id.* at 90.

do. Bell replied that so many people had worked so hard on it, the President should go ahead 'and sign the damn thing.' And so he did.⁷⁰

The absence of labor organizations from the debate preceding the legislation, accordingly, is connected to the overall absence of explicit ideologies during Chapter 11's enactment stage. As Carruthers and Halliday put it, Chapter 11 "carries the mark of weakened unions and assertive company managers."⁷¹ The trade unions' limited contribution to the reform focused on benefits to workers in bankruptcy, while participation rights were not pursued.⁷² Carruthers and Halliday suggest that "labor may have been distracted, for it was heavily involved with bills such as the Employee Retirement Income Security Act, which passed in 1974 with the strong support of organized labor, and the Labor Law Reform Act, which unions tried to get passed in the late 1970s. . . ."⁷³ Consequently, employees' interest in the bankruptcy scheme was limited to safeguarding the existing position of employees as preferred creditors in a distribution scenario, rather than pursuing avenues of obtaining a voice during corporate reorganizations. This priority status was established before the reforms were put in place and were only maintained under the reform. According to their priority status, employees were paid ahead of unsecured creditors while the amount was capped at a limited sum. When Congress revisited the law, lobbying was trapped in a conceptual framework dictated by their prior bankruptcy experience and the traditional rules regarding employee protections (improving their priority, increasing the maximum sum to which their priority applied, and extending priority to employee benefits). While channelling their focus and demands towards these areas, trade unions completely failed to understand and anticipate the consequences of the 1978 reform and neglected the opportunity to lobby for protection thorough the terms dealing with executory contracts and collective agreements or plan approval. Indeed, "[the] workers' well entrenched position in prior bankruptcy statutes proved something of a liability, especially in the United States, for it locked organized labor into a conceptual frame that blinded it to dangers that

70. *Id.* at 86.

71. *Id.* at 9.

72. CARRUTHERS & HALLIDAY, *supra* note 67, at 328–30 (indicating that the Chief legal council of the Garment Workers Union, Max Zimny, led the charge on behalf of the American Federation of Labor and the Congress of Industrial Organizations). In an interview, Zimny referred to his efforts as "singular." *Id.* at 329.

73. CARRUTHERS & HALLIDAY, *supra* note 67, at 328–29.

only became fully apparent after the Bankruptcy Code had been enacted."⁷⁴

Importantly, instead of attracting politicians and union lobbyists, the pre-Chapter 11 legislation process attracted legal professionals. Thus, in front of the Congress judiciary committee to which the bill was submitted, bankruptcy practitioners and judges were the dominant active participants.⁷⁵ These participants rendered a professional non-partisan dimension to this process.⁷⁶ At the same time, the desire to uphold and in some ways increase the influence of the legal profession over large corporate reorganizations was highly relevant to the debate as well as to the procedure that was ultimately adopted: a court-driven procedure steered by lawyers, in which significant legal fees could be extracted and where the judiciary is of central importance. Instead of having an interest in the outcomes that would follow in a distributive, public policy perspective, these constituencies were consumed with the will to preserve (or enhance) their role within the procedure. Internal conflict regarding the elevation of bankruptcy judges to a status similar to that of federal court judges and the following subjection of large corporate reorganizations to their jurisdiction consumed the judiciary.⁷⁷ At the same time, this professional "colonization" of the debate eliminated the charged political struggle that the legislative process ought to have been, particularly given the decision to largely oust government supervision from large company restructurings and to reinstate the DIP. Ultimately, the decision to establish a court driven procedure, steered by lawyers, has been detrimental to the development of Chapter 11, not least because of the federal setting in which bankruptcy courts operate.

B. *Shaping Chapter 11's Bargaining Environment*

Formally, the courts were careful to reduce their role in any particular Chapter 11 proceeding to the orderly compliance of participants to its administrative guidelines.⁷⁸ Nonetheless, in practice, socio-political

74. *Id.* at 308.

75. SKEEL, *supra* note 54, at 175. Skeel discusses the fact that the SEC was absent from these debates. See also CARRUTHERS & HALLIDAY, *supra* note 67, at 63–157 (providing a detailed review of the role of the legal profession and the financial industry in shaping Chapter 11).

76. See ANDREW ABBOTT, *THE SYSTEM OF PROFESSIONS: AN ESSAY ON THE DIVISION OF EXPERT LABOR* (Univ. of Chi. Press 1988).

77. CARRUTHERS & HALLIDAY, *supra* note 67, at 84–86.

78. As Hon. Ronald Barliant of the Chicago Bankruptcy Court commented, "The subject of a chapter 11 plan is financial: the debtor's capital structure. Nothing in chapter 11 dictates the result in a particular case; you cannot look in a law book to find the optimal debt-to-equity ratio for a debtor. Chapter 11 creates a framework that allocates leverage and requires the gathering

choices were made in which the boundaries of control were redesigned. Examining the issue of employee protection from the viewpoint of controlling rights shows that there are three principal domains in which this is evident. First, in managing the restructuring of the business, courts have expanded managerial discretion by continuously moving the limits established under the procedural rules of the Code, effectively increasing the leverage that the DIP possesses throughout the restructuring negotiations. In practice, this has meant extending the time allowed to stay under bankruptcy protection, expanding the scope of the stay of proceedings, and favoring the debtor in disputes related to the management of the company, thus allowing the debtor to sell the entire business or at least parts of it during the procedure before a restructuring plan is approved. All these measures safeguard the debtor's discretion, effectively allowing the procedure to end successfully. In doing so, the courts have increased the temptation for the debtor to resort to bankruptcy for strategic reasons, and for these reasons alone.⁷⁹ Second, in relation to employees, beyond the implicit assumption that increased reorganizations will provide better protection of employment, courts did not provide them with participation rights that would reflect their interest in the firm beyond their contractual entitlements.⁸⁰ Thus, their ability to control or influence the content of the reorganization plan was blocked because they were excluded from the plan confirmation stage and creditors' committees. Third, courts created a new collective bargaining regime within the realm of Chapter 11. Under this regime, while emphasizing the collective nature of the process, courts effectively reduced collective rights as compared with the out-of-bankruptcy regime.⁸¹

1. DIP Control, Absolute Priority, and New Value

The primary balancing mechanism against the DIP's ability to control Chapter 11's business outcome was the requirement that any reorganization plan be approved in creditors' meetings by a predetermined majority and voted through classes of creditors with similar interests. Accordingly, a majority of creditors in a class can bind the other forty-nine percent, as long as the total dollar amount of

and exchange of information to produce a negotiated plan of reorganization." Hon. Ronald A. Barliant, *Advanced Chapter 11 Issues*, AM. BANKR. INST. (2001).

79. See *infra* Part III(B)(1) & (4).

80. See *infra* Part III(B)(2) & (3). Compare Joseph William Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611 (1988) (arguing for participation rights and the option to buy the failing firm as the acknowledgment of an employee proprietary interest in the firm, created through continuous work).

81. See *infra* Part III(B)(6).

the claims held by the majority is at least two-thirds of the total amount of all the claims that vote.⁸² This softened the harsh consequences of strict adherence to the Absolute Priority Rule, which existed under the Chandler Act and imposed a blanket prohibition on insiders (mainly shareholders and managers) from retaining any value in the company post-restructuring without the consent of all superior class of creditors (especially bond holders).⁸³ Under Chapter 11, it is presumed that the requirement for plan confirmation constitutes a counter balancing mechanism against the debtor's control over the content of a reorganization plan, while striking a balance against the problems associated with strict absolute priority.⁸⁴

The option to deviate from the absolute priority rule is enthusiastically taken advantage of. As some research shows, eighty percent of confirmed plans in cases involving publicly held corporations allocated some equity to old shareholders.⁸⁵ The retention of control by manager-shareholders is only a manifestation of the fact that a plan developed and conceived by the DIP is ultimately subject to very minimal contention by other stakeholders, not least employees and unsecured creditors. However, this excludes finance providers who are able to leverage influence through an alternative mechanism, mainly DIP financing mechanisms.⁸⁶ Employees' ability to influence the procedure, on the other hand, is largely dictated by the need to retain their services in the company, subject to the costs of dismissals as well as the hiring and training new employees.

The ability to control the negotiations and to obtain the consent of the creditor classes to the plan formulated by the DIP is made possible by several procedural rules, all established through continuous judicial rule setting. First, once entering the realm of Chapter 11, the DIP enjoys an exclusivity period to formulate and propose a reorganization plan; while this occurs, the "automatic stay" shelters it.⁸⁷ Effectively, this shifts leverage to the DIP *vis-à-vis* all its creditors, including the company employees, as only it can create a plan, which will serve as the basis for negotiations. Initially Congress limited the

82. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 1126(c), 92 Stat. 2549, 2634 (1978) (codified at 11 U.S.C. § 1126(c) (2006)).

83. See SKEEL, *supra* note 54 at 124-25 regarding the rule's origins.

84. 11 U.S.C. § 1126 (spelling out Chapter 11's voting rules).

85. See Barliant, *supra* note 78 (quoting Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990)).

86. See *supra* Part IV.

87. The exclusivity period gives the debtor one hundred twenty days to file a plan and another sixty days to solicit acceptance. Bankruptcy Reform Act of 1978, § 1121 (codified at 11 U.S.C. § 1121).

leverage of the DIP by putting a time constraint of four months on the exclusivity period. Contrary to this initial intention, however, courts allowed debtors to remain under bankruptcy protection for a considerable time, usually throughout the procedure and even when an initial offer had failed to be accepted. The initial stay is rarely contested since courts usually approve it. If, after the initial four months, a plan is not agreed to, the court is reluctant to make an order, which effectively renders the initial decision to permit Chapter 11 reorganization wrong. In other words, once the initial automatic stay period has failed to produce an agreement, the court has the perverse incentive to extend the stay to justify the initial decision not to intervene, and to help the DIP to reach a plan of reorganization. The incentive to carry on with the push for an accepted reorganization plan is supported by the flexible standards for acceptable plans contained in Chapter 11, which, as mentioned above, offer the debtor's managers and owners an opportunity to obtain shares in the reorganized firm.⁸⁸

Secondly, under Chapter 11, when only one class approves the plan, it can still be approved if it does not "discriminate unfairly" and is "fair and equitable."⁸⁹ These rules were developed under Chandler Act adjudication so as to avoid the harsh consequences of strict adherence to the absolute priority rule, and Congress transposed the rules into the 1978 Bankruptcy Code. As already discussed, unlike the Chandler Act, Chapter 11 today actually deviates from the absolute priority rule through a plan confirmation process that allocates value to a inferior class despite some creditors' objection. Furthermore, U.S. courts have created the doctrine of "cram down."⁹⁰ According to this doctrine, if a senior class agrees to a plan and no junior class receives payments or money's worth under the plan, the cram down rule allows the plan to be confirmed despite the objection of a lower class of creditors. Effectively, this means that the most senior class that is not paid in full (usually secured creditors) ends up owning the majority of company shares since the only confirmable plan would be one that gives the equity to that non-accepting creditor class. This further strengthens the control of secured creditors over the plan formation and approval process. Only if a superior class of creditors is convinced that lower ranking creditors have something to contribute to the value of the company will they agree that this class of creditors

88. Compare LoPucki, *supra* note 50, at 255 (noting that managers retain five to ten percent equity on average). See Lynn LoPucki & William Whitford, *Bargaining over Equity Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990).

89. Bankruptcy Reform Act of 1978, § 1129(b)(1) (codified at 11 U.S.C. § 1129(b)(1)).

90. *Id.* § 1129(b) (codified at 11 U.S.C. § 1129(b)).

retains some equity. Hence, the DIP works not only to protect its own interests, but also to satisfy the secured creditor, which holds strategic importance and increased influence over the DIP due to its position under this rule. Through this rule, the approval stage becomes the confirmation of a plan, which was effectively negotiated between the debtor and his superior class of creditor over the heads of the rest of the creditors.⁹¹

Furthermore, the absolute priority rule means that the classification of claims according to their priority is the most important issue in determining the nature of the reorganization plan that is produced. Under these circumstances, the decision not to recognize the special status of a particular creditor group within the priority of claims holds implicit importance. Not recognizing that employee claims are different than other claims in the priority scheme and adhering to the market configuration reflects an important policy decision.

The harsh effects of the absolute priority rule can be tempered by the court under the "New Value exception," which was created originally to ease the result of strict adherence to absolute priority under the Chandler Act.⁹² Under the New Value exception, the debtor's old shareholders are permitted to retain an interest in the company even though higher priority creditors are not paid in full, as long as the shareholders contribute "money or money's worth" to the restructuring effort.⁹³

When focusing on New Value as potentially being "money's worth," the issue of labor contribution naturally comes up. In theory, recognizing labor contribution as "New Value" would permit the allocation of rights to employees under a restructuring plan in the absence of the approval by a superior class of creditors. This, in turn, could allow employees to bargain for value in the reorganized firm when continuous operation and cooperation is required. When created, however, the New Value exception did not expand to include the right of shareholders or managers to retain their interest in the company through continuous work. Thus, managers' promise to continue managing the business in the future did not qualify as New Value because the value was regarded as too "intangible."⁹⁴

91. The third limb during these negotiations is the DIP financier who holds "super priority status" and through contractual mechanisms extract control. See *infra* Part IV.

92. See Douglas G. Baird & Robert K. Rasmussen, *Boyd's Legacy and Blackstone Ghost*, 1999 SUP. CT. REV. 393, 419-20 (1999).

93. *Case v. L.A. Lumber Prods.*, 308 U.S. 106, 123 (1939).

94. *Id.*

This must be understood against the backdrop of the pre-Chandler Act era, when insiders were able to freely retain ownership through equity receivership reorganizations, precisely the problem that the Chandler Act was supposed to address. From this perspective, through New Value, insiders could strike a deal with senior creditors over the heads of junior creditors, hence circumventing the intended purpose of the Chandler Act altogether.⁹⁵ On the other hand, under Chapter 11 the Absolute Priority rule allows a senior class of creditors to block a plan unless it is paid in full or the plan is approved by the rest of the class through the required majority voting. This veto power creates a particular problem in cases when value under a plan of reorganization (for example, through obtaining shares in the restructured entity) could be the only way to induce managers as well as employees to remain in the company. In other words, the New Value exception can be a way to avoid liquidation, inducing continuous contribution by lower creditor classes, while allowing for flexibility in the plan formation and approval process. Thus, bearing in mind the rigidity of the Absolute Priority rule, not allowing labor contribution to be regarded as “money’s worth” impedes potential reorganization. On the other hand, courts routinely permit old equity holders to retain value in the restructured firm through what they regard as a “fair and equitable” contribution of money to the company.⁹⁶

The problem reached the Supreme Court in the case of *Ahlers*.⁹⁷ A small family-held company, which owned and managed a farm, experienced financial difficulties and asked to confirm a Chapter 11 plan with its creditors. The senior of these creditors was a single lender holding a mortgage agreement with security interest over the whole of the farm. The secured creditor—as permitted under the absolute priority rule—was not willing to approve any restructuring plan if it left the owner-managers of the company in possession of the farm. On the other hand, the Ahlers, the owners of the farm, had to continuously work on the farm to preserve the value of its stock and crops so that they could pay off the mortgage and retain the chance that they would be able to pay their creditors in full if their fortunes changed. The Ahlers appealed to the bankruptcy court to acknowledge their continuous contribution to the farm as New Value and to approve a

95. See SKEEL, *supra* note 54, at 234.

96. See *In re Union Fin. Servs. Grp.*, 303 B.R. 390 (Bankr. E.D. Mo. 2003).

97. *Nw. Bank Worthington v. Ahlers*, 485 U.S. 197 (1988); see also John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 MICH. L. REV. 963, 964–65 (1989).

payment schedule, which would leave them in possession of the farm.⁹⁸

The U.S. Supreme Court, when considering the Ahlers' continuous work as New Value, was not willing to extend the exception so that it would include work. Rather, it regarded rights created through work (aside from wages, of course) as "non fixed claims" and thus as not qualified as "money or money's worth." Accordingly, because of absolute priority, as far as it relates to an equitable non-fixed claim, employees must be subordinated to all other creditors, including shareholders. Only after all other debtors are satisfied in full or agree to the plan may the firm employees leave the process with equity in hand.

The particular problem that *Ahlers* creates is recurrent in small and medium enterprises, where only through ongoing operation can a business survive and have any value at all. With the hope of managing through troubled times and even saving the business, owners carry on trading and investing time and money in their company beyond their wage claims. Typically, this is a family-owned or small business scenario, such as in *Ahlers*, where the managers were both the employees and the owners of the family farm. Making them work to sustain the business, and at the same time leaving them subject to the security holder's discretion as to whether to allow them to retain any interest in the business under the reorganization plan, raises many difficulties. However, the subjection of labor contribution to the discretion of secured and non-secured creditors' superiority extends beyond small and medium firms. In large corporations, labor contribution in exchange for ownership rights in the reorganized firm may be the only way to retain experienced employees and to preserve the value of the business. The inability to give new equity in return for work with court approval rather than through creditors' consent impedes the rescuing of businesses and the creation of "employee-led" reorganizations.

The meaning of *Ahlers* extends beyond the scope of the New Value exception because the Court was not willing to attach any value to workers' contribution to the company beyond that which was guaranteed under the contract of employment. Implicitly, by denying the opportunity for employees to obtain control through continuous work, reliance interest, or any other non-contractual claim for that matter, was denied.⁹⁹

98. *Id.*

99. See Singer, *supra* note 80, at 701-33 (regarding employees reliance interest); see also Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing Fiduci-*

2. Voting and Confirming a Plan

In relation to voting on the reorganization plan, the courts allow the debtor to strategically classify claims and use the claim classification as a tool to obtain plan confirmation. The only instruction is that “substantially similar” claims can but are not required to be placed in the same class. Thus, as § 1123(a)(4) of the Code requires that all claims within a class “are treated the same,” the debtor can group seemingly similar claims into different groups in order to permit different treatments under the plan or to attain plan confirmation by including plan-opposing creditors with cooperative creditors to balance the objections.¹⁰⁰ In relation to employees, theoretically, and as indeed the case is in other jurisdictions, the plan confirmation stage lends employees, as a class with a special and separate interest in the plan, significant leverage.¹⁰¹ Since employees are expected to vote as a group, they may hold effective veto over the plan confirmation, at least *vis-à-vis* shareholders, subject to the absolute priority and cram down rules. Similarly, if employees are given preference over other unsecured creditors, their leverage would increase. In other words, the voice of employees can change according to the treatment of their claims either as separate *or* as elevated when compared to other creditors.

Ultimately, the position of employees as a separate class rests on the decision over whether or not the contract of employment is different than other creditors’ contracts. A non-traditional view of the employment contract may give weight to implicit obligations towards employees,¹⁰² or a proprietary interest, created through continuous work, to employees in the firm,¹⁰³ which may lead to giving employees, as a group, a special place within the scheme of plan confirmation.

ary Duty to Protect Displaced Workers, 69 N.C. L. REV. 1189, 1240–41 (1991) (providing a contractual approach justifying employee rights during plant closure); Marleen A. O’Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 905–14 (1993); Marleen A. O’Connor, *Promoting Economic Justice in Plant Closings: Exploring the Fiduciary/Contract Law Distinction to Enforce Implicit Employment Agreements*, in PROGRESSIVE CORPORATE LAW 219–45 (Lawrence E. Mitchell ed., 1995) (providing a contractual approach justifying employee rights during plant closure).

100. *Finova Grp. Inc. v. BNP Paribas (In re Finova Grp. Inc.)*, 304 B.R. 630, 633–34 (D. Del. 2004) (establishing that within a class “equal treatment” is required, not “equal payment.”). There has to be “reasonable basis,” however, for treating similar claims differently. *In re Hoffer Indus. Inc.*, 321 B.R. 498 (Bankr. E.D. Ark. 2005).

101. See, Canadian Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36 (Can.) (allowing employees to form a separate class, but not necessarily: it is down to the court to decide on a case by case basis.). See JANIS PEARL SARRA, CREDITORS RIGHTS AND THE PUBLIC INTEREST: RESTRUCTURING INSOLVENT CORPORATIONS 132 (2003).

102. See O’Connor, *supra* note 99.

103. See Singer, *supra* note 80.

By contrast, it can be argued that only past wages and related debts are to be taken into account and employees are nothing more than regular unsecured creditors. The former proposition, that the employment contract is a different type of contract, may lead to an even stronger claim, namely, that the employment agreement, with its deferred wage structure and other non-wage related rights, holds priority over other regular contractual claims. Again, the strength of this argument is evident when considered in the Chapter 11 context: the Absolute Priority rule conditions any plan on the approval of superior voting classes and allows the parties to cram down a plan despite disapproval by subordinated classes if all superior classes approve the plan. However, under Chapter 11, employees are placed as a non-secured regular fixed claim creditor and thus do not have any priority status over other fixed claim creditors. This is not surprising once the claim classification process is placed within the larger view of the corporation as a nexus of contracts. Furthermore, not only do employees lack any priority over other fixed claim interest holders, but they also do not vote as a separate group, but rather together with other unsecured creditors.¹⁰⁴

However, some portion of employees' claims, namely the portion that enjoys preferred status in distribution, cannot possibly be seen as regular unsecured debt, and thus, potentially permit veto through voting, subject to its subordination to higher priority claims.¹⁰⁵ Section 507(a)(4) of the Bankruptcy Code provides employees with a priority status (which is fourth in the order of priority) against their back wages to a limit of \$11,725 earned, while § 507(a)(5) provides priority status (fifth in its overall priority) to another \$10,000 owed to the employee benefit plan in relation to the 180 days which preceded the filing of the bankruptcy petition.¹⁰⁶ These priority claims can be

104. Cf. *Nathanson v. NLRB*, 344 U.S. 25, 28 (1952) (“[T]he board argues that the interest of the United States in eradicating unfair labor practices is so great that the back pay order should be given the additional sanction of priority in payment. Whether that should be done is a legislative decision.”).

105. See David Milman, *Priority Rights on Corporate Insolvency*, in *CURRENT ISSUES IN INSOLVENCY LAW* 57 (Alison Clarke ed., 1991), for a review of the establishment of a priority system, its justifications and rationales. See Charlotte Villiers, *Employees as Creditors: A Challenge for Justice in Insolvency Law* 20 *Co. L.* 222 (1999), for a discussion of employee priority. See also Susan Cantlie, *Preferred Priority in Bankruptcy*, in *CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW* (Jacob S. Ziegel ed. 1994); Ronald Daniels, *Stakeholders and Takeovers: Can Contractarianism be Compassionate?*, 43 *U. TORONTO L.J.* 315 (1993); Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 *J. LEGAL STUD.* 1 (1981).

106. The priority is given to “wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual.” Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 507(a)(4), 92 Stat. 2549, 2584 (1978) (codified at 11 U.S.C. § 507(a)(4) (2006)). Another

placed in classes and paid over time, but only in full, and only if the class accepts. There is no “cram down” of any class of priority creditors, and so if the class does not accept the offered terms, the priority creditors in that class must be paid in cash at confirmation.¹⁰⁷ Nonetheless, since the priority of wages refers to a fixed sum, which is backward-looking and limited in its scope, the ability of employees to effectively leverage their preferential status over the content of the plan is modest, and takes place only in small scale Chapter 11 cases where the preferred debt holds relative significance. Paradoxically, when preferential claims are significant, the scope for reorganization is limited and liquidation seems to be the more probable alternative. Thus, and as indeed is the case in large scale Chapter 11 proceedings, preferential claims are paid in full at confirmation or before it, and employees are left with no further protections or voice.

Lastly, once approved, the court will not question the merits of the plan and its fairness. Chapter 11’s financial test requires only two things: first that a plan is “feasible,”¹⁰⁸ which courts have interpreted as “within its going concern value”; second, that it satisfies the best-interest-of-creditors test,¹⁰⁹ which is met if the plan would provide creditors the same amount as they would have received under liquidation. Accordingly, as Baird stated, “The plan is prepared by a group that has a substantial interest in overvaluing the business for purposes of Chapter 11 reorganization, and undervaluing the business for purposes of Chapter 7 [governing liquidations].”¹¹⁰ Furthermore, in the absence of any external office holder, the DIP controls the information regarding the threshold that is provided. With low liquidation value, any reorganization plan can satisfy the “best interest of creditors” test. Through control over the information, the debtor is free to suggest the steps required to achieve maximization of restructuring value, presenting these steps as the only ones possible, secured by the inability of others to challenge this assessment. Chapter 11 does require that information be made openly available,¹¹¹ but significantly,

section caps the claims of an employee to one year. *Id.* § 502(b)(7) (codified at 11 U.S.C. § 502(b)(7)).

107. *Id.* § 1129(a)(9)(B) (codified at 11 U.S.C. § 1129(a)(9)(B)).

108. *Id.* § 1129(a)(11) (codified at 11 U.S.C. § 1129(a)(11)).

109. *Id.* § 1129(a)(7) (codified at 11 U.S.C. § 1129(a)(7)).

110. DOUGLAS G. BAIRD, *THE ELEMENTS OF BANKRUPTCY* 254 (2001).

111. The debtor files schedules and reports of financial information at the commencement of, and during the case, and must answer questions at meetings of creditors. The creditors’ committee is entitled to obtain information under §§ 1102-3 and for a plan to be approved, a disclosure statement must be provided. Bankruptcy Reform Act of 1978, § 1103(c)(2) (codified at 11 U.S.C. § 1103(c)(2)). Before voting, voting parties are provided with a disclosure statement and plan summary. *Id.* § 1125 (codified at 11 U.S.C. § 1125). The disclosure statement must include

the DIP mechanism allows the availability of only financial and trivial data. The important information—regarding the business, its day-to-day operations, its relationships with and within the labor force, and with customers and suppliers—is only available through control. Accordingly, with no alternative plan available or practically formulated, lack of independent information in the hands of creditors, and the costs of delays and looming uncertainty, the DIP is placed in a strong bargaining position.

In sum, the ability to classify claims permits the DIP to limit the control of all creditors over the plan. The limited judicial scrutiny of the content of the plan leaves the DIP with few constraints regarding how the plan is formed. At the same time, since the DIP can remain under bankruptcy protection for a long period of time, the most significant mechanisms which control the DIP—the time and acceptance requirements—were practically eliminated from the legal scheme, stripping the procedural protections for all creditors, employees, and unsecured creditors more than others. By obtaining acceptance through the prescribed majority of the voting classes, shareholders and managers can retain their stakes in the post-Chapter 11 firm. Therefore, the incentive is to practically remain under Chapter 11 protection as long as is needed to obtain the “consent” of the creditor classes to the plan most beneficial from the perspective of the controllers. Based on this view, the issue in Chapter 11’s success is hardly whether or not the procedure ends in plan confirmation; rather, an analysis should be made of the nature of the company that emerges from the procedure, its long-term viability, and how the rights in this entity are allocated between the pre-petition creditors.

3. Participation in Creditors’ Committees

Under Chapter 11, the negotiation between the debtor and creditors takes place through creditor committees that have the right to obtain information and that hold direct access to the court to enforce their rights.¹¹² From the early days of Chapter 11, trade union representatives were permitted to participate in general, unsecured creditor committees.¹¹³ The reasoning behind this, though, was the employees’ entitlement to payments of unpaid wages, rather than an equitable or

historical financial statements; pro forma financial statements forecasting future performance; a statement of the assumed conditions upon which the pro forma statements are based; a description of claims and interests dealt with by the plan; and a listing of assets, with all information relevant to their value in liquidation proceedings.

112. *Id.* §§ 1102–03 (codified at 11 U.S.C. §§ 1102–03).

113. *In re Altair Airlines, Inc.*, 727 F.2d 88, 90–91 (3d Cir. 1984).

proprietary basis for inclusion. Accordingly Chapter 11 includes no structured participation by employees through committees. Indirectly however, union members working under an existing CBA can be represented collectively during the negotiations that take place under § 1113 of the Code. Furthermore § 1114, which deals with the rejection of obligations under health and benefit plans to retired employees, presumes representation by a body representative of the retired employees. Unlike § 1113, representation in § 1114 covers both organized and unorganized employees, since § 1114 relates to both.¹¹⁴ Although the representation of existing and former employees must be logically separated, in practice the union represents the former employees as well.¹¹⁵ If a court appoints a committee under § 1113 or 1114, it has the same rights, powers, and duties as a committee appointed under §§ 1102 and 1103, which govern the rights of regular creditors' committees. Significantly, this allows for the retention of professionals that can investigate matters, participate in the formulation of a plan, request the appointment of a trustee or examiner, and "perform such other services as are in the interest of those represented."¹¹⁶ Nevertheless, it is established that filing a motion under § 1114 does not require the court to appoint a committee. In *Anchor Glass Container* for example, the court chose not to exercise its discretion to appoint a committee since "the appointment of a committee would cause delay that would be detrimental to all parties in interest," and so would frustrate the purpose of the legislation.¹¹⁷

In relation to non-unionized employees, or when a § 1113 procedure has not been triggered, the Code allows the trustee to appoint additional committees if it is appropriate.¹¹⁸ The appointment of a trustee is not obligatory; it is regarded as the exception rather than the rule,¹¹⁹ and in practice it is only in some high profile cases that such a trustee is appointed. Furthermore, § 1102(a)(2) provides that the court may order the appointment of additional committees, either on the request of a party with an interest in the proceedings or on the request of the trustee "to ensure adequate representation."¹²⁰ As the code provides little guidance on the terms for such an appointment,

114. See *In re Horizon Nat'l Res. Co.*, 316 B.R. 268, 275 (Bankr. E.D. Ky. 2004).

115. See *Allied Chem. Workers v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 173 (1971) (discussing the Supreme Court going so far as to suggest that unions have "internal conflicts" when they seek to represent both active employees and retirees in labor negotiations).

116. Bankruptcy Reform Act of 1978, § 1103(c) (codified at 11 U.S.C. § 1103(c)).

117. *In re Anchor Glass Container Corp.*, 342 B.R. 878 (Bankr. M.D. Fla. 2005).

118. Bankruptcy Reform Act of 1978, § 1102(a)(1) (codified at 11 U.S.C. § 1102(a)(1)).

119. *In re Sharon Steel Corp.*, 871 F.2d 1217, 1225-26 (3d Cir. 1989).

120. 11 U.S.C. § 1102(a)(2).

courts have developed the law on a case-by-case basis.¹²¹ In the Enron debacle, for example, with an estimated twenty thousand affected employees and retirees, an employment-related issues committee was formed, following a request by the trustee. This unique committee had the legal power to take sworn statements and subpoena documents and witnesses. Following the establishment of this committee, a \$29 million severance settlement was reached according to which former employees received a one-time payment of \$7,000 to \$8,000.¹²² It seems, however, that this does not signify a new development in Chapter 11. Other special interest committees were formed in recent cases, but in no other reported case has a committee representative of employee interests been formed.¹²³ The case of Enron, its high profile collapse, the corruption involved, and the fact that the company was, effectively, completely liquidated is unique. Mismanagement led to the loss of pension funds established through defined contribution schemes and so employees lost significant benefits acquired in the past.¹²⁴ Many of Enron's management, including its CEO and CFO, although permitted to remain in control, were under criminal investigation.¹²⁵ It is thus only with reference to these unusual circumstances that the appointment of an employee representative committee should be seen. The reluctance of the courts to appoint special creditor committees or indeed to appoint a trustee, has been part of the judicial campaign to strengthen the control of the debtor and to facilitate a constructive restructuring environment.

4. Sale of Assets While Undergoing Chapter 11 Reorganization

Absent structured participation, the negotiation process between the DIP and its employees shifts to the familiar collective bargaining process, which is affected by indirect regulations. During restructuring negotiations and while under Chapter 11 protection, perhaps the most powerful tool in the hands of the DIP is the ability to dispose of assets which are "inefficient" to maintain. Section 363(c) of the Bank-

121. See Mary J. Wiggins, *Finance and Factionalism: The Uneasy Present (and Future) of Special Interest Committees in Corporate Reorganization Law*, 41 SAN DIEGO L. REV. 1373 (2004).

122. *Id.* at 1378.

123. During the collapse of Global Crossing in 2002, for example, the company dismissed 1,500 employees and paid about eighteen million dollars in severance and vacation pay. Of the thirty-two million dollars owed to approximately 1,200 employees, \$5.5 million was entitled to priority payment. The US trustee and the court refused the application to set up an employee representative committee.

124. Steven L. Willborn, *Workers in Troubled Firms: When are (Should) They be Protected?*, 7 U. PA. J.L. & EMP. L. 35, 47 (2004).

125. LoPUCKI, *supra* note 50, at 148 (discussing the role of Enron's pre-bankruptcy management).

ruptcy Code allows certain types of sales to be conducted in the regular course of business and Congress designed the Code to preserve ongoing value when undergoing a bankruptcy procedure.¹²⁶ Section 363(b), on the other hand, provides a mechanism by which the company controller may use, sell, or lease assets outside the ordinary course of business.

The drafters of § 363 probably thought in terms of sales of particular assets, not entire businesses.¹²⁷ Nonetheless, this ability to sell assets during Chapter 11 reorganization has taken a central role in Chapter 11 reorganizations, especially in labor-management-conflict-driven reorganizations. Baird and Rasmussen have argued, “Rarely is Chapter 11 a forum where the various stakeholders in a publicly held firm negotiate among each other over the firm’s destiny.”¹²⁸ They argue that in effect, Chapter 11 has become a foreclosure procedure in which burdening liabilities are dismissed, the company is refinanced, and its capital structure is restructured. Only then—when other alternatives are absent—does the company put itself before the creditors for approval. This explains the length of time companies remain under Chapter 11 protection: it is not to prepare a reorganization plan but rather to implement one, while keeping free of significant legal or bargaining constraints. In recent years, this method of partial liquidation has swelled to the point that the real restructuring of the firm effectively takes place before any plan is submitted for approval.¹²⁹ In this context, the entire business, rather than just parts of it, is routinely put up for sale during a Chapter 11 procedure¹³⁰ while liquidation sales before a Chapter 11 reorganization are confirmed through creditors’ votes, rendering the approval process and the plan confirmation stage practically irrelevant, and only of academic interest.¹³¹ In cir-

126. The section applies to Chapters 7, 11, 12 and 13 of the Bankruptcy Code Bankruptcy Reform Act of 1978, § 103(a) (codified at 11 U.S.C. § 103(a)).

127. See H.R. REP. NO. 95-595, at 181–84 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141–45.

128. Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 752 (2003); George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANK. L.J. 235 (2002).

129. See Jason Brege, *An Efficient Model of Section 363(B) Sales*, 92 VA. L. REV. 1639, 1641 (2006) (mentioning several things: TWA’s sale of its planes and landing gates to American Airlines; Enron’s sale of principal assets and main pipe line within a few months of filing its bankruptcy petition; Budget’s sale of its main assets to its parent company Avis, within few weeks of petition; and Polaroid’s sale of assets to the private equity group BankOne, all of which occurred before a restructure plan was presented for creditors’ approval).

130. See also *infra* Part IV (regarding the § 363 sale of Chrysler and GM).

131. Brege, *supra* note 129, at 1642. See ЛОПУСКИ, *supra* note 50, at 168 (indicating that between 2001 and 2006, twenty-one large publicly held corporations sold the whole of their business by applying § 363 before plan approval).

cumventing the necessity for plan confirmation, such sales introduce into the negotiations an additional source of pressure on the company employees, pressuring them to compromise before they are presented with a “done deal.” The transformation of Chapter 11 into a foreclosure mechanism through § 363 is attributed to the emergence of secured creditor-driven reorganizations, rather than just to the attractiveness of this possibility to the DIP. For finance providers, asset sales present the fastest and most definite way to secure returns on their loans, especially when the loans are over-secured,¹³² without being subjected to the balancing of competing interests that the plan confirmation process was designed to achieve.

Therefore, § 363(b) of the Bankruptcy Code is perhaps one of Chapter 11’s most central components. Such a sale requires only a notice to the creditors’ committee and a hearing before the bankruptcy court,¹³³ while the burden of proof in any objection to the sale is placed on the creditor opposing it.¹³⁴ Furthermore, beyond disclosure of the terms of the sale, § 363 does not include any disclosure requirement, as opposed to § 1125(b), which concerns the disclosure requirements necessary before a court approves a plan. Absent detailed disclosure of reasons for sale along with alternatives to and motives for selling, a limited possibility of objecting to the sale exists. This means that a hearing may not even be held, since the grounds for objection may not be available to opposing creditors. The standards for approving a sale are minimal and vague, and central to these standards is the “good faith” requirement, generally meaning an opportunity to obtain competing offers.¹³⁵ In *In re Lionel Corp.*, the court maintained that it should be careful in establishing rigid standards when interpreting Chapter 11 to enable the facilitation of reorganizations as Congress intended.¹³⁶ Following *In re Lionel Corp.*, the courts abandoned a “necessity test”¹³⁷ and began to consistently re-

132. Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANAL. 511, 551 (2009).

133. The notice must be sent to all creditors, or the unsecured creditors’ committee, and must contain a description of the terms and conditions of the sale, along with time specification for filing objections. Pub. L. No. 95-598, § 363(b)(1), 92 Stat. 2549, 2572 (1978) (codified at 11 U.S.C. § 363(b)(1) (2006)).

134. *Id.* (placing the burden of proof on ‘an interest holder’ only with relation to showing an interest in the asset sold).

135. *In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143 (3d Cir. 1986).

136. *Comm. of Equity Sec. Holders v. Lionel Corp.* (*In re Lionel Corp.*), 722 F.2d 1063, 1070 (2d Cir. 1983) (“Chapter 5 of the House Bill dealing with reorganizations states that the purpose of a business reorganization is to restructure a business’ finances to enable it to operate productively, provide jobs for its employees, pay its creditors and produce a return for its stockholders.”).

137. *See In re Solar Mfg. Corp.*, 176 F.2d 493 (3d Cir. 1949).

quire only a “good business reason” to approve such sales. Under this flexible and lenient standard, courts will usually consider several factors: the proportionate value of the assets to the estate as a whole; the amount of time elapsed since the filing; the likelihood that a plan of reorganization will be proposed and confirmed in the near future; the effect of the proposed disposition on future plans or reorganizations; the proceeds to be obtained from the disposition; and whether the asset is increasing or decreasing in value.¹³⁸

Some authors have suggested that these ongoing Chapter 11 sales are prone to agency costs and pricing below market value: pre-bankruptcy entitlements may not be respected, and minimal court interference combined with a constrained market for assets could lead to depressed prices and lower recovery for creditors than they would otherwise obtain through the normal confirmation process.¹³⁹ Often, sales are made to insiders with superior information and through “sweetheart deals.”¹⁴⁰ Thus, either the sale is made to managers (in small and medium size companies) or managers push the sale forward in return for stock options, retention of bonuses, or consultation contracts.¹⁴¹ Furthermore, § 363(f) of the Code offers the buyer the benefit of an asset with a title free and clear of claims.¹⁴² Appeals of the sale are only permissible under § 363(m), which requires the objector to obtain a stay pending appeal that is only available when the purchaser has not acted in good faith. Thus the sale is not only easy and fast, but it is also most likely final. Whether such sales are efficient or not remains uncertain. However, as an alternative “de facto” exit strategy from Chapter 11, such sales are undoubtedly attractive to the secured creditor, who wishes to reduce risks as soon as possible and will be paid first according to his priority of claim. Secured creditors thus have an interest in any sale which guarantees payment regardless of any surplus lost in the process. Accordingly, as ties with the DIP

138. See *In re Lionel Corp.*, 722 F.2d at 1070. Additional factors in the business justification standard require that the sale be adequately and reasonably noticed. *Fleet Nat'l Bank v. Doorcrafters (In re N. Atl. Millwork Corp.)*, 155 B.R. 271, 275 (Bankr. D. Mass. 1993). The disposition must be “fair and expeditious.” *In re White Motor Credit Corp.*, 14 B.R. 584, 591 (Bankr. N.D. Ohio 1981).

139. Brege, *supra* note 129, at 1644; Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1 (2007). The efficiency case against such sales is disputed while some commentators claim that a § 363(b) sale is actually more efficient than the lengthy confirmation process.

140. See Elizabeth B. Rose, *Chocolate, Flowers, and §363(B): The Opportunity of Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249 (2006) (reviewing inside dealing and other DIP misappropriation).

141. LoPucki, *supra* note 50, at 174.

142. Assuming that a notice to an interest holder was given. FED. R. BANKR. P. 9014.

and influence over it increase—for example, through DIP financing arrangements—such sales will increasingly take place in circumstances where the asset is prone to be undervalued.¹⁴³

Inefficient as such sales may be, courts can perhaps correct these inefficiencies through increased scrutiny and better information flow to creditors. Such steps are necessary both to reduce the frequency of such sales and to increase the efficiency of the market valuation when such sales take place. However, the role of these sales as a source of pressure on non-consenting parties during the pre-plan negotiation stage, and in shattering the balance that Chapter 11 was originally intended to create, cannot be eliminated through procedural measures alone. In our context, the availability of such sales is a source of immense pressure on the company employees, casting its shadow over the negotiation process and pushing employees to agree to a plan containing terms that they and other unsecured creditors would have never agreed through Chapter 11's regular plan confirmation process.

The combination of the establishment of Chapter 11 as a cause for termination of the employment contract, together with the ability to sell company assets while under Chapter 11 protection and effectively restructure the business absent an approved reorganization plan, results in the labor force itself being restructured whilst its company is under Chapter 11 protection. This is a far cry from the envisioned multi-party negotiation process that the Code originally intended to establish.

5. Transfer of the Employment Contract

It is evident that a central threat to the employees is that their plant will be sold while their company undergoes a Chapter 11 reorganization, prior to plan confirmation and without any ability to block the sale. As discussed, non-unionized employees cannot do much to prevent such sales, and a purchaser of assets of ongoing operations is not statutorily obligated to assume the predecessor's employment agreements.¹⁴⁴ This is so even if the employees were working under the terms of a CBA, absent a superseding contractual obligation. However, most CBAs do contain a "successorship clause."¹⁴⁵ Under these circumstances, it is a requirement that the CBA be terminated before

143. See Stuart C. Gilson et al., *Valuation of Bankrupt Firms*, 13 REV. FIN. STUD. 43, 45 (2000).

144. *NLRB v. Burns Int'l Sec. Servs. Inc.*, 406 U.S. 272, 279 (1972).

145. Ketterman, *supra* note 6.

the plant is transferred or, alternatively, a negotiated modification of the collective agreement is agreed with the union.¹⁴⁶

Chapter 11 establishes a procedure under which a CBA can be modified or terminated. Section 1113, which will be further discussed below, requires both negotiation in good faith and a judicial procedure for termination. Thus, a preferred course of action for the debtor, one which is allowed by the courts, is to sell its assets and then ask to repudiate the CBA under § 1113. After such a sale takes effect, there is no practical reason to maintain the labor force and so repudiation becomes “necessary,” a central requirement to repudiate a CBA.

This issue has been subject to uncertainty in since the late 1990s. In *In re Lady H. Coal Co.*,¹⁴⁷ the court denied a rejection application following the sale of assets upon the finding that the debtor made no effort to find a buyer who would negotiate with the union, appeared to have ignored a potential purchaser who was willing to do so, and obligated itself to a “sweetheart” deal for the benefit of insiders. In this case, the court granted a free sale of the assets, but denied the motion of the debtor to reject the existing CBA, since the debtor had agreed to the sale of its assets unencumbered by its CBA before seeking rejection. The court held that “a debtor has a duty under § 1113 to not oblige itself prior to negotiations with its union employees”; that no bargain with the employees could have taken place in good faith under these circumstances; and that “employee creditors are protected by the right to file claims for breach of the [labor agreement] with such damages to be satisfied by payments from the proceeds of sale.”¹⁴⁸

Following *Lady H*, *United Food & Commercial Workers Union, Local 211 v. Family Snacks, Inc. (Family Snacks)*¹⁴⁹ involved a Chapter 11, § 363 sale of a producer and distributor of potato chips and other packaged food. This was followed by a repudiation application under § 1113. Contrary to the *Lady H*, previous cases had confirmed that a Chapter 11 piecemeal sale of the company assets allows for rejection of a CBA, because once assets are sold, repudiation becomes “necessary” to the conclusion of the company restructuring.¹⁵⁰ In *Family Snacks*, while referring to the legislative purpose of “facilitating corporate restructures,” the court held that a requirement that would ne-

146. See *USW v. Cooper-Standard Auto.*, No. 1:04-CV-358-TS, 2004 WL 2599132 (N.D. Ind. Nov. 2, 2004).

147. *In re Lady H. Coal Co.*, 193 B.R. 233, 242 (Bankr. S.D. W.Va. 1996).

148. *Id.*

149. *UFCW, Local 211 v. Family Snacks, Inc. (In re Family Snacks, Inc.)*, 257 B.R. 884 (B.A.P. 8th Cir. 2001).

150. See *In re Ionosphere Clubs, Inc.*, 134 B.R. 515, 517 (Bankr. S.D.N.Y. 1991).

cessitate negotiations prior to a sale would effectively push companies who are preparing piecemeal or ongoing concern sales to move into Chapter 7, which governs company liquidation. Because this was not the intention of the legislation, the court held

that there are practical problems with the union's position that negotiations for rejection must occur before a sale In certain factual settings, the union's position would make it impossible for a debtor to accept the highest and best offer for its assets and would precipitate the loss of potential purchasers to the detriment of all other creditors. It is difficult to accept the argument that § 1113 was designed to give a union the power to so strangle a debtor's attempts to reorganize through liquidation.¹⁵¹

Thus, in this case, the court firmly established that confirming a rejection of a plan under § 1113 could happen before, in conjunction with, *or after* the business was sold under § 363. Thus, committing to a sale of the whole business, or parts of it, and only later making an application to repudiate the CBA, would not, on its own, be regarded as bad faith.

Thus, under these narrow circumstances where a CBA with a successorship clause exists, the debtor may sell assets or the whole business free from contractual obligations towards the related employees, and only later ask to reject the relevant CBA by making a § 1113 application. Negotiations with employees, accordingly, are held in the shadow of these rules and of course push trade union members to agree to extensive concessions driven by factual necessities and legal constraints. Absent agreement, the debtor is free to seek rejection of the collective agreement under § 1113. The only issue that remains is what, accordingly, are the substantive requirements of § 1113 and how do they shape the negotiation procedure in which the available options are constrained by the reality of a probable sale of the business.

6. Rejection of Collective Bargaining Agreements

As already mentioned, U.S. labor law permits the unilateral rejection of the employment contract of non-unionized workers, and so does Chapter 11. With regard to those employees who work under the terms of a CBA, most CBAs provide that an employer may only discharge employees for "just cause." However, economic downturns that give rise to bankruptcy are regarded as such causes.¹⁵² Furthermore, Chapter 11 provides an exception to the rule that the law forbids the unilateral rejection of existing collective bargaining

151. *In re Family Snacks, Inc.*, 257 B.R. at 897.

152. Willborn, *supra* note 124, at 37.

agreements.¹⁵³ Thus, in relation to CBAs, Chapter 11 establishes a detailed framework under which a CBA can be voided and within which the negotiations towards a new agreement must take place.

The law prior to the enactment of Chapter 11 permitted the controller to dismiss executory contracts within the limits of the “business judgment rule.”¹⁵⁴ The courts recognized, however, that CBAs are unusual executory contracts and so applied a more stringent standard than the business judgment rule, while at the same time leaving certain discretions with the DIP.¹⁵⁵ The Second Circuit established the rule in *Shopmen’s Local Union No. 455 v. Kevin Steel Products*¹⁵⁶ and *Brotherhood of Railway Airline and S.S. Clerks v. R.E.A. Express Inc.* that the standard for rejection was a situation in which a rejection of the agreement would lead to collapse of the firm and loss of jobs, thus applying a test akin to a “necessity” requirement.¹⁵⁷

As we have seen, this option—albeit a constrained one—of rejecting a CBA did not concern labor representatives in the period of time leading up to the enactment of the 1978 reform, and thus, they did not feel the need to negotiate detailed provisions to govern the issue.¹⁵⁸ Perhaps to their surprise then, in February 1984, in the case of *NLRB v. Bildisco & Bildisco*,¹⁵⁹ involving the reorganization of a medium-sized construction company, the Supreme Court ruled that CBAs are executory contracts subject to the general terms of § 365 of the Code, permitting the debtor to renounce such contracts. The Court held that this was consistent with the collective nature of Chapter 11 and its intended purpose of facilitating corporate restructuring. In applying § 365, the Court established that the standard for rejection, although stricter than the business judgment rule, falls short of the absolute necessity test. Accordingly, a court may permit a debtor to reject a CBA if the debtor can prove that the agreement burdens the estate and that the “balance of equities” weighs in favor of rejection, taking into account the interest of all parties in the bankruptcy case.¹⁶⁰ In addition, the Court held that before it approves repudiation of a CBA, the parties must persuade it that they made reasonable

153. The National Labor Relations Act, Pub. L. No. 74-198, § 1, 49 Stat. 449, 449 (1935) (codified at 29 U.S.C. § 151 (2006)) (prohibiting the modification of collective agreements unilaterally, while establishing that to do so, would amount to an “unfair labor practice.”).

154. UK Bankruptcy Act, 1869, 32 & 33 Vict. ch. 71 (Eng.).

155. See David L. Gregory, *Labor Contract Rejection in Bankruptcy: The Supreme Court’s Attack on Labor in NLRB v. Bildisco*, 25 B.C. L. REV. 539, 561 (1984).

156. *Shopmen’s Local Union No. 455 v. Kevin Steel Prods.*, 519 F.2d 698, 704 (2d Cir. 1975).

157. *Bhd. of Ry. v. REA Express Inc.*, 523 F.2d 164, 169 (2d Cir. 1975).

158. See *supra* Part III(B)(1).

159. *NLRB v. Bildisco*, 465 U.S. 513 (1984).

160. *Id.* at 526.

efforts to negotiate a voluntary modification.¹⁶¹ Lastly, the Court stated that rejecting such an agreement before securing the permission of a bankruptcy judge does not amount to unfair labor practice under the National Labor Relations Act.¹⁶²

The *Bildisco* decision immediately served as an incentive to reorganize early through Chapter 11 with the strategic purpose of altering an existing CBA.¹⁶³ Only following this development did trade unions lobby in Congress to overrule the *Bildisco* decision.¹⁶⁴ In 1984, following these efforts, Congress introduced § 1113 into Chapter 11 as part of the *Bankruptcy Amendments and Federal Judgeship Act*.¹⁶⁵ The debtor's attempted rejection of retiree benefit contracts in the first LTV steel reorganization of 1988 precipitated Congress's passage of § 1114.¹⁶⁶ While §§ 1113 and 1114 do not prohibit repudiation of collective agreements or retiree benefit plans, they attempt to establish the terms under which such repudiation may take place, while creating procedural and substantive conditions governing the rejection of collective agreements. Congress legislated both §§ 1113 and 1114 with the interest of employees in mind. It is also interesting to note the ease in which labor lobbying obtained bankruptcy protections, once they identified the risks associated with Chapter 11.

Under a § 1113 procedure, the debtor must bargain before rejecting the contract, but if bargaining in good faith does not produce an agreement, the court has to be convinced that the "balance of equities" favors rejection.¹⁶⁷ The courts have distilled nine steps under § 1113(b) and (c) as prerequisites to rejection of a collective bargaining agreement: (1) the debtor must make a proposal to the union to

161. *Id.*

162. *Id.* at 532.

163. See CARRUTHERS & HALLIDAY, *supra* note 67, at 337 (illustrating the case of Wilson Foods Corporation, who filed for Chapter 11 protection in 1984 while solvent, repudiated its labor contracts covering 6,000 employees, and reduced wages between forty and fifty percent).

164. See *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1082 (3d Cir. 1986) ("[W]hen the Supreme Court announced its decision *NLRB v. Bildisco & Bildisco* on February 24, 1984, labor groups mounted an immediate and intense lobbying effort in congress to change the law.").

165. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 541, 98 Stat. 333, 390-91 (1984) (codified at 28 U.S.C. § 1113 (2006)).

166. See Leslie T. Gladstone, *Retiree Benefits Bankruptcy Protection Act of 1988: Welfare Benefits in Need of Reform*, 65 AM. BANKR. L.J. 427 (1991), for the history of the enactment of § 1114.

167. Under § 1113(e) an interim relief from a collective bargaining agreement may be obtained if it is "essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate." Bankruptcy Amendments and Federal Judgeship Act of 1984, § 541 (codified at 28 U.S.C. § 1113(e) (2006)). Lately, these standards were declared to be more stringent than the business judgment rule. See *In re Delta Airlines Inc.*, 359 B.R. 491, 498 (Bankr. S.D.N.Y. 2007).

modify the collective bargaining agreement; (2) the proposal must be based on the most complete and reliable information available at the time of the proposal; (3) the proposed modifications must be necessary to permit the reorganization of the debtor; (4) the proposed modifications must ensure that all creditors, the debtor, and all affected parties are treated fairly and equitably; (5) the debtor must provide the union with such relevant information as is necessary to evaluate the proposal; (6) the debtor must meet at reasonable times with the union during the period between making the proposal and hearing the motion; (7) the debtor must confer in good faith and attempt to reach mutually satisfactory modifications of the agreement; (8) the union must have refused to accept the debtor's proposal without good cause; and (9) the balance of equities must clearly favor rejection.¹⁶⁸

The debtor must satisfy all of these standards to confirm rejection. However, the first, second, fifth and sixth parts of the test are usually perfunctorily mentioned by the court and then brushed off without substantial analysis. For example, § 1113(b)(1)(B) & § 1114(f)(1)(B) require the debtor to provide the negotiating representative with "such relevant information as is necessary to evaluate the proposal." Although in a recent case a court denied an application for rejection of a CBA because a debtor refused to turn over its financial modeling software to the unions,¹⁶⁹ usually, rather than forcing the debtor to meet its burden of proof, courts merely require that a debtor come forward with the information it has provided the union.¹⁷⁰ In *In re Texas Sheet Metals, Inc.*,¹⁷¹ the union asserted that the debtor had not used the most recent financial information available, but the court placed the burden on the union of specifying the information required, effectively reducing its ability to oppose the extent and relevance of the information produced, thus transforming the requirement to mere formality.

168. *In re Am. Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984). See also *UFCW, Local 211 v. Family Snacks, Inc.* (*In re Family Snacks, Inc.*), 257 B.R., 884, 892 (B.A.P. 8th Cir. 2001); *United Food & Commercial Workers Local Union v. Appletree Mkts, Inc.* (*In re Appletree Mkts., Inc.*), 155 B.R. 431, 437-38 (S.D. Tex. 1993); *In re Elec. Contracting Servs. Co.*, 305 B.R. 22, 26 (Bankr. D. Colo. 2003); *Nat'l Forge Co. v. Indep. Union of Nat'l Forge Empls.* (*In re Nat'l Forge Co.*), 289 B.R. 803 (Bankr. W.D. Pa. 2003). See also Judith D. Nichols, *Rejection of Collective Bargaining Agreements by Chapter 11 Debtors: The Necessity Requirement Under Section 1113*, 21 GA. L. REV. 967, 989-90 (1987); Mitchell Rait, *Rejection of Collective Bargaining Agreement Under Section 1113 of the Bankruptcy Code: The Second Circuit Enters the Arena*, 63 AM. BANKR. L.J. 355, 370 (1989).

169. *In re Mesaba Aviation Inc.*, 341 B.R. 693, 713 (Bankr. D. Minn. 2006).

170. Ann J. McClain, *Bankruptcy Code Section 1113 and the Simple Rejection of Collective Bargaining Agreements: Labor Loses Again*, 80 GEO. L.J. 191, 198-99 (1991).

171. *In re Tex. Sheet Metals, Inc.*, 90 B.R. 260 (Bankr. S.D. Tex. 1988).

Most often when courts deny § 1113 relief to a debtor, it is on the grounds of failure to negotiate or bargain in “good faith” (term 7), failure to show that the debtor’s proposal was “fair and equitable” (term 4), or failure to meet the “necessity” standard (term 3).¹⁷² The issue becomes one of balancing the need to reorganize against the concessions asked for by the union. Inevitably, the court’s assessment of the proposed agreement is influenced by the political views of the particular judge on the vested rights held by employees in their work place.¹⁷³ As McClain argued, “[The] courts have construed each of the nine elements broadly and have placed greater emphasis on those parts of the test that permit subjective analysis, giving the debtor more room to maneuver.”¹⁷⁴ For example, when the courts consider the fourth test, namely that the proposed modifications are “fair and equitable,” they may choose to compare the pay cuts of unionized and non-unionized workers.¹⁷⁵ Most courts, however, look at the reasonableness of the union wage cuts in isolation.¹⁷⁶ As for the good faith requirement, courts have interpreted it broadly and have not presented many difficulties to the debtor. The court will usually look into the course of negotiations, the details of each proposal and counterproposal, the number and length of meetings, and the information exchanged.¹⁷⁷ However, a one-sided proposal,¹⁷⁸ or a mere four day interval between the debtor’s presentation of the proposal to the union and the debtor’s filing, have not been regarded as contrary to good faith.¹⁷⁹ In *In re Allied Delivery System*,¹⁸⁰ the bankruptcy court held that the good faith requirement was met as long as negotiations were held, regardless of their nature. On the other hand, courts have held that a debtor’s refusal to negotiate after a plan was submitted constituted bad faith and justified the denial of its application under

172. Michael L. Bernstein, *American Workers in Crisis: Does the Chapter 11 Business Bankruptcy Law Treat Employees and Retirees Fairly?*, 26 AM. BANKR. INST. L. REV. 10 (2007).

173. N.Y. Typographical Union No. 6 v. Maxwell Newspapers, Inc. (*In re Maxwell Newspapers, Inc.*), 981 F.2d 85, 89 (2d Cir. 1992) (“This statute requires unions to face those changed circumstances that occur when a company becomes insolvent, and it requires all affected parties to compromise in the face of financial hardship. At the same time, § 1113 also imposes requirements on the debtor to prevent it from using bankruptcy as a judicial hammer to break the union.”).

174. McClain, *supra* note 170, at 198.

175. See *In re Am. Provision Co.*, 44 B.R. 907, 910 (Bankr. D. Minn. 1984).

176. McClain, *supra* note 170, at 200.

177. Bernstein, *supra* note 172, at 12.

178. *In re Tex. Sheet Metals, Inc.*, 90 B.R. 260, 271 (Bankr. S.D. Tex. 1988).

179. *In re Century Brass Prods.*, 55 B.R. 712, 716 (Bankr. D. Conn. 1985), *rev’d on other grounds*, 795 F.2d 265 (2d Cir. 1986).

180. *In re Allied Delivery Sys.*, 49 B.R. 700, 703 (Bankr. N.D. Ohio 1985).

§§ 1113 and 1114.¹⁸¹ The burden of proof was originally placed on the debtor to show that it was negotiated in good faith.¹⁸² Nonetheless, contrary to the literal reading of § 1113, the courts have placed the burden on the union, once a meeting is held.¹⁸³ The reversal of the burden of proof was used by the courts to further limit the union's ability to object to rejection in other contexts as well, such as in the context of showing that relevant financial information was not available.¹⁸⁴ Furthermore, in relation to the requirement that the union may not reject a debtor's proposal without good cause, the courts usually conclude that any rejection by the union is without good cause.¹⁸⁵ Thus, for example, in *In re Royal Composing Room*, the Second Circuit held that when a union takes a hard-line position, rejection of a proposed CBA is almost always without good cause.¹⁸⁶

Courts have focused a large part of the judicial consideration of the terms for rejection on § 1113(b)(1)(A), under which a debtor must propose only "those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor . . ." (the third element of the nine-part § 1113 test), which was described as "the focal point of courts' decisions to reject CBAs."¹⁸⁷ The Third Circuit interpreted the necessity requirement strictly, equating "necessary" with "essential," and hence allowing only the minimum modifications that are absolutely essential to permit the debtor to reorganize.¹⁸⁸ However, the Second Circuit rejected this approach and interpreted the necessity requirement as demanding that "its proposal is made in good faith and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully."¹⁸⁹ It now seems settled that most courts will follow the Second Circuit's less strict interpretation of what modifications are permitted.¹⁹⁰ With regard to § 1114, it seems that a more stringent application of the necessity test

181. See *In re Delta Airlines Inc.*, 342 B.R. 685, 694–97 (Bankr. S.D.N.Y. 2006).

182. *Nat'l Forge Co. v. Indep. Union of Nat'l Forge Empls. (In re Nat'l Forge Co.)*, 279 B.R. 493, 500 (Bankr. W.D. Pa. 2002).

183. McClain, *supra* note 170, at 202.

184. See *supra* note 151 and accompanying text.

185. McClain, *supra* note 170, at 203.

186. *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc. (In re Royal Composing Room, Inc.)*, 848 F.2d 345, 349 (2d Cir. 1988).

187. McClain, *supra* note 170, at 208.

188. *Wheeling-Pittsburgh Steel Corp v. United Steelworkers of Am.*, 791 F.2d 1074, 1088 (3d Cir. 1986).

189. *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82, 90 (2d Cir. 1987).

190. John D. Ayer, *The Intersection of Chapter 11 and Labor Law*, 26 AM. BANKR. INST. L.J. May 2007, at 22.

may be applied, as the Congressional sponsors of § 1114 expressed their intent to codify the strict interpretation of the “necessary” standard enunciated in *Wheeling Pittsburgh Steel*.¹⁹¹ Lastly, the ninth requirement of § 1113, that the balance of equities “clearly favor rejection of the collective bargaining agreement,” has almost been equated with the *Bildisco* standard, which supports such rejection in favor of achieving Chapter 11’s purpose: achieving and approving a restructuring plan.¹⁹²

Thus, effectively, DIP can unilaterally reject the collective agreement in the expectation of minimal court interference.¹⁹³ Indeed, although § 1113 was envisioned as a pro-employee response to *Bildisco*, it has actually placed employees in a worse position because it codified *Bildisco*’s substantive standards while its components have become a mere formality through judicial interpretation.¹⁹⁴ Since courts see the purpose of Chapter 11 as being to “facilitate restructurings,” they tend to assess the required balancing in a way that favors the debtor, regarding employees as potential obstacles preventing successful restructurings. Thus, courts will opt to reject considerations and doctrines of collective labor law when interpreting § 1113. For example, the National Labor Relations Act requires the debtor to bargain in good faith with the union, otherwise this will constitute an “unfair labor practice” in accordance with § 8(a)(5) and subsection (b)(3). Since claims regarding such unfair practices are adjudicated by the National Labor Relations Board, a substantial degree of interpretation of the good faith requirement was undertaken by a judicial body with employee credentials.¹⁹⁵ However, the courts explicitly avoided transposing these established interpretations into their adjudication. For example, the bankruptcy court in *In re Kentucky Truck Sales* held that Congress did not intend it to interpret the good faith test of the § 1113 test in compliance with labor law precedents.¹⁹⁶ Similarly, in *In*

191. 134 CONG. REC. S. 6823-27 (daily ed. May 26, 1988) (statement of Sen. Howard Metzenbaum).

192. Although the balance of equities must “clearly” favor rejection rather than just “militate in favor.” See *In re Ind. Grocery Co.*, 136 B.R. 182, 196 (Bankr. S.D. Ind. 1990).

193. There are several cases involving the rejection of a collective bargaining agreement. See generally *N.Y. Typographical Union No. 6 v. Maxwell Newspapers, Inc.* (*In re Maxwell Newspapers, Inc.*), 981 F.2d 85 (2d Cir. 1992); *Sheet Metals Workers’ Int’l Ass’n v. Mile Hi Metal Sys., Inc.* (*In re Mile Hi Metal Sys., Inc.*), 899 F.2d 887 (10th Cir. 1990); *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc.* (*In re Royal Composing Room, Inc.*), 848 F.2d 345 (2d Cir. 1988); *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82 (2d Cir. 1987); *In re Salt Creek Freightways*, 46 B.R. 347 (Bankr. D. Wyo. 1985).

194. See McClain, *supra* note 170.

195. 29 U.S.C. §§ 153-54.

196. *In re Ky. Truck Sales*, 52 B.R. 797, 801 (Bankr. W.D. Ky. 1985).

re Century Brass Products, the court noted that § 1113 was not intended to import traditional labor law into the bankruptcy court.¹⁹⁷ If anything, the courts consider labor law precedents when it is beneficial to the debtor. For example, in *In re Texas Sheet Metals, Inc.*, the court, while relying on labor law doctrines, required the union to present a counterproposal under the good faith test.¹⁹⁸ Consequently, as McClain stated, nearly every decision since 1984 has granted the debtor's petition for rejection of the collective bargaining agreement.¹⁹⁹

Following the rejection of a collective agreement under § 1113, the debtor remains an employer and continues to be obligated to bargain collectively with the employees' certified bargaining representatives over the terms of a new CBA.²⁰⁰ However, in all major disputes between employees and the DIP in the context of Chapter 11 reorganizations, after a § 1113 rejection of a CBA, the debtor can effectively impose a new collective contract unilaterally.²⁰¹ Thus, employees are left with little bargaining power and with no choice (or effective leverage) other than to strike.²⁰² Such a course of action cannot be freely practiced since it can also harm the interests of employees by potentially destroying the business itself. However, by casting its shadow over collective negotiations, it can nonetheless leave some leverage in the hands of employees. Courts traditionally permit this course of action after a § 1113 rejection of a CBA, despite the fact that the original agreement usually contains both a no-strike clause and a grievance and arbitration procedure.²⁰³ This also makes sense, as the termination of a CBA must be seen as a unilateral action, which takes the

197. *In re Century Brass Prods.*, 55 B.R. 712, 716 (Bankr. D. Conn. 1985), *rev'd on other grounds*, 795 F.2d 265 (2d Cir. 1986).

198. *In re Tex. Sheet Metal, Inc.*, 90 B.R. 260, 262 (Bankr. S.D. Tex. 1988).

199. McClain, *supra* note 170, at 205.

200. *NLRB v. Bildisco*, 465 U.S. 513, 534 (1984).

201. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 105, 92 Stat. 2549, 2555 (1978) (codified at 11 U.S.C. § 105 (2006)) (indicating that the court holds general equitable power to reject the CBA in whole or in part).

202. Note that this course of action is, of course, not available to retirees. Several statutes form the legal framework, which govern the legal framework which governs the collective bargaining process outside the insolvency context. The Railway Labor Act, 45 U.S.C. §§ 151-88 (2000) (governing the railway and airline industry); The National Labor Relations Act, 29 U.S.C. §§ 151-69 (2006); The Norris LaGuardia Act 1932, 29 U.S.C. §§ 1101-15 (2006) (governing the collective bargaining process in other industries).

203. *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc.* (*In re Royal Composing Room, Inc.*), 62 B.R. 403, 405 (Bankr. S.D.N.Y. 1986), *aff'd*, 848 F.2d 345 (2d Cir. 1988) (confirming the right to strike in such circumstances). As a general rule, under U.S. law, the Norris-LaGuardia Act prohibits the courts from enjoining a dispute concerning "the terms and conditions of employment." The Norris LaGuardia Act 1932, 29 U.S.C. §§ 1101-15 (2006). *But see* *Boys Markets Inc. v. Retail Clerk's Union, Local 770*, 398 U.S. 235, 253-56 (1970) (holding

dispute outside the realm of the mandatory negotiation process designed by the general rules that govern the collective bargaining process. As established under labor law, once negotiations fail, both sides are allowed to resort to self-help without judicial interference.²⁰⁴

However, the U.S. appellate courts recently curtailed this right to strike following a § 1113 procedure in the case of *Northwest Airlines Corporation v. Association of Flight Attendants*.²⁰⁵ In *Northwest*, the court held that the prohibition on enjoining a labor dispute did not bar a court injunction against a strike since the union's proposed strike, after the bankruptcy court's rejection of the CBA, would violate the union's separate and fundamental duty under the law "to exert every reasonable effort to make and maintain agreements . . . and to settle all disputes."²⁰⁶ To justify this intervention in the mechanisms of labor disputes governed by both Chapter 11 and labor laws, the court suggested that a strike may put the airline out of business and so a prohibition on such measures aligns with the overriding objective of Chapter 11 to facilitate corporate restructuring and protect the variety of stakeholders dependent on the firm's survival.²⁰⁷

In any event, the ability to strike following a § 1113 procedure is a secondary issue, as is the application of § 1113 itself. If we focus on the cases in which an agreement with the labor force was not reached and where § 1113 was applied or a strike took place, we might miss the real point of reference in our discussion. Like any legal rule, its establishment can direct parties in future cases and the way they conduct themselves. Accordingly, the threat of a § 1113 procedure can pressure future parties to compromise before the law is applied by the court. The result is that a specific balance is struck in future agreements that is affected by the rules which govern the case in the absence of an agreement. Since most bargaining is made and concluded in the shadow of the law, the effects of the rules can never be fully estimated. In our specific context, these rules will direct employees to make further concessions, to ease the reorganization of the company by the DIP, and to reach agreements before they face a § 1113 proce-

that the Act does not bar the granting of injunctive relief enforcing arbitration under a mandatory grievance adjustment or arbitration procedure).

204. *Bhd. of Ry. v. Fla. E. Coast Ry. Co.* 384 U.S. 238, 246 (1966).

205. *Nw. Airlines Corp. v. Ass'n of Flight Attendants*, 483 F.3d 160, 167 (2d Cir. 2007).

206. *Railway Labor Act*, Pub. L. No. 69-257, § 2, 44 Stat. 577, 578-79 (1926) (codified at 42 U.S.C. § 152 (2006)).

207. *See* *UFCW, Local 211 v. Family Snacks, Inc. (In re Family Snacks, Inc.)*, 257 B.R. 884, 899-907 (B.A.P. 8th Cir. 2001) (following the reasoning of the *Northwest Airlines* decision). *See* Richard M. Seltzer & Thomas N. Ciantra, *The Return of Government by Injunction in Airline Bankruptcies*, 15 AM. BANKR. INST. L. REV. 499 (2007) (reviewing *Northwest Airlines*).

dure which, absent the strike option, becomes just a repudiation procedure.

Lastly, a note must be made about the relation between the regulation of § 1113 and the evolution of strategic, labor-related, bankruptcy phenomena. In a Chapter 11 procedure involving the rejection of a CBA, the question of “good faith” may arise in two different contexts. As noted above, the question of good faith may be raised in relation to § 1113 and whether or not the debtor attempted to resolve the problem through *bona fide* negotiation with the union a reduction of compensation. However, a preliminary question to ask is whether or not the debtor has an honest belief that rehabilitation is necessary through Chapter 11 at all. Historically, when a Chapter 11 stay of proceeding was triggered for the purpose of nullifying labor contracts, the courts dismissed the case for bad faith.²⁰⁸ It is ironic then that the establishment of § 1113, with its presumed protection of the company employees, effectively cleared the path for using Chapter 11 for this “strategic” purpose alone, placing the issue of good faith in the context of the manner in which collective bargaining was conducted. Once the scheme is in place, it becomes hard to argue that bankruptcy ought not to serve as a strategic choice in the context of collective labor negotiations.

IV. THE PRESENT CHAPTER 11: GM, CHRYSLER, AND CREDITOR CONTROL

Within the context of large corporate failures in industries with large numbers of employees, the bankruptcies of Chrysler in April 30, 2009 and General Motors (GM) in June 1, 2009, provide a new reference point: never before has the government used bankruptcy to bailout a major industrial corporation. For both Chrysler and GM, the federal government used its power as a pre-petition- and DIP-lender to influence management and to force a sale of assets and favored debt to the United Auto Workers union (UAW) and to a new, government-owned company, leaving the remainder of the assets for the rest of the creditors.

In *Chrysler*, the bail-out was accompanied by what some view as disregard for pre-bankruptcy entitlements. Pre-petition Chrysler had

208. See *Int'l Bhd. of Teamsters v. Quick Charge*, 168 F.2d 513, 515 (10th Cir. 1948) (“[I]t is difficult to escape the conclusion that the sole purpose on the part of Quick Charge in filing the reorganization proceedings under Section 77B was to rid itself of the labor dispute with the Union.”); *In re Mamie Conti Gowns, Inc.*, 12 F. Supp. 478, 478–80 (S.D.N.Y. 1935); *In re Trinti Constr. Co.*, 29 B.R. 971, 974 (Bankr. E.D. Wis. 1983); *In re C & W Mining Co.*, 38 B.R. 496 (Bankr. N.D. Ohio 1984).

secured bank debt in secured government (TARP) loans that amounted to about \$6.9 billion. Unsecured claims of suppliers were worth \$5.3 billion. Current and former employees also had unsecured claims, which included \$9 billion to an underfunded pension fund alone. Equity was held by Cerberus and Daimler.²⁰⁹

When Chrysler exited Chapter 11, the secured bank debt had been wiped away, unsecured debts remained on its balance sheet, and equity was held by Fiat, employees, and the US and Canadian governments. Secured creditors were paid twenty-nine cents on the dollar. In other words, while secured creditors had to be satisfied with less than full payment, non-secured creditors, employees included, were satisfied in full.²¹⁰

For GM, the fourth largest bankruptcy in U.S. history,²¹¹ it took only forty days to emerge from bankruptcy. Similarly to Chrysler, assets were sold to “new GM,” where the U.S. government held sixty-percent of the shares, with the rest being held by the Canadian government, bondholders, and the UAW union. Holders of \$27 billion in GM unsecured bonds received stock in the reorganized company rather than the cash they were owed. One \$20 billion bondholder was a union-controlled trust fund that took the stock to pay future retiree health care costs. The 650,000 retirees under the union’s trust had their coverage reduced. Here as well, the government used its influence as a pre-petition- and DIP-financier (owed together around \$50 billion) to dictate the outcome through a § 363 sale. However, because bondholders received payments in stock, it is less clear (than in Chrysler’s case) whether and to what extent were pre-bankruptcy entitlements prejudiced.

There are two ways to view these bankruptcies. The first view regards these as an extreme, *sui generis* example of a procedure that should not be repeated. According to the second view, these procedures only highlight current practices while being within the boundaries of Chapter 11. As we shall see, both views pose difficulties when examined from an employee perspective.

Following the first view, these reorganizations are reminiscent of the pre-Chandler Act world, where insiders and creditors with preferred access to the decision-making process could influence the out-

209. *In re Chrysler, LLC*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009).

210. Mark J. Roe & David Skeel Jr., *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727 (2010).

211. Lehmann Brothers and Washington Mutual’s assets pre-bankruptcy were much larger (\$719 billion and \$341 billion respectively, compared with GM’s \$96.3 billion). See *Bankruptcy Research Database*, *supra* note 44.

comes, while deviating from the priorities in distribution as established by the pre-bankruptcy entitlements.²¹² Indeed, in some ways the restructuring resembles a federal agency receivership rather than a typical Chapter 11 reorganization.²¹³ In Chrysler, secured creditors were cashed out on less than full payment, while creditors of a lesser priority, namely unsecured creditors and employees, remained on the balance sheet. Employees also received equity in the new company. Furthermore, although the firm's assets were sold through an auction, the process gave the federal government and the UAW authority to review the bids prior to acceptance. This signaled that they would outbid any competing offer and therefore eliminate such competition *a priori*. Because this bidding process was not fully transparent and it could not accommodate further bidders, it also raised the suspicion that it did not yield maximum returns. No mention of § 1129 was made by the court, meaning either that the plan could not be confirmed in accordance with the designated procedure of § 1129²¹⁴ or that the court did not see the reorganization as Chapter 11 reorganization at all. In GM's case, in an attempt to fit the case into a regular Chapter 11 procedure, the court declared that

Neither the Code, nor the case law—especially the case law in the Second Circuit—requires waiting for the plan confirmation process to take its course when the inevitable consequence would be liquidation. Bankruptcy courts have the power to authorize sales of assets at a time when there still is value to preserve—to prevent the death of the patient on the operating table.²¹⁵

As we have seen above, it is less clear whether priorities were bypassed in this process.

There are the obvious risks of rising credit costs if disregarding pre-bankruptcy entitlements becomes common practice.²¹⁶ Furthermore, there are anti-competitive effects when saving a particular company rather than another within the same industry.²¹⁷ Because of this back-

212. See Roe and Skeel Jr., *supra* note 210, at 730 (“The requirement in § 1129(a)(8) that each class of creditors consent or receive full payment wasn’t used. A market test wasn’t used. There was no judicial valuation of the firm. Chrysler went through the motions of selling its principal assets to a newly formed entity controlled by its preexisting principal creditors, a process that has been historically suspect in bankruptcy.”).

213. See Jonathan R. Macey, et al., *BANKING LAW & REGULATIONS* (3d ed. 2001).

214. See Roe & Skeel Jr., *supra* note 210, at 730.

215. Motion for Approval of Sale of Assets to Vehicle Acquisition Holding LLC at 3, *In re General Motors Corp.*, No. 09-50026 (S.D.N.Y. July 5, 2009) [hereinafter Motion for Approval].

216. Deniz Anginer & Joseph A. Warburton, *The Chrysler Effect: The Impact of the Chrysler Bailout on Borrowing Costs* (World Bank Policy, Research, Working Paper No. 5462, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1699612.

217. Airlines, such as British Airways, complained to the US and UK authorities that the filings for Chapter 11 by Delta and Northwest mean they can no longer operate on a level play-

ground, it is suggested that these cases should be confined to the specific historical circumstances. In other words, these cases should be discussed from the unique historical perspective of the 2008 credit crisis, nationalizations and bailouts, rather than in their Chapter 11 context.²¹⁸ From an employee perspective, placing the discussion within the context of the 2008 financial meltdown and government bailouts mean that such intervention cannot be expected in other contexts (i.e. corporate collapse in a non-credit-distressed environment), even if an industrial company is highly labor-dependent.

From another perspective, there seems to be little new in these reorganizations.²¹⁹ In Chrysler's case, assets were auctioned while secured creditors received the proceeds from the highest bidder. The process did not disturb the Absolute Priority rule, as lower ranking creditors received nothing. Their payment came instead from the purchaser, who for social and economic reasons, decided to pay their debt in full. In terms of Chapter 11's procedures and the sale of the assets through § 363, the analysis confirms the description of § 363 sales provided above.²²⁰ As we have seen, it is quite common for significant sales of divisions and even whole companies to take place through § 363 of the bankruptcy code. Even if it is not clear whether or not the highest bid was accepted, this is the case in many other § 363 sales.²²¹ Finally, it has often been the case that a § 363 sale *de facto* circumvents the § 1129 approval process, as long as the only matter that is settled is a sale to the highest bidder and not the allocation of rights post-sale.²²² As a matter of practice, it is common for a purchaser to assume pre-petition liabilities.²²³ Pre-packaged bankruptcies usually end quickly, making the Chrysler and GM bankruptcy

ing field. See <http://www.aircargonews.com/060125/baopenmarket.html> (providing a speech by British Airways chairman, Martin Broughton, at the Wings Club in New York City on January 20, 2006).

218. See generally Roe & Skeel Jr., *supra* note 210, at 727.

219. See Edward Morrison, *Chrysler, GM and the future of Chapter 11* (Columbia University Workshop on Bankruptcy and Business Reorganizations, Research, Paper No. 365), available at <http://ssrn.com/abstract=1529734>; Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531 (2009).

220. See *supra* Part III(B)(4).

221. Motion for Approval, *supra* note 215 (indicating that pursuant to 11 U.S.C. § 363 (2006), the expert witness valuation ranged between \$0 to \$1.2 billion, meaning that secured creditors in fact received more than they would have received in a regular market driven bidding process).

222. As long as the sale was motivated by a valid business reason. *Comm. of Equity Sec. Holders v. Lionel Corp.* (*In re Lionel Corp.*), 722 F.2d 1063, 1069 (2d Cir. 1983). Assets are sold through a non-collusive auction process. See 11 U.S.C. §§ 363(n), 6004(f)(1) (permitting private or public auction); *Wintz v. Am. Freightways, Inc.* (*In re Wintz Cos.*), 219 F.3d 807 (8th Cir. 2000).

223. Morrison, *supra* note 219, at 7 (noting several such cases).

processes fast, perhaps, but not unusual.²²⁴ Moreover, the ability of the purchaser-government to become the dictator of business outcomes is no different than the ability of other secured lenders, who position themselves in a position of veto before bankruptcy ascends (by debt purchasing) and through DIP financing (in Chrysler, the terms of the DIP financing agreement prohibited the extension of the exclusivity period and imposed a strict time frame for the execution of the auction process).²²⁵ It is accordingly argued that the government interventions pushed the boundaries of Chapter 11 to their limits, only to reveal the extent of power wielded by the secured and DIP lender, and the state of the modern Chapter 11 process.

From an employee perspective, this approach simply highlights existing problems and difficulties associated with creditor control. If the fact that the government was the financier of the procedure and the ultimate owner of the newly formed companies can be eliminated from the discussion altogether, then it follows that such a procedure can be led by another third party who is not concerned with the issue of employment protection at all. In other words, if these reorganizations only mark the direction of the evolution of Chapter 11 reorganizations, nothing prevents a coalition of strong creditors, for example, to fill the place of the government, only this time without taking such a protective position (if any) towards the firm employees.

Indeed, viewed from the perspective of creditor control, the discussion shifts into familiar waters. It is argued that since its enactment, the control over Chapter 11 proceedings has gradually shifted from managers to creditors. This reflects both the fact that companies enter Chapter 11 with higher debts, as well as an ideological shift which mirrors the transition in power from managers to shareholders that has taken place outside the insolvency realm since the 1970s. The mechanisms which enabled this shift in power towards financial institutions were established within the basic legal measures of Chapter 11 and were designed to counterbalance the debtor's discretion and to guarantee value maximization.²²⁶ In the post-Chapter 11 period, these rules gave finance providers the assurance that Chapter 11 restructuring protected their interests. Highly leveraged companies are compelled to obtain the consent of their creditors for a Chapter 11 procedure because of these rules, yet at the price of surrendering con-

224. According to the LoPucki database, in 2007 the median pre-packaged case took forty-three days. *Bankruptcy Research Database*, *supra* note 44.

225. See Ayotte & Morrison, *supra* note 132, at 27 (finding that during 2001 in two thirds of cases DIP financiers were prepetition secured lenders).

226. See *supra* Part II(A) and accompanying footnotes.

trol to these creditors. Furthermore, the “super priority status” given to Chapter 11 financing,²²⁷ leads to strong coalitions between the financier and the DIP, underpinned by the creation of shared control.²²⁸ Usually, in return for the loan, the finance provider obtains influence over the debtor during restructuring negotiations and influences the plan that is being proposed. Sometimes the loan is repaid by obtaining equity in the reorganized company.²²⁹ The leverage DIP lenders regularly obtain enables the imposition of increasingly severe covenants under the finance agreement, to the point that the control of Chapter 11 restructuring has been taken away from the bankruptcy court and placed into the hands of the DIP financier.²³⁰

Together these measures support the management’s desire to remain in Chapter 11 for a long period of time. At the same time it allows finance providers to offset some of their losses through DIP financing and to obtain control under the DIP financing contract.²³¹ As in the pre-Chandler Act world, investment bankers and managerial elites, usually designated by the board for the specific purpose of taking the company through Chapter 11, can bond again. The increase in control of secured creditors can be traced back to the 1980s. During the “takeover frenzy” years, many takeovers were in fact highly leveraged buyouts (LBOs), which were enabled and facilitated due, in part, to the changing insolvency regime. Under the new regime the bidding management was no longer intimidated by the risks associated with accumulating debt (since even if they failed, under the rules of Chapter 11 they would not lose control). Simultaneously, the accumulation of debts became desirable for corporate management, since it reduced the attractiveness of their company for a potential takeover, and thus served a similar purpose to that of a “poison pill.” From the perspective of the finance providers, LBOs and high leverage Mergers & Acquisitions (M&As) were financially feasible because secured creditors were guaranteed to obtain effective control in

227. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 364, 92 Stat. 2549, 2574 (1978) (codified at U.S.C. § 364 (2006)).

228. See David A. Skeel, Jr., *The Past, Present and Future of Debtor-In-Possession Financing*, 25 CARDOZO L. REV. 1905 (2004) (giving examples of how DIP financiers obtain control over the procedure).

229. See David Skeel, *Creditors’ Ball: The “New” New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917 (2003); Douglas G. Baird, *The New Face of Chapter 11*, 12 AM. BANK. INST. L. REV. 101 (2004); Douglass G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209 (2006).

230. Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129 (2006).

231. Skeel, *supra* note 229, at 918–19.

bankruptcy.²³² Indeed, it is suggested that secured creditors, through financing mechanisms and other forms of control during the insolvency process, “hijacked Chapter 11.”²³³ Thus, legal and market developments have combined to metamorphose Chapter 11 from its original stated purpose of reorganization, for the benefit of unsecured creditors and the wider community, into a federal unified foreclosure mechanism. The debtor and its fate are controlled by secured creditors aided by insiders and bankruptcy professionals motivated by substantial inducements, personal profit and shelter from liability. Within the multilateral bargaining environment of Chapter 11, in the context of economic decline, business realities and the need to keep the firm in operation are combined with legal processes and dictate a power relationship between management, capital providers, and labor. A legal regime that supports the increase of control in the hands of capital providers (pre- as well as post-petition) and management weakens the position of the firm employees.

In sum, the current structure of Chapter 11 reorganizations, which some claim that the Chrysler bankruptcy highlighted, illustrate how post- and pre-petition financiers are the ultimate controllers of the procedure and the dictators of business outcomes. If one accepts the fact that the Chrysler reorganization only extends the boundaries of these practices, employees should beware of assuring themselves that the flexibility of Chapter 11 will be further utilized to protect their interests. Absent the government as a third party “White Knight,” these characteristics will be used to undermine rather than advance the protection of jobs.

V. THE FUTURE OF EMPLOYEES UNDER CHAPTER 11

As we have seen above, several determinants shaped the development of the regulations thus far. First, the view of the regulations as a collective mechanism for creditor protection has dominated the structure and logic of Chapter 11. This view is underpinned by an ideological vision of corporate regulations as instruments for the objective of the maximization of the firm’s value. Second, an alternative sociopolitical view of the company as a vehicle upon which various stakeholders are dependent has supported the protection of these stakeholders. This notion underpins the introduction of the DIP

232. See SKEEL, *supra* note 54, at 214–16.

233. George W. Kunej, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19 (2004); see also Skeel, *supra* note 229; Baird, *supra* note 229. But see Lynn M. LoPucki, *The Nature of the Bankruptcy Firm: A Response to Baird and Rasmussen’s The End of Bankruptcy*, 56 STAN. L. REV. 645 (2003).

mechanism and more generally the legal scheme, which incentivizes corporate reorganizations at an early stage of financial decline. However, from an employee perspective, the legitimization of the protection of multiple stakeholders undermines employee protection, especially within the bilateral context of collective bargaining. Third, because of the institutional setting of court competition within a federal setting, the scope for developing mechanisms for employee protection or participation in the plan preparation and confirmation process has been very limited indeed. With this backdrop, it is claimed that changes within one or all of these determinants may throw the system onto a new trajectory.

Perhaps the starting point should be the ideological underpinning of the regulations. The outbreak of the credit crisis caused a financial meltdown worldwide on a scale unknown to anyone who did not live through the Great Depression. It originated in the American and British real estate markets and exposed the weaknesses of their corporate, finance, and risk regulations. Consequently, this financial crisis has subjected the foundations of the legal and political domains to the sort of reconsideration that has not been possible since the 1970s. For the first time since the rise of neo-liberalism, the prevailing consensus can and has been seriously questioned.²³⁴ As far as it concerns employee voice in the mechanisms of corporate governance and control, the problems connected to short-term investment practices and excessive risk-taking may be controlled through employee participation that will foster, inspire, and enable strategic long-term choices. While this claim has been marginalized over the last decades, this and similar claims now have a new receptive environment in which to thrive.

The government's intervention in the markets and the widespread nationalization of financial institutions that were on the verge of collapse were the first signs that pointed to the scope and nature of the changes that might take place. Based on a detailed regulatory regime, the government's intervention was designed to alleviate the crisis and contain it, but with the goal of withdrawing from the market once it is stabilized. Thus, nationalization was designed to stabilize the markets and to prevent their overhaul in the long term. At the same time, nationalization of corporations on the verge of collapse reflected the notion that some institutions are simply too large to be allowed to fail.

234. See, e.g., *What Went Wrong with Economics?*, *ECONOMIST* (July 16, 2009), <http://www.economist.com/node/14031376>; see also *The Future of Capitalism*, *FIN. TIMES* (last visited Apr. 2, 2012), <http://www.ft.com/indepth/capitalism-future> (posing the following question: "The credit crunch has destroyed faith in the free market ideology that has dominated Western economic thinking for a generation. But what can – and should – replace it?").

This also points towards an underlying understanding, perhaps even an emerging consensus, that the public has a legitimate interest in many large public corporations. Although financial institutions were at the heart of these government-led rescues, during the crisis the government intervened in companies outside this industry because of the risks to their labor force and their dependent communities. It was these concerns that prompted the restructuring of GM and Chrysler: the perceived public interest in the continuous existence of an important national industry and the need to safeguard the continuation of the health and pension funds of more than a million current and former employees. However, although the presumption that the state does not intervene in the market when large public corporations fail has been rebutted, government intervention can be expected to take place only when failure occurs against the backdrop of a widespread financial downturn. It remains to be seen whether a widespread decline in a given industry, as opposed to the markets as a whole, will allow for a government-led intervention to take place. With regard to the development of employee voice mechanisms, as an issue directly related to this newly found legitimization for intervention in the markets, a question remains: in what direction can these pressures be channeled?

In the context of Chapter 11 the question that must be asked is twofold. First, should court competition be eliminated?²³⁵ Competition between courts over the business of the big Chapter 11 cases in the U.S. has led to the creation of a flexible procedure in which managerial discretion was enhanced. Because control remains with pre-insolvency management, and is sheltered by the courts and financed through mechanisms of shared control, employees are left marginalized from the procedure.

The issue of court competition perhaps could be reduced organically, without legislation. The ability to compete in bankruptcy has been underpinned by the social legitimization of the ideology that supports managerial discretion and a flexible labor market. Thus, in theory, reduced legitimization of unilateralism in management practices is directly connected to strengthening the capacity of employees for collective bargaining within Chapter 11. Therefore, an ideological shift may point to a subsequent change in the nature of adjudication under Chapter 11, including the de-legitimization of court competition itself. Whether and how changing ideological attitudes towards both

235. LoPUCKI, *supra* note 54 at 249–54 (discussing the various options to minimize court competition).

managerial discretion and collective bargaining under Chapter 11 will and should change is a matter for careful consideration. Under current practices, the entrance into bankruptcy has little bearing on the ongoing trading activity of the company, apart from the value of its shares. Thus, Chapter 11 is repeatedly hailed within the legal and financial profession as enabling continuous trading. This could recently be seen during the collapse of Lehman Brothers, when the offices in London were practically abandoned once the administrator took over, while in the U.S., business continued despite the invoking of Chapter 11.

Moreover, the credit crisis may turn out to be significant in the sense that it altered social, managerial, and judicial attitudes towards employees and towards dialogue with employees rather than establishing a new platform for labor legislation. Outside bankruptcy, an emerging new consensus could encourage the propensity of employees to join trade unions. Such a change could alter both their position outside as well as inside bankruptcy. As we have seen above, the existence of a CBA turns out to be the most important legal tool for allowing employees to participate in the Chapter 11 process. Moreover, in the bankruptcy realm, the discussion above reviewed how the ability of employees to challenge the DIP's decisions in court, particularly relating to the business avenue which is chosen, is limited.²³⁶ However, in an altered ideological climate, the court may become sympathetic to such challenges. Such challenges could be based on the inadequate provision of information to employees or on the fact of an employment agreement's termination rather than alteration. Thus, it may be possible to limit the exclusivity period and power of the DIP by challenging breaches of negotiation obligations with the union or the lack of viable restructuring options that could have been pursued. As always, the circumstantial nature of bankruptcy and of the company's labor structure in particular calls for flexibility in handling labor disputes. If allowed, the ability to challenge the proposed plan, or more accurately, the threat of litigation, will result in more serious consideration of viable options to retain the employees. Thus, a new, subtle balance between the objective of creditor wealth maximization and the interests of employees could emerge.

Lastly, assuming that the institutional limitations for promoting employee voice can be overcome, and that a change in the prevailing consensus will influence managerial attitudes, social perspectives of managerial unilateralism, and judicial discretion, the additional issue

236. See *supra* Part III(B)(2).

of financial leverage will have to be considered. If indeed a changed ideological climate could open the door for employees to challenge the DIP reorganization plan, “challenging” also means presenting an alternative. Such an alternative could be either an employee-supported bidder, a “white knight” who promises to keep the labor force intact, or an employee-led restructuring, ending in an employee buy-out and an employee-owned company. Employee-owned firms are found throughout the globe, including in the U.S., and often exhibit efficient and well-run governance institutions.²³⁷ Nonetheless, because leveraging such transactions is not within the reach of employees, these are still very much limited to small and medium-sized companies.

In large corporations, pension funds that manage employee retirement funds will have to finance such transactions. These fund managers control a great pool of workers’ funds, and thus have the potential to provide leverage and finance employee initiatives relating to alternative restructuring plans and corporate sales, particularly in the bankruptcy context. Such alternatives could be of great significance to the protection of jobs in the economy in general. Any empowerment of employees with effective voice must accommodate the possibility of introducing alternative restructuring proposals so as to be able to seriously challenge the decisions made by the controller. This is of course connected to larger issues: the nature of the investments in pension funds and whether they can and should be driven by the interests of existing employees, retirees, or the working class.

Here is where the difficulty lies. The overriding interests of the pension fund, like any other fund managed in trust, seems not to be the preservation of jobs, but rather, the maximization of yield on the investment. Even if this preliminary obstacle is overcome, the real question remains: ought we to support pension fund investment policies that are driven by the desire to maintain potentially inefficient or even fraudulently managed companies in operation as long as it is designed to keep jobs in the economy? This brings about difficult questions relating to the interests of retirees, as opposed to existing employees, as well as the viability and sustainability of pension funds in an aging society. As pension funds grow, so will the pressure to channel these funds into various initiatives. At the same time, in the next few years the sustainability of pension funds will have to be addressed by governments and the private sector.

237. David Kershaw, *No End in Sight for the History of Corporate Law: The Case of Employee Participation in Corporate Governance*, 2 J. CORP. L. STUD. 34 (2002).

Increasingly, scholars are debating if and how it is possible to control pension fund holdings so as to affect corporate restructuring and enhance corporate accountability through shareholder activism.²³⁸ In the U.S., to a limited extent, this has taken place already through trade unions that were able to use their position to influence corporate outcomes.²³⁹ Critics of the idea of employee activism through pension fund holding will point to the U.S. experience. In California, the two largest pension funds—the California Public Employees' Retirement System and the California State Teachers' Retirement System—have lost billions of dollars in value through investments in real estate. Hundreds of thousands of retiring state employees now face the choice of accepting much reduced pension checks or working past their retirement age. With the reality of under-funded pension funds and an aging population, the task is for the law to reconfigure so that it will support investment policies that promote the creation of jobs and the maintenance of viable businesses in temporary difficulties, rather than investing in companies just for the purpose of delaying the inevitable. In other words, solving the paradoxical division between the interests of the employee in his retirement fund and the interests of existing employees in their workplace is at the core of the future of collective labor law in general and the ability to influence the outcomes of Chapter 11 in particular.

VI. CONCLUSION

Neo-liberal ideology inspired Chapter 11 when it reduced the role of the state, strengthened the DIP mechanism, and placed it at the core of both small and large corporate restructuring. Nonetheless, Congress built into Chapter 11 some balance against managerial unilateralism through the introduction of various checks and balances and the creation of a forum in which multi-party negotiations regarding alternative restructuring plans for the company can take place, in some cases even involving a trustee representative of the public interest. Following the logic of value maximization, Chapter 11 also created mechanisms of shared control between the DIP and finance providers. Within the triangle of labor–capital–management, employees were positioned as outsiders whose interests were to be dealt with under separate legal procedures. At the same time, Chapter 11 has

238. Simon Deakin, *Workers, Finance, and Democracy*, in *THE FUTURE OF LABOUR LAW: LIBER AMICORUM BOB HEPPLE QC* (2004).

239. Teresa Ghilarducci et al., *Labour's Paradoxical Interests and the Evolution of Corporate Governance*, 24 *J.L. & Soc'y* 106 (1997).

been mooted as a “stakeholder friendly” procedure in that it encourages early corporate restructuring and hence the saving of businesses.

When considering Chapter 11 in historical perspective, however, it is evident that if Congress’ intended purpose when introducing Chapter 11 in 1978 was to create a balanced legal procedure, this objective did not materialize. Because of court competition, Chapter 11 has continuously developed to increase its attractiveness to the case setters. Accordingly, by expanding and sheltering managerial discretion and continuously undermining the plan confirmation stage, courts have been instrumental in creating a legal framework that goes beyond the intended purpose of the regulation’s drafters. As a consequence of the strengthening of managerial discretion, in particular the extension of time permitted for management to remain under Chapter 11’s protection, market mechanisms which were subsequently judicially recognized created a relationship of dependency between management and DIP financiers. As described above, this development ultimately shifted power from management to finance providers.

An important part of the strengthening of managerial discretion has been the avoidance of the opportunities for vesting employees with voice. As shown above, employees, although significant stakeholders in the firm, are not able to affect the negotiation process. Under Chapter 11, non-unionized employees hold no influence over the decision-making process. They are treated like regular unsecured creditors and their employment contract can be terminated at will. The contract of employment, accordingly, is not treated as a different type of contract. This decision has specific implications on the Chapter 11 context: employees do not form a separate class of creditors and their ability to influence the restructuring plan is limited. Unionized employees, on the other hand, holding a valid CBA, are dealt with through the detailed designated mechanisms of Chapter 11, which Congress designed to establish the boundaries of a collective bargaining process. This framework envisioned the protection of employees and retirees against unilateral modification of their employment contract. In practice, however, courts’ interpretation of the scheme, designed to “facilitate restructurings” to the benefit of the various stakeholders, not solely for the protection of employees, only made it more attractive for employers within heavily unionized industries to undergo Chapter 11 restructurings for labor related strategic purposes alone. This development has shifted collective bargaining from its natural arena of labor laws designed during the New Deal era into the sphere of Chapter 11. The strategic reorganizations of companies under Chapter 11 force other companies within the same industry to

undergo similar restructuring to remain competitive, thus adding to the overall consequences of the scheme.²⁴⁰ Thus, strong protections for the DIP, combined with the prospect of retaining control over the company at the end of the procedure, have lent Chapter 11 its attractiveness to the DIP. When a labor dispute is at the core of the procedure, the fact that a CBA with multiple employers, as opposed to one employer, can be disposed of enhances Chapter 11's attractiveness. The ability to selectively choose which obligations the debtor wishes to honor lends the use of Chapter 11 a competitive advantage which further compels competitors to choose this mechanism.

An emerging new ideological consensus, driven by the recession that began in 2008, may put pressure on courts to allow employees to participate in the Chapter 11 negotiations, challenge a reorganization plan, and even make their own plan of reorganization, leading to employee-owned firms.

240. See FINCH, *supra* note 17, at 285 (indicating that in the airline industry, for example, fixed capital costs for the aeroplanes make up a large part of the airlines' expenditures. As of the end of 2007, over half the airline industry's seating capacity was on airlines that were operating under Chapter 11. On September 14, 2005, Delta Airlines and Northwest Airlines initiated Chapter 11 proceedings. They joined United Airlines, which has been operating under bankruptcy protection since December 2002 and US Airways, which was by then on its second trip to the bankruptcy court since September 2001.).