TEN LESSONS FOR CONGRESS TO PONDER ABOUT THE LABOR/BANKRUPTCY INTERSECTION

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INTRODUCTION

At some level, having Congress use the bankruptcy process as a means for fixing labor-related problems is like rearranging the deck chairs on the Titanic. Amending the Bankruptcy Code might at best treat some of the symptoms of organized labor's increasing challenges, but history has shown that it rarely cures the underlying disease. Furthermore, when bankruptcy reform ends up as the prescription of choice to cure labor law's ills, such a cure can often bring with it some unintended side effects to the bankruptcy process itself, potentially compromising its effectiveness as a value-maximizing procedural device for all affected stakeholders.

There is, of course, no denying that employers have used and continue to use bankruptcy as a way to avoid labor obligations, whether they are pensions, retiree medical benefits, or collective bargaining agreements. For understandable reasons, however, retirees and employees may fail to appreciate that a debtor's use of bankruptcy for this purpose is nothing personal against them. Debtors use the bankruptcy process to avoid all kinds of obligations, especially when those obligations are both large and lacking in any nonbankruptcy leverage against the debtor. Bankruptcy has been used to mitigate the effects of mass tort liabilities, large breach of contract judgments, burdensome executory contracts, and even unsecured bank loans. In short, bankruptcy can be a kind of "equal-opportunity destroyer."

Workers and retirees, then, are not alone in believing that their interests have not been adequately accounted for in the delicate balance that the Bankruptcy Code tries to achieve between promoting reorganizations and requiring debtors to honor commitments made to various pre-petition claimants. What makes employees and retirees perhaps unique among the various groups of creditors affected by the bankruptcy process is not the frequency with which they have been the victims of the Bankruptcy Code's legal sanctioning of a debtor-employer's failure to honor its pre-petition commitments. Rather, the reason why workers and retirees arguably feel bankruptcy's pain even more acutely than other disappointed claimants is that so often the claim they have against their bankrupt employer is their sole source of income or medical benefits.

There are three major labor-related claims that are impacted by the bankruptcy process, and all three were tested within a decade after the 1978 enactment of the modern Bankruptcy Code. In 1984, the Supreme Court held that collective bargaining agreements could be rejected by the debtor in bankruptcy just like any other burdensome executory contract,[1] and Congress responded by enacting Bankruptcy Code section 1113.[2] In 1986, the LTV Steel Corporation filed chapter

[1] *See* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 516 (1984).
[2] 11 U.S.C. § 1113 (2012) (stating debtor "may assume or reject a collective bargaining agreement only in accordance with the provisions of this section").

11 and then ceased paying its retiree medical benefits,[3] prompting Congress to enact Bankruptcy Code section 1114.[4]

Finally, in 1987, the Pension Benefit Guaranty Corporation (PBGC) decided while LTV was still in chapter 11 to terminate its defined-benefit pension plans and to assume liability to the plan participants.[5] When LTV later decided to create "follow-on plans" to cover the gap between the PBGC's statutory insurance coverage and the originally promised pension benefits, the PBGC decided to restore responsibility for the pension plans back to LTV.[6] Congress played no role in the resolution of this third labor-related crisis in bankruptcy, and no new Bankruptcy Code sections were enacted in response. Instead, the Supreme Court resolved the issue by upholding the PBGC's plan-restoration powers as a way for the PBGC to combat the moral hazard that is inherent in its own insurance function.[7]

Following this initial post-1978 Code flurry of Congressional and Supreme Court responses to the various crises that were prompted by the uneasy intersection between labor law and bankruptcy, there was a period of relative calm in the labor/bankruptcy arena. That quiet period ended, however, when this nation's recent economic meltdown once again brought labor legacy costs to the forefront with high-profile labor-bankruptcy cases such as Chrysler, GM, Patriot Coal and Hostess Brands. In the twenty-year interim, there were a few important circuit court decisions, to be sure,[8] but no game-changing Congressional amendments to the Bankruptcy Code[9] or Supreme Court pronouncements on the labor-bankruptcy intersection.

The American Bankruptcy Institute has constituted a commission to prepare recommendations to Congress on ways to improve the chapter 11 process, including its profound and undeniable effects on labor.[10] Furthermore, Rep. John Conyers, Jr. (D-Mich) introduced on January 3, 2013, "Protecting Employees and Retirees in

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[3] LTV informed its retirees of its decision to terminate medical benefits by sending them a letter dated July 17, 1986. For a copy of that letter, *see Retiree Benefits in Bankruptcy: Oversight Hearing on H.R. 5283 and related Bills Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 99th Cong., 149 (1986).

[4] 11 U.S.C. § 1114(e) (2012) (providing debtor "shall timely pay and shall not modify any retiree benefits" except in accordance with section provisions).

[5] Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 641 (1990).

[6] *See id.* at 643.

[7] *See id.* at 656.

[8] *See, e.g.*, IUE-CWA v. Visteon Corp. (*In re* Visteon Corp.), 612 F.3d 210 (3d Cir. 2010); Nw. Airlines Corp. v. Ass'n of Flight Attendants-CWA, AFL-CIO (*In re* Nw. Airlines Corp.), 483 F.3d 160 (2d Cir. 2007); Truck Drivers Local 807 v. Carey Transportation, Inc., 816 F.2d 82 (2d Cir. 1987); Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074 (3d Cir. 1986).

[9] The 2005 BAPCPA amendments did include a minor amendment to section 1114. The new section 1114(l) says that if a debtor-employer effects a pre-bankruptcy modification of retiree medical benefits at a time when the debtor was insolvent, then the bankruptcy court shall reinstate the benefits at their pre-modification level "unless the court finds that the balance of the equities clearly favors such modification." 11 U.S.C. § 1114(l).

[10] *See* Stephanie M. Acree, *ABI Commission Holds Hearing Focusing on Labor Issues in Business Bankruptcies*, 25 BBLR 382 (Mar. 21, 2013) (explaining Commission's recommendations for Congress).

Business Bankruptcies Act of 2013" (H.R. 100),[11] a bill that would create major changes in the Bankruptcy Code's current approach to retiree medical benefits, collective bargaining agreements, and executive compensation.[12] Accordingly, it seems fitting to reflect on the lessons that might be gleaned from what has already transpired in the labor/bankruptcy arena since the last major round of legislative activity on this subject. They say that those who fail to study history are doomed to repeat it. In that spirit, I offer the following ten lessons for Congress to keep in mind as it considers what to do—or not do—with regard to bankruptcy law's treatment of labor-related obligations.

LESSON NO. 1: YOU CANNOT EFFECTIVELY FIX A NON-BANKRUPTCY PROBLEM WITH A BANKRUPTCY-SPECIFIC SOLUTION.

Exhibit No. 1 for this lesson is the enactment of section 1114 as a way to deal with the problem of unfunded retiree medical benefits. The true underlying problem with retiree medical benefits is that they represent promises of future benefits with no cash put aside by the employer to back them. That is not a bankruptcy problem; instead, it is what economists would call a classic "deferred maintenance" problem.[13] Certainly unfunded retiree medical benefits are a type of financial deferred-maintenance problem that will manifest itself when a company like LTV, which had a lopsided ratio of retirees to current workers, files chapter 11 bankruptcy.[14] At best, the section 1114 response by Congress was a better-than-nothing band-aid that helped some retirees in some circumstances to reap a higher return on their promised medical benefits than they otherwise might have.

Yet, those who think that section 1114 "solved" the problem of unfunded retiree medical benefits are clearly kidding themselves. The only real solution to the retiree medical benefit debacle is the one that needed to take place decades ago: a

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[11] H.R. 159, 113th Cong. (2013).

[12] *See* Acree, *supra* note 10. This was not the first time that Rep. Conyers had introduced a bill like this that attempted to address labor law issues in bankruptcy. *See Campaign Promises, Labor, Corporate Bankruptcy*, OBAMA 44 REPORT CARD, http://obama44reportcard.com/articleResourceIndex.php?articleResourceCategoryKey=11 (detailing history of previous failed bills since 2007 that attempted to address the labor-bankruptcy intersection).

[13] *See What is Deferred Maintenance?*, WISE GEEK, http://www.wisegeek.com/what-is-deferred-maintenance.htm.

> Deferred maintenance is maintenance that should be performed, but is not, for reasons ranging from budgetary constraints to staffing limitations. The concern with deferred maintenance is that while it may not have long term consequences in some cases because it will be attended to eventually, it can increase the risk of creating a safety hazard, a breakdown or another problem which could cause a spike in costs.

Id.

[14] *See* David A. Pratt, *The Past, Present and Future of Retiree Health Benefits*, 3 J. HEALTH & BIOMEDICAL L. 103, 110–14 (2007) (discussing history of employer-sponsored retiree benefit programs and current problems associated with underfunding).

serious pre-funding requirement, the failure of which would give rise to a super-priority for the covered retirees that would be effective against other creditors of the company, both inside and outside of bankruptcy.

A good model of this type of legislation is the Fair Labor Standards Act's "hot goods" provisions.[15] Under these provisions, an employer that fails to comply with federal minimum wage and overtime provisions can be enjoined from selling its goods in commerce until those provisions are met and the unpaid wages are paid.[16] Thus, these provisions create the equivalent of a "super-priority" for outstanding minimum-wage and overtime claims that is effective both inside and outside of bankruptcy. The Supreme Court has made clear that even a secured creditor can be enjoined from selling goods that were produced by a debtor that violated the minimum wage and overtime provisions of the Fair Labor Standards Act.[17]

Ironically, the biggest determinant of what form of protection that a labor-law claimant ends up getting from Congress may be the happenstance of which high-profile company failure triggers the labor-law crisis. To put this point a different way, Congress tends to react very specifically to the particular case that highlights a given labor problem that it seeks to solve, rather than stepping back and trying to see the broader scope of the underlying problem. So, for example, when the Studebaker company shut down its operations in the early 1960's and reneged on its defined-benefit pension promises without ever filing for bankruptcy,[18] Congress responded with a solution to the problem of underfunded pension plans that was not bankruptcy-specific: the enactment of ERISA.[19]

Ultimately, Congress chose not to include retiree medical benefits within the scope of ERISA's vesting and pre-funding requirements, thus setting the stage for the next crisis for labor-related claims when LTV filed chapter 11 in 1986. I often wonder what Congress would have done if LTV had simply announced that it was going out of business without even filing for bankruptcy, just liked Studebaker did. In such a nonbankruptcy business-failure scenario, the retirees would just as surely not have received their promised medical benefits, given the lack of pre-funding and the lack of any ongoing company to fund them in the future. Would that setting

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[15] 29 U.S.C. §§ 206(a)(1), 207(a)(1), 215(a)(1) (1988).

[16] *See* Citicorp Indus. Credit, Inc. v. Brock, 483 U.S. 27, 39–40 (1987).

[17] *See id.* (holding broad prohibition on interstate shipment of "hot goods" applies to secured creditors who acquire goods pursuant to security agreement).

[18] *See* Shelley Smith Curtis, *Potential for Crisis: Pension Benefit Insurance and the PBGC*, 39 FED. INS. & CORP. COUNS. Q. 131, 131 (1989).

[19] *See* Rettig v. Pension Benefit Guar. Corp., 744 F.2d 133, 137 (D.C. Cir. 1984) ("Throughout the deliberations that culminated in the enactment of ERISA, Congress was inundated with tragic stories of pension plan failures in which thousands of employees saw the destruction of the small measure of retirement security they had built up through decades of forced savings and deferred compensation."). ERISA created both a mandatory pre-funding and vesting requirement for defined-benefit pension plans. 29 U.S.C. §§ 1051, 1081 (2006). ERISA also created a new federal insurance corporation, the PBGC, to serve as a safety net for workers when companies failed to comply with their pre-funding obligations, or when employers' plans were terminated before they had a chance to fund them. 29 U.S.C. § 1302 (2006).

have prompted Congress to enact a broader protection for retiree medical benefits, perhaps bringing those benefits under the ERISA requirements of vesting and pre-funding?

The reason why I have my doubts about whether even a Studebaker-like crisis would have caused Congress to expand ERISA to include retiree medical benefits is that such a solution, unlike the requirements under Bankruptcy Code section 1114, would have required additional federal funding. First, there would be the costs of additional staffing for the PBGC, the federal insurer of defined-benefit pensions that ERISA created. Second, besides new staffing costs, there would have been the additional insurance risk for unfunded retiree medical benefits that the PBGC would have needed to cover as part of its already hefty portfolio of underfunded pension plans, a risk that would ultimately be borne by the federal government itself if the PBGC were to become insolvent.

Section 1114 creates a two-pronged priority for retiree medical benefit claims. First, in section 1114(e)(1), it provides that the debtor-in-possession "shall timely pay" and "shall not modify" any retiree medical benefits except to the extent that the court allows such reductions in payment.[20] Second, in section 1114(e)(2), it says that any retiree medical benefit payment that is required to be made by the debtor-in-possession before plan confirmation gets an administrative expense priority status.[21]

The beauty of the section 1114 solution to the retiree medical benefits crisis was that it was perceived to be costless—or, at least, costless to the federal government. If retirees in bankruptcy were going to be given an elevated priority that they heretofore did not enjoy, that new priority was clearly going to cost some other claimant in the zero-sum game that is bankruptcy. Conveniently enough for Congress, however, the particular parties who would bear the cost of this new bankruptcy-specific priority were yet to be determined.

LESSON NO. 2: THE MOST POTENT BANKRUPTCY LEVERAGE FOR AN EMPLOYEE OR RETIREE IS THAT WHICH HAS A NON-BANKRUPTCY SOURCE.

Congress can, and does, give bankruptcy-specific priorities to various favored claimants,[22] but the most effective priorities in bankruptcy are those that reflect some sort of nonbankruptcy leverage. Part of the reason for this reality is the ability of a debtor-in-possession to realize its going-concern value through a section 363 sale of assets free and clear of any claims or interests in the assets.[23] In that case, the

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[20] 11 U.S.C. § 1114(e)(1).

[21] *Id.* at § 1114(e)(2).

[22] *See, e.g.*, 11 U.S.C. §§ 507(a) (2012) (listing ten categories of unsecured priority claimants); 11 U.S.C. § 507(b) (defining super-priority claim for creditor whose adequate protection proved to be inadequate); 11 U.S.C. § 364(c)(1) (2012) (creating administrative expense priority claim for post-petition lender that trumps even a section 507(b) super-priority claim).

[23] *See, e.g.*, *In re* Trans World Airlines, Inc., 322 F.3d 283, 288–90 (3d Cir. 2003) (holding that airline

bankruptcy-specific priorities will attach to the proceeds of the sale, but a claimant with nonbankruptcy leverage may do better still, by seeing its claim, regardless of its priority position, follow the assets into the hands of the new buyer.

A couple of recent examples of this phenomenon were the high-profile chapter 11 cases of GM and Chrysler.[24] In both of those cases, the significant legacy costs of unfunded retiree medical benefits were arguably the primary reason why these auto manufacturers found themselves in bankruptcy.[25] In both cases, the debtor-in-possession opted to reorganize using the streamlined process of a section 363 sale rather than the traditional chapter 11 plan confirmation route.[26]

The retirees who were owed medical benefits in the GM and Chrysler cases consisted of both union and nonunion retirees.[27] The unions that represented the UAW retirees were going to continue to provide a skilled workforce to the purchasers of the assets; the nonunion retirees had no equivalent proxies that were still in the company's workforce, and therefore lacked the nonbankruptcy leverage enjoyed by the union retirees.[28] Both the union retirees and the nonunion retirees were protected by section 1114 of the Bankruptcy Code, but the treatment that each set of retirees received for their medical benefit claims was radically different.[29]

The union retirees were given a VEBA trust that was funded with carved-out assets to cover their future medical benefits.[30] Even though the VEBA trust was not going to give them all of their medical benefits as originally promised, the trust was significantly funded nevertheless, and would give the retirees at least a good portion of what they were promised.[31] The nonunion retirees, by contrast, were given

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workers' employment discrimination claims against the debtor, as well as claims to a travel-voucher program that TWA established to settle a sex-discrimination suit, were both "interests in property" that were extinguished by the debtor's section 363 sale of all TWA's assets).

[24] *In re* Gen. Motors Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009); *In re* Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009).

[25] *See In re Gen. Motors Corp.*, 407 B.R. at 484 (stating GM and Chrysler created huge liabilities and lost much of their competitiveness by committing to offer healthcare benefits that were provided by their foreign competitors' governments).

[26] *In re Gen. Motors Corp.*, 407 B.R. at 473; *In re Chrysler LLC*, 405 B.R. at 92–93.

[27] *In re Gen. Motors Corp.*, 407 B.R. at 475 (stating 68% of GM's 91,000 U.S. workers belonged to a union); *In re Chrysler LLC*, 405 B.R. at 88–89 (stating 70% of Chrysler's 38,500 U.S. workers worked under collective bargaining agreement).

[28] *See In re Gen. Motors Corp.*, 407 B.R. at 509–12; *In re Chrysler LLC*, 405 B.R. at 110.

[29] *In re Gen. Motors Corp.*, 407 B.R. at 496–97 (discussing disparate treatment of creditors).

[30] The final VEBA deal for the Chrysler retirees obligated New Chrysler (Chrysler's post-bankruptcy going-concern) to give the VEBA a $4.6 billion unsecured note plus 55% of the total outstanding stock to be issued in New Chrysler. *Ramifications of Auto Industry Bankruptcies (Part II): Hearings Before the Subcomm. On Commercial and Admin. Law of the H. Comm. on the Judiciary*, 111th Cong. 16, 22–23 (2009) (testimony of Ron Bloom, Senior Advisor, U.S. Department of the Treasury). The GM retirees ended up with a promise from New GM to put a $2.5 billion note in their medical-benefit VEBA, along with 12% of New GM's stock. *Id.* at 23.

[31] *In re Gen. Motors Corp.*, 407 B.R. at 484–85, 519 (finding UAW Settlement fair and equitable, successful in preserving acceptable level of core medical benefits, and in overall best interests of both estate and UAW members).

nothing more than what section 1114 entitled them to: an unsecured administrative expense claim against the proceeds of the section 363 sale that were mostly encumbered by the claims of secured creditors.[32]

I am not merely speculating on the courts' motives when I say that the reason why the union retirees in *GM* and *Chrysler* were given better treatment than the nonunion retirees is that they enjoyed nonbankruptcy leverage by virtue of their membership in a union whose active workers would supply the labor for the post-bankruptcy companies. The bankruptcy judges in both cases conceded as much. In *GM*, the court stressed that the retiree-benefit VEBAs were given to the union retirees in consideration for new commitments that their active union members were making to the new GM.[33] Similarly, the court in *Chrysler* noted that "New Chrysler views the skilled workforce as essential to its future operations," and that "its leadership would not have recommended that its members ratify the amended collective bargaining agreement unless New Chrysler agreed to fund the VEBA."[34]

The Supreme Court has said that absent federal policy to the contrary, property rights in bankruptcy are defined by state law.[35] Obviously, one needs to look no further than to section 507 to see plenty of "federal policy to the contrary," since that section lists no fewer than ten categories of claims that receive a special priority in bankruptcy.[36] The section 1114 priority for retiree benefits is not even included among the ten categories in section 507,[37] but I would argue that the bankruptcy-specific priority (or more precisely, the chapter 11-specific priority) of retiree benefits is potentially even more damaging to the overall bankruptcy process than are the section 507 priorities.

What makes the section 1114 priority different from (and arguably more problematic than) the section 507 priority categories is that the section 1114 priority does not reflect the nonbankruptcy leverage that is enjoyed by most of the section 507 priority claimants. In other words, most of the significant section 507 priority claims are in some sense merely reflecting leverage that the claimants would enjoy even outside of bankruptcy. Section 1114, by contrast, is a true "springing priority," since retiree benefit claims typically do not have a lot of nonbankruptcy leverage.

Consider each of the major section 507 claimants: administrative expense claims, wage claims, and tax claims. Administrative expense claims generally arise

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[32] *See id.* at 509–10 (observing non-UAW retirees may be left with unsecured claims and would likely face "unfortunate reality of the bankruptcy process").

[33] *See id.* at 498.

[34] *In re* Chrysler LLC, 405 B.R. 84, 99–100 (Bankr. S.D.N.Y. 2009).

[35] *See* Butner v. United States, 440 U.S. 48, 54–55 (1979) (stating "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law," and "[p]roperty interests are created and defined by state law.").

[36] 11 U.S.C. § 507(a) (2012).

[37] *See* 11 U.S.C. § 1114(e)(1) & (e)(2).

when a claimant gives value to the debtor-in-possession;[38] most administrative expense claimants have the inherent leverage of choosing whether to give that value or not. In a chapter 11 case, wage claimants are usually the very workers whose labor the debtor-in-possession will require in order to emerge from bankruptcy. It is no wonder, then, that first-day orders typically allow the payment of such wages. Finally, tax claimants enjoy plenty of unique leverage outside of bankruptcy that comes from representing the government's interest in collecting revenue.

Even those categories in section 507 that do not reflect natural leverage, such as consumer deposits or grain or fish storage facility claims, have a statutory cap that would make it highly unlikely that such a springing priority would ever compromise the overall value-maximization goal of the chapter 11 reorganization process.[39] By contrast, the priority for retirees for their medical benefits in chapter 11 does not have a cap and can often be massive in scope. Therefore, it should not be surprising that the existence of this priority has the potential to skew the nature and effectiveness of the chapter 11 process.

LESSON NO. 3: WHEN YOU CREATE LARGE SPRINGING PRIORITIES THAT APPLY ONLY IN A PARTICULAR KIND OF REORGANIZATION PROCESS, EMPLOYERS THAT ARE FACED WITH THOSE TYPES OF CLAIMS WILL SEEK TO AVOID THAT PROCESS.

The GM and Chrysler cases were not the first examples of debtors-in-possession that bypassed a traditional chapter 11 plan process in favor of a section 363 sale as a way to circumvent the effects that a large springing priority of retiree medical benefits would otherwise have had on their ability to reorganize. The Horizon Natural Resources Company was a Kentucky-based coal company that filed chapter 11 and tried to sell its assets as a going-concern business that would continue to honor its collective bargaining agreements and its retiree medical benefit obligations.[40] Unfortunately, these labor obligations were so large relative to the value of the company that no buyer was willing to buy the company if such obligations were part of the deal.[41]

As a result, the debtor-in-possession in *Horizon* sought and received permission from the bankruptcy court to effect a section 363 sale free and clear of all claims, including the claims of the retirees to their promised medical benefits.[42] The

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[38] *See* 11 U.S.C. § 503(b) (2012) (defining administrative expenses claims as "the actual, necessary costs . . . of preserving the estate," including several categories of professional fees for services rendered for the benefit of the estate); *see also* 11 U.S.C. § 364(a) (unsecured loans made in the ordinary course of business to the debtor-in-possession automatically receive administrative expense status).

[39] 11 U.S.C.A. §§ 507(a)(6) & (7) (2013) (capping priority claims of grain or fish storage facility owners at $6,150 and capping consumer-deposit priority claims at $2,775).

[40] *See In re* Horizon Natural Resources Co., 316 B.R. 268, 272–73 (Bankr. E.D. Ky. 2004).

[41] *Id.* at 274 ("[T]he debtors undertook vigorous efforts to market their operations with the obligations . . . but . . . no offers to purchase the assets with the obligations have been received.").

[42] *Id.* at 282–83.

retirees' section 1114 unsecured claims to their benefits would have to be asserted against the proceeds of the section 363 sale, but those proceeds were largely encumbered by the claims of secured creditors.[43] The only silver lining in this sad tale was that the section 363 sale allowed some of the current workers to retain their jobs, albeit at a reduced wage rate.[44] Even that small silver lining would probably not have been possible with a piecemeal liquidation of the company's assets, which would have yielded much less than the 363 sale of the assets as a going-concern.[45]

In support of its decision to allow the section 363 sale free and clear of retiree claims for medical benefits, the bankruptcy court in *Horizon* cited a similar case, *In re Leckie Smokeless Coal*.[46] In *Leckie*, the major legacy cost for the debtor was not section 1114 retiree benefit obligations, but rather Coal Act obligations totaling about $7 million.[47] The problem was that the company's assets were only worth about $2 million free and clear of all claims.[48] The court in *Leckie* ultimately allowed the section 363 sale free of the Coal Act obligations on the theory that absent such a sale, the debtor would simply have to conduct a piecemeal liquidation of assets that would yield fewer dollars than could be realized if the assets were sold as a unit without those obligations.[49]

LESSON NO. 4: THE ONLY THING WORSE THAN A BANKRUPTCY-SPECIFIC PRIORITY IS A CHAPTER 11-SPECIFIC PRIORITY.

As noted above, Congress has a tendency to be very reactive in crafting legislation to address the various crises that come to its attention. However, just because the crisis of unfunded retiree medical benefits happened to rear its ugly head in the context of LTV's chapter 11 filing, it does not follow that unfunded retiree benefits are a chapter 11-specific problem needing a chapter 11-specific

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[43] *See id.* at 274 (noting that without the section 363 "free and clear" sale, the assets would not even generate enough proceeds to pay off post-petition lenders and administrative priority claims); *see also* James Dao, *Miners' Benefits Vanish With Bankruptcy Ruling*, N.Y. Times, October 24, 2004, http://query.nytimes.com/gst/fullpage.html?res=9B03E6D61F3AF937A15753C1A9629C8B63 (noting that the section 363 sale in this case caused nearly 3,800 coal workers, retirees and their dependents to lose health insurance).

[44] *In re Horizon Natural Resources Co.*, 316 B.R. at 282–83.

[45] The wide divergence between the going-concern value and the piecemeal-liquidation value of a company is fairly typical. In *Chrysler*, for example, the court contrasted the $2 billion purchase price for the proposed asset sale under section 363 with the $800 million high-end estimate of a liquidation of Chrysler. *In re* Chrysler LLC, 405 B.R. 84, 96–97 (Bankr. S.D.N.Y. 2009).

[46] *In re Horizon Natural Resources Co.*, 316 B.R. at 279 (citing United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co. (*In re* Leckie Smokeless Coal Co.), 99 F.3d 573, 586–87 (4th Cir. 1996)).

[47] *In re Leckie Smokeless Coal Co.*, 99 F.3d at 586.

[48] *Id.* (stating "the Bankruptcy Court found that $1.9 million represented a fair and reasonable price for the debtors' assets; the debtors' accrued Coal Act obligations, though, stand at about $7 million.").

[49] *Id.* at 586–87 ("If a free and clear order could not be issued, the assets would almost inevitably have to be sold piecemeal, thereby generating fewer funds with which to satisfy the claims of the Fund, the Plan, and the debtors' other creditors.").

solution. Struggling companies can, and do, fail outside of bankruptcy as well as inside of bankruptcy, and certainly companies that file bankruptcy can file chapter 7 from the start or even end up converting to chapter 7 after a failed attempt at chapter 11.

Therefore, besides being an incomplete and ineffective solution to the problem of unfunded retiree medical benefits, section 1114 can also serve as a kind of "poison pill" to the chapter 11 option for a company seeking to reorganize that is heavily burdened with retiree medical benefit obligations. Also, because the section 1114(e) priority is restricted to chapter 11, any chapter 11 plan of reorganization that gives favored treatment to retiree medical benefits must contend with section 1129(a)(7)'s "best interests of creditors" test.[50]

Section 1129(a)(7) says that no holders of impaired claims or interests can be forced to accept a chapter 11 plan that fails to give them at least as much as they would receive in a chapter 7 liquidation of the same debtor.[51] Imagine a hypothetical chapter 11 debtor that has a going-concern value of $500 million and a chapter 7 liquidation value of $450 million. Imagine that this debtor has $300 million in secured debt, $150 million in retiree medical obligations, and $300 million in general unsecured claims. The debtor proposes a plan in which secured debt is paid in full, retiree benefits are given their full section 1114 priority ahead of general unsecured claims, and general unsecured claimants are given a total of $50 million in value.

Any general unsecured creditors that are unhappy with that plan treatment should be able to object and block the plan on the theory that the proposed plan is not giving them as much value as they would receive in a chapter 7 liquidation of the same debtor.[52] In a chapter 7 liquidation, the section 1114 priority would disappear and the retirees' claim for unfunded benefits would share equally with other nonpriority unsecured creditors. In a chapter 7 liquidation, the non-retiree unsecured creditors would receive a total of $100 million in value versus the $50 million they would receive in a chapter 11 plan that attempts to respect the section 1114 priority for retiree medical benefits.

Consider, too, the not-uncommon case where a debtor knows that it wants to liquidate, but the debtor has not decided which chapter, 7 or 11, would be the most efficient forum in which to maximize its liquidation value. That was the issue facing the debtor in *In re North American Royalties*.[53] In that case, the bankruptcy court needed to decide whether to approve an agreement between the chapter 11 debtor's unions and the debtor to terminate the retiree medical benefit obligations that were included in the debtor's pre-petition collective bargaining agreement with

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[50] *See* 11 U.S.C. § 1129(a)(7) (2012).
[51] 11 U.S.C. § 1129(a)(7)(A)(ii).
[52] *See* 11 U.S.C. § 1128(b) (2012) ("A party in interest may object to confirmation of a plan.").
[53] *In re* N. Am. Royalties, Co., 276 B.R. 860 (Bankr. E.D. Tenn. 2002).

the unions.[54] The court ultimately determined that even though section 1114 would not require the court's approval for such a termination, section 363(b) would require it as a transaction outside of the ordinary course of business.[55]

As a result of this holding by the bankruptcy court, the debtor in *North American Royalties* had to demonstrate that it had a sound business reason for eliminating the retiree medical benefits that were otherwise owed to the hourly employees who were covered by the collective bargaining agreement.[56] At this point in the case, however, the chapter 11 estate consisted of nothing more than the cash proceeds of the section 363 sale that had already been consummated.[57] An attorney for a lenders' group said that if the court found that retiree medical benefits could not be terminated, he would simply move to convert the case to a chapter 7 liquidation so that the section 1114 priority for retiree benefits would not apply at all.[58]

LESSON NO. 5: IF YOU ARE GOING TO CREATE A NEW PRIORITY BY BORROWING FROM ANOTHER BANKRUPTCY CODE SECTION, AT LEAST BORROW FROM THE RIGHT SECTION.

Perhaps the strangest feature of the section 1114 solution to the problem of unfunded retiree medical benefits is how Congress used section 1113 as a template for that section, even though the problem of collective bargaining agreements in bankruptcy is fundamentally different from the issue of unfunded retiree medical benefits. Collective bargaining agreements represent a type of executory contract, where performance remains on both sides.[59] Unfunded retiree medical benefits, by contrast, represent a claim by the retirees for past work performed. Collective bargaining agreements are a two-way street for the union workers and the employer going forward; retiree medical benefits are a one-way street for the retirees who were promised the medical benefits.

The natural place to have inserted a special priority for retiree benefit claims would have been section 507(a), where we find most of the other bankruptcy-specific priority claims.[60] That would have also solved the problem, described above, when section 1129(a)(7)'s "best interests of creditors" test clashes with section 1114's chapter 11-specific priority.[61] That is because the section 507(a)

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[54] *See id.* at 862.
[55] *Id.* at 863.
[56] *Id.* at 862–63.
[57] *Id.* at 864 (stating employee "benefits can be paid only from money that might otherwise be retained to pay creditors' claims in the bankruptcy cases.").
[58] *Id.* at 865.
[59] *See* Michelle Morgan Harner, Carl E. Black & Eric R. Goodman, *Debtors Beware: The Expanding Universe of Non-Assumable/Non-Assignable Contracts in Bankruptcy*, 13 AM. BANKR. INST. L. REV. 187, 187 n.1 (2005).
[60] 11 U.S.C. § 507(a) (2012).
[61] *See* 11 U.S.C. §§ 1129(a)(7), 1114(e).

priorities apply in both chapter 7 cases and chapter 11 cases, unlike the section 1114 priority.[62] One problem with attaching a section 507(a) priority to retiree medical benefits is timing of payment, but special procedures on timing could have easily been written into a section 507(a) priority for retirees if that's what Congress had wanted to do. Similarly, Congress could have incorporated into a section 507(a) priority for retiree medical benefits a way for the debtor to reduce or eliminate the claims, just as we have now in section 1114.

One consequence of this mismatched template for the retiree benefit priority in bankruptcy is that retirees are supposed to bargain with the debtor-in-possession concerning any modifications that the debtor wishes to impose on its retiree medical benefit obligations.[63] Yet the very notion of bargaining suggests that each side has some leverage to bring to the table. Union workers that bargain with an employer about the terms of a collective bargaining agreement typically have their future labor for the employer as a bargaining chip. What leverage can retirees bring to the table, given that retirees have already given the company all of the labor that they once had to give?

If the retirees are union retirees, they can sometimes ride the coattails of their active union members, as was true in the cases of Chrysler and GM. But not every retiree covered by section 1114 is necessarily going to be a union worker. And even union retirees cannot always be confident that their interests will coincide with the natural interests of current union workers to secure better wages for themselves. There have been a number of situations during the past decade that have highlighted the obvious conflicts between the interests of union retirees to their medical benefits and the interests of current union workers to higher wages.[64]

LESSON NO. 6: IF YOU WANT TO GIVE A BANKRUPTCY PRIORITY TO A PARTICULAR KIND OF CLAIM, MAKE IT CLEAR WHAT THE PRIORITY IS.

Nobody would deny that sections 1113 and 1114 are both intended to give a priority in bankruptcy to a debtor's collective bargaining agreement obligations and

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[62] *See* 11 U.S.C. § 103(a) (2012) (providing "chapters 1, 3 and 5 of this title apply in a case under chapter 7, 11, 12 or 13 of this title").

[63] *See* 11 U.S.C. § 1114(g) (describing negotiating procedure debtor-in-possession must follow before being authorized by the court to modify retiree medical benefits in chapter 11 case).

[64] *See, e.g.*, Janet Forgrieve, *Grocery Workers' Fund May Go Bust; No Proposal on Table to Raise Payments into Trust for Retirees*, ROCKY MTN. NEWS, Nov. 4, 2004, (pointing out how union supermarket retirees in Denver have "[n]o standing in contract negotiations between the stores and the current workers"); Jeff Green, *GM Retirees May Fight Reductions in Benefits; Michigan Lawsuit Challenges UAW*, BUFF. NEWS, Jan. 2, 2006, (noting "[h]istorically, active UAW workers have been reluctant to cut retiree benefits because many are near retirement age or have parents and other relatives who are already union retirees," but "[l]osses at GM and Ford have forced a change"); Todd Lighty, *Retirees May Sue City Hall Over Union Deal, Back Pay*, CHI. TRIB., December 28, 2005, http://articles.chicagotribune.com/2005-12-28/news/0512280378_1_union-deal-retirees-negotiations (detailing events surrounding tension between union and its retirees).

to its retiree medical benefit obligations, respectively. Where both sections fail, however, is in defining the precise nature and extent of the priority that is being given. In other words, where exactly within bankruptcy's pecking-order of claims are these favored claims supposed to fit?

Consider, first, an example of the uncertainty surrounding the section 1113 priority. Suppose that an auto manufacturer files chapter 11 at a time when it is in the middle of a collective bargaining agreement that pays its union workers $30 per hour on average. Suppose that the debtor can demonstrate that it would need to liquidate if it had to continue paying $30 per hour to its union workers. If the debtor could modify its union agreement to $20 per hour, it could operate with a very slight profit as a going-concern but could not afford to pay any of its other pre-petition unsecured creditors anything. If the debtor could hire replacement workers at $15 per hour (or modify its collective bargaining agreement to pay its union workers that same rate), then it could generate enough of a going-concern surplus that it could pay its non-labor unsecured creditors 50 cents on the dollar as part of its chapter 11 plan.

Section 1113 tells us that the union must accept a proposal by the debtor that includes modifications in the collective bargaining agreement that "are necessary to permit the reorganization of the debtor and assure[] that all creditors, the debtor and all of the affected parties are treated fairly and equitably," or else the court will simply allow the debtor to reject the original collective bargaining agreement.[65] As high-minded as that statutory language might sound—after all, who can argue with adverbs like "fairly" and "equitably"?— the problem with it is that it fails to answer the critical question of relative priority as between the union workers under their collective bargaining agreement and the other pre-petition unsecured creditors of the debtor. To put this point another way, that language does not give the bankruptcy judge clear guidance as to whether the debtor in the above hypothetical should be allowed to demand a modification of the collective bargaining agreement to $15 an hour (thus giving nonunion creditors some value) or to just $20 an hour (thus preserving more value for the union workers).[66]

Section 1114 suffers from a similar ambiguity as to the relative priority accorded to retiree medical benefit claims. Section 1114(e)(1) says that prior to a

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[65] *See* 11 U.S.C. § 1113(b) & (c).

[66] Some might argue that this hypothetical in effect illustrates the two different standards that courts have used for deciding which modifications of a collective bargaining are "necessary" for an effective reorganization under section 1113: only those that are absolutely essential for reorganization (the $20 per hour approach in my hypothetical that leaves no value for the other unsecured creditors and no cushion for the reorganized debtor), or those that leave some value for other unsecured creditors and some cushion for the reorganizing debtor (the $15 per hour approach). *Compare* Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., AFL-CIO-CLC, 791 F.2d 1074, 1088 (3d Cir. 1986) (holding "necessary" under section 1113 means "essential"), *with* Truck Drivers Local 807 v. Carey Transp. Inc., 816 F.2d 82, 89 (2d Cir. 1987) (holding that "necessary" under section 1113 does not mean "bare minimum" or "essential," but instead incorporates any changes necessary to enable debtor to complete reorganization process successfully).

court-sanctioned modification of retiree medical benefits, a debtor-in-possession "shall timely pay and shall not modify any retiree benefits[.]"[67] When courts were first called upon to interpret that language, they struggled to decide just how far it was meant to go. Did that mean that pre-modification retiree benefits needed to be paid even in a case where the debtor's only available cash was already encumbered by a valid pre-petition security interest?

Most courts that were faced with that dilemma quickly concluded that Congress could not have intended to go *that* far with this new retiree benefit super-priority in bankruptcy, if for no other reason than the constitutional problems inherent in creating new priorities that would trump pre-existing property interests in bankruptcy.[68] However, one bankruptcy court received a letter from Senator Howard Metzenbaum, the sponsoring senator of the retiree legislation, after that court took the position that even this new retiree priority could not upset the rights of preexisting secured creditors. Senator Metzenbaum's letter urged that the retirees continue to be paid their benefits, consistent with "the intent of Congress."[69] When this bankruptcy judge rejected the senator's plea for reconsideration of the court's decision, the obviously exasperated judge could not help adding in his opinion that "short of printing money, there is no way to see that all claims are paid in full."[70]

At least section 1114 makes clear that the debtor's modification of its retiree benefit obligations gives rise to a claim for the retirees who are affected.[71] Section

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[67] 11 U.S.C. § 1114(e)(1). Section 1113(f) contains a similar "shall pay" command, at least implicitly, by its statement that "[n]o provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of this section." 11 U.S.C. § 1113(f). Section 1113(f) does not tell us, however, what happens to the priority of claims that arise when a debtor-in-possession *does* unilaterally fail to pay obligations under a collective bargaining agreement without first getting a court-approved modification of such terms. There is a split in the circuits as to whether section 1113(f) claims for unauthorized and unilateral modifications of collective bargaining agreements get administrative expense priority status. The majority of circuits say no. *See, e.g.*, *In re* Roth Am., Inc., 975 F.2d 949, 958 (3d Cir. 1992) (holding that "11 U.S.C. § 1113 does not create a superpriority or automatic first priority for claims under an unrejected collective bargaining agreement"). The Sixth Circuit is alone in saying yes. *See* United Steelworkers of Am. v. Unimet Corp. (*In re* Unimet Corp.), 842 F.2d 879, 884–85 (6th Cir. 1988).

[68] *See In re* GF Corp., 115 B.R. 579, 582–83 (Bankr. N.D. Ohio 1990), *vacated in part*, 120 B.R. 421 (Bankr. N.D. Ohio 1990); *In re* Jones & Lamson Mach. Co., 102 B.R. 12, 15–17 (Bankr. D. Conn. 1989) (interpreting stop-gap precursor to section 1114).

[69] *In re GF Corp.*, 115 B.R. at 581, 585.

[70] *Id.* at 585.

[71] 11 U.S.C. § 1114(e)(2) (providing "[a]ny payment for retiree benefits required to be made before a plan confirmed under section 1129 of this title is effective has the status of an allowed administrative expense as provided in section 503 of this title."). Even here, though, Congress failed to specify to what extent the retirees' claim enjoys the administrative expense priority status. Does the priority apply even as to amounts by which the debtor-in-possession was authorized by the bankruptcy court to modify the benefits? Or does it apply instead only to retiree benefits owed but not paid by the debtor-in-possession prior to a court-authorized modification of benefits? The few cases considering the issue have gone with the latter interpretation, although there is nothing in the language of § 1114(e)(2) that would dictate that result. *See, e.g., In re* Ionosphere Clubs, Inc., 134 B.R. 515, 527 (Bankr. S.D.N.Y. 1991) (holding retiree benefits lost to modification under section 1114 are general unsecured claims rather than administrative expense claims); *In*

1113 does not specify whether a court-sanctioned rejection of a collective bargaining agreement gives rise to a damages claim for the union workers who are affected by the rejection. The Second Circuit in *In re Northwest Airlines*[72] held that the debtor's rejection of the flight attendants' collective bargaining agreement in that case did not give rise to a damages claim for the flight attendants. The Second Circuit's rationale was that a collective bargaining agreement rejection that the bankruptcy court allows under section 1113 merely "abrogates" the contract rather than breaches it.[73]

That seems like an odd result, and one that Congress was unlikely to have intended, given that it allows section 1113 to put union workers whose employer is in bankruptcy in a *worse* position than they would be if the employer were not in bankruptcy. If the employer were not in bankruptcy and breached a labor contract, the affected union employees would at least be able to bring a claim against the employer for damages.[74] In a different essay,[75] I took issue with the Third Circuit's result in *In re Visteon*,[76] where the court held that the protections of section 1114 apply even in a case where the retirees' medical benefits are not vested. I criticized this decision as creating what amounts to a "springing claim" in bankruptcy: a contractual "right to payment" for the retirees that only comes into being if their employer files chapter 11.[77]

The result that is created by the Second Circuit's decision in *Northwest* is in some sense the flipside of the phenomenon I criticized in *Visteon*: it creates what amounts to a "disappearing claim" in bankruptcy, a "right to payment" that existed for union workers outside of bankruptcy but no longer does simply because the employer is now in chapter 11. Neither the *Visteon* nor the *Northwest* result is defensible, because each one makes the existence or nonexistence of a creditor's claim a function of whether or not the debtor is in bankruptcy. No clearly stated federal policy is served in either case, and thus both cases violate the Supreme

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re Tower Auto. Inc., 241 F.R.D. 162, 167 (S.D.N.Y. 2006) (emphasizing legislative history of Retiree Benefits Bankruptcy Protection Act "makes clear" that retiree benefits lost due to section 1114 modification are unsecured claims); *In re GF Corp.*, 120 B.R. at 423 n.1 (same). Another ambiguity surrounding the administrative expense priority of section 1114(e)(2) is whether it can apply to retiree medical benefits that the debtor failed to pay pre-petition. On this issue, courts have been split. *Compare* Adventure Resources, Inc. v. Holland, 193 B.R. 787, 796–98 (S.D. W.Va. 1996) *rev'd in part on other grounds*, *aff'd in part*, 137 F.3d 786 (4th Cir. 1998) (holding section 1114(e)(2)'s priority does not encompass claims that were due pre-petition), *with In re* A.C.E. Elevator Co., 347 B.R. 473, 485 (Bankr. S.D.N.Y. 1996) (holding section 1114(e)(2)'s priority does encompass claims that were due pre-petition).

[72] 483 F.3d 160 (2d Cir. 2007).

[73] *Id.* at 172.

[74] Outside of bankruptcy, an employer cannot unilaterally modify a collective bargaining agreement unless its good-faith negotiations with the affected union have reached an impasse. *See* NLRB v. Katz, 369 U.S. 736, 741–42, 748 (1962).

[75] Daniel Keating, *Transforming a Non-Claim Into a Claim: § 1114 and the Curious Case of In re Visteon*, 85 AM. BANKR. L.J. 1 (2011).

[76] *In re* Visteon Corp., 612 F.3d 210 (3d Cir. 2010).

[77] Keating, *supra* note 75, at 3.

Court's admonition in *Butner* that property rights in bankruptcy should generally be determined by reference to nonbankruptcy entitlements.[78]

Some might argue that the ambiguity as to the relative priority of collective bargaining and retiree benefit claims is actually a positive feature of the Bankruptcy Code, since the uncertainty encourages both sides to reach a negotiated settlement.[79] This argument would posit that neither side wants to risk litigating the issue and ending up in a worse position than they could achieve in a settlement.[80] By this logic, then, it is actually a good thing that the bankruptcy judge in a section 1113 or 1114 setting has so much leeway in deciding which modifications are both "necessary" and treat "all of the affected parties . . . fairly and equitably."[81]

I have two responses to any argument that the ambiguity as to priority that we currently have in sections 1113 and 1114 is actually constructive. First, if this ambiguous standard is such a good thing, then why is organized labor generally unhappy with how these two sections have played out in practice for its members? I am presuming that unions are generally unhappy because, as noted above, one of their advocates, Rep. John Conyers, Jr. (D-MI), just introduced H.R. 100, a bill that would revise the current requirements covering the rejection of collective bargaining agreements and retiree medical benefits in bankruptcy.[82]

My second response to the argument in favor of constructive ambiguity is that such an approach can lead to the unseemly side effect of media side-shows in which the relative priority of retiree benefits is litigated in the popular press rather than through the courts. That, in effect, is what has happened in the chapter 11 case of Patriot Coal Corporation, which is still unfolding at the federal bankruptcy court for the Eastern District of Missouri in my hometown of St. Louis. Because the priority of retiree medical benefits is not clear in section 1114, and because that priority rests primarily in the hands of a bankruptcy judge rather than in the words of a clearly articulated statute, the affected claimants apparently see strategic gain in mounting a public-relations campaign for the court to maintain their benefit levels.

The affected unions in the Patriot case have been taking out full-page ads in the local newspaper, as well as encouraging rallies outside of the federal courthouse in St. Louis to press their cause for maximum retention of retiree benefits in the chapter 11 case.[83] The idea, I suppose, is for the judge in that case to feel public

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[78] *See supra* note 35 and accompanying text.

[79] *Cf.* Henry S. Farber & Harry C. Katz, *Interest Arbitration, Outcomes, and the Incentive to Bargain*, 33 INDUST. & LAB. REL. REV. 55–56, 60, 63 (1979) (concluding bargainers' uncertainty about arbitrator's idea of a fair settlement increases bargainers' range of acceptable outcomes and thus promotes settlement, and increased certainty through fact-finding is counterproductive towards reaching settlement in good-faith bargaining scenario).

[80] *Id.* at 56, 60.

[81] 11 U.S.C. §§ 1113(b)(1)(A), 1114(f)(1)(A) & (g)(3) (2012).

[82] Protecting Employees and Retirees in Business Bankruptcies Act of 2013, H.R. 100, 113th Cong. (2013).

[83] *See* Jeffrey Tomich and Tim O'Neil, *Miners Rally in Bid to Protect Retiree Health Benefits*, ST. LOUIS POST-DISPATCH, January 29, 2013, http://www.stltoday.com/business/local/miners-rally-in-bid-to-protect-

pressure to interpret the Code's ambiguity on this issue more favorably for the retirees. The predecessor to the debtor-in-possession, which has been accused by the union of unloading the retiree liabilities as part of a spinoff six years earlier that was "designed to fail,"[84] has felt compelled to respond with newspaper ads of its own that defend the legitimacy of the spinoff. I do not believe that anyone gains when the legal process starts to become indistinguishable from the politic process, but that has been an unfortunate byproduct of the Code's ambiguity on these labor priority claims.

LESSON NO. 7: IF YOU MAKE A PARTICULAR TYPE OF EMPLOYEE BENEFIT MORE EXPENSIVE FOR AN EMPLOYER, FEWER EMPLOYERS WILL GIVE THE BENEFIT.

This is a lesson that has implications for both bankruptcy and nonbankruptcy legislation alike. On the bankruptcy side of things, one way for Congress to make a benefit more expensive for an employer is to engraft a bankruptcy-specific priority onto the benefit, thus adding another hurdle to an employer's ability to reorganize in bankruptcy.

With both defined-benefit pension plans and retiree medical benefits, we have seen a steady decline during the past few decades in the number of employers that offer those particular benefits. From 1980 to 2008, the proportion of private-sector employees that were participating in a defined-benefit pension plan fell from 38 percent to 20 percent.[85] Between 1997 and 2010, the percentage of private-sector employers offering retiree health benefits to early retirees dropped from 28.9 percent to 17.7 percent.[86]

It was easy enough for employers to offer generous defined-benefit pension plans and retiree health benefits back in the days when pension plans did not have to be pre-funded and when retiree medical benefits obligations did not even need to be shown on an employer's balance sheet. In those days, the ability to make these types of promises to employees in lieu of higher current wages was like an unlimited unsecured line of credit for employers, if not a de facto Ponzi scheme on the backs of the workers to whom the future benefits were promised.

The challenge for ERISA, even from the very inception of that statute, has been

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retiree-health-benefits/article_01c4c709-2f4c-5496-bbce-1a2608cc4eac.html. On May 29, 2013, the bankruptcy judge in the Patriot case ruled that the debtor could reject its collective bargaining agreements and reduce its retiree health benefits in an effort to reorganize. *See* Tim Logan, *Patriot Can Sever Mine Workers Contract, Cut Retiree Benefits, Judge Rules*, ST. LOUIS POST-DISPATCH, May 30, 2013, http://www.stltoday.com/business/local/patriot-can-sever-mine-workers-contract-cut-retiree-benefits-judge/article_41bd96a9-287f-5f8b-b21f-ede5f9ecdb9b.html.

[84] That is the phrase used in a lawsuit filed last fall by the union against Peabody Energy Corp., which spun off Patriot on October 31, 2007. *See* Tomich & O'Neil, *supra* note 83.

[85] *See* Barbara A. Butrica et al., *The Disappearing Defined Benefit Pension and Its Potential Impact on the Retirement Incomes of Baby Boomers*, 69 SOC. SEC. BULL. at 1 (2009).

[86] *See* Paul Fronstin and Nevin Adams, *Employment-Based Retiree Health Benefits: Trends in Access and Coverage, 1997-2010*, 377 EMP. BENEFIT RES. INST. at 5, 7 (October 2012).

to ensure that employers will ultimately pre-fund their defined-benefit pension promises without making the employers either eliminate such benefits altogether or go bankrupt in the process of pre-funding these legacy costs. The fundamental problem for ERISA in this regard is that by the time ERISA was enacted, most companies that offered defined-benefit pension plans had already made significant defined-benefit promises. Realistically, these future promises could not be funded immediately, and thus employers were allowed by ERISA to pay these already accrued pension liabilities over a period of many years.[87]

Even the more recent ERISA overhaul legislation, the Pension Protection Act of 2006 (PPA),[88] faced this same fundamental tension: the firms that posed the greatest financial risk to the PBGC due to the firms' underfunded pension liabilities were often the very same firms that could least afford to remedy the problem quickly. In light of this reality, it was perhaps not as ironic as it might otherwise have seemed that the PPA, which was specifically designed to strengthen the balance sheet of the PBGC, would include special exemptions for the very industry (airlines) that was probably the worst underfunded-pension offender.[89]

The defining moment for the fate of retiree medical benefits came not through federal legislation, which even today does not require pre-funding of such benefits, but instead through a change in the Financial Accounting Standards. When FASB Statement No.106 was issued in 1990 and became effective in 1993, private firms could no longer hide the cost of their future retiree medical benefit liabilities from their balance sheets.[90] This FASB-generated requirement on a firm to show the cost of its future retiree medical benefit liability for all the world to see, including shareholders and lenders, certainly served to accelerate what had already been a marked trend among private employers towards the phasing out of such benefits.

LESSON NO. 8: SOMETIMES THE LESS GENEROUS EMPLOYEE BENEFIT IS THE MORE RELIABLE ONE.

This is a lesson that unions have come to appreciate, especially in the realm of retiree medical benefits. At least with defined-benefit pension plans, the federal government provides insurance in the form of the PBGC. Although the PBGC insurance comes with coverage limits, those limits end up significantly affecting only the highest-earning pensioners covered by the insurance.[91] Nevertheless, a

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[87] 26 U.S.C. § 412(b)(2)(B) (2006) (requiring amortization periods of between five and thirty years for employers to fund already-accrued defined-benefit pension obligations).

[88] Pub. L. No. 109-280, 120 Stat. 780 (2006).

[89] *See id.* at § 402 (describing special rules for airlines that allow additional time for airlines to amortize past underfunding of plans).

[90] *See Summary of Statement No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions*, FASB.ORG (Issued Dec. 1990), http://www.fasb.org/summary/stsum106.shtml (establishing standards for accounting of postretirement benefits).

[91] For a person retiring at age 65, the coverage limit for the PBGC's insurance for 2013 is just under

fully funded defined-contribution pension plan can still offer some advantages to beneficiaries over the defined-benefit variety, especially if the employer is struggling financially. These include the likelihood that the defined-contribution plan is safe from the bankruptcy of the employer, plus the possibility of directly benefitting from faster growth of the assets in the plan when investment returns are high.

Because retiree medical benefit promises are not backed by federal insurance, the case for a defined-contribution version of such benefits can often be even stronger than the case for defined-contribution pension plans. In heavily unionized industries such as the auto, steel and airline industries, the generous promises that were once made of fully subsidized medical care for life have eventually become financially unsustainable.[92] The trend in those industries has been toward replacing these open-ended promises with closed-ended Voluntary Employee Benefit Associations (VEBAs).[93] VEBAs are a trust device in which the employer contributes a defined amount to the trust, and the beneficiaries of the trust are limited to receiving whatever benefits the trust assets can generate.[94]

Ironically, in many cases it has been the unions themselves that have initiated the creation of a VEBA trust for the benefit of their members' retiree health benefits. That is the pattern that has emerged in the automobile industry.[95] The key issues for the two sides negotiating such a transformation from open-ended promises to VEBA trusts have been how much the employer will contribute to such a trust, and how much of that contribution will take the form of immediate cash versus stock or promissory notes.

The best scenario for the beneficiaries of the retiree-benefit VEBA occurs when all of the employers' contributions will be made in immediate cash. Under that scenario, the beneficiaries' ability to collect retiree health benefits is no longer dependent on the future success of the employer that made the promises. If it is funded properly, a VEBA can become a form of bankruptcy insurance for the beneficiaries of the trust, a feature that is especially valuable for retirees in industries where the bankruptcy filings of employers are not that uncommon.

In practice, the VEBA solution to the retiree medical benefit problem has been

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$5,000 per month. *See* Pension Benefit Guar. Corp., *Maximum Monthly Annuity Guarantees, Pension Benefits*, PBGC.GOV, http://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee.html#2013.

[92] *See* Kristin Gunderson Hunt, *Employers Look to VEBAs to Shift Retiree Health Liabilities*, 42 BUS. INS. 9, 9 (2008) ("[F]inancially distressed organizations with large union populations, such as manufacturing, utility and airline entities, are the most likely candidates to turn to VEBAs to transfer their retiree medical obligations.").

[93] *See* Steven J. Sacher, *Issueman Tackles the New VEBAs*, 35 PENS. & BEN. REP. (BNA) 820, 822 (2008) (examining benefits VEBAs offer companies facing adverse conditions and union retirees).

[94] *See* Hunt, *supra* note 92, at 9 ("Corporate interest in funding the trusts and then transferring their control to labor unions-and thereby transferring their retiree health care liabilities to the unions-has grown.").

[95] All of the Big Three American automakers, Chrysler, GM, and Ford, entered into class-action VEBA settlements with their unions that were initiated by the union. *See* Diane M. Soubly, *Recent Developments in Collectively Bargained VEBAs*, 22 BENEFITS L.J. 5, 22–24 (2009) (detailing class-action route to VEBAs).

far from a panacea for the retirees who have been forced to rely on the funding that is generated by such a trust for their medical benefits. The first harsh reality for retirees of the transformation to VEBAs has been that the coverage levels of even the most generously funded VEBAs have proven to be far less than the scope of coverage that the retirees were originally promised by their employer.[96] As one union member put it in explaining his reluctant support for his company's transformation from an open-ended retiree medical benefit plan to a VEBA trust, the only realistic choices left for retirees are between silver and lead; the gold option is completely off the table.[97]

A second practical downside to the VEBA trusts for retirees is that many of the major VEBA trusts have been funded largely by a combination of promissory notes as well as the stock of the company that is shedding the originally promised retiree benefit obligations.[98] Thus, the financial strength and the overall scope of the retirees' medical benefits still end up being tied to the fortunes of the employer that promised them. The advantage of separateness from the employer's fortunes that a VEBA trust can theoretically offer has proven to be illusory in practice with these all-too-common note-and-stock-heavy funding methods.

The trends toward defined-contribution pension plans and VEBA trusts for retiree medical benefits have implications for any bankruptcy reform efforts aimed at improving the plight of workers and retirees of employers who either file bankruptcy or liquidate without the benefit of a bankruptcy filing. What this means is that if Congress wants to give special protections to pensions or retiree health benefits, it needs to focus its attention on the forms that these benefits currently are taking, rather than the forms that these benefits once took.

LESSON NO. 9: A PIECEMEAL LIQUIDATION CAN EVISCERATE EVEN THE MOST POWERFUL PRIORITY.

As I have followed the tragic stories for the past two decades of the many promises that were broken by employers to their union workers and retirees, I have often wondered if there would have been any way to give a truly ironclad guarantee to workers concerning their collective bargaining agreements and to retirees concerning their promised medical benefits. As a thought experiment along those lines, I have considered what might be the consequence of federal legislation that

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[96] As one example, the Big Three automakers agreed in their pre-bankruptcy retiree-benefit settlements to pay a total of $52 billion into their VEBA trusts for overall retiree medical benefit obligations that were estimated at $88 billion. Katie Merx, *VEBA Gag Order Irks UAW Ranks: GM Retirees Seek Details of Health Trusts*, DETROIT FREE PRESS, January 6, 2008, *available at* 2008 WLNR 311728.

[97] Kimberly Peterson, *Companies Eye Trusts for Retirees*, FORT WAYNE J. GAZETTE, September 7, 2007, http://www.journalgazette.net/apps/pbcs.dll/article?AID=/20070907/BIZ/709070411.

[98] *See supra* note 30 and accompanying text (detailing debt and stock funding of retiree medical benefit VEBAs created in GM and Chrysler bankruptcies).

simply prohibited the rejection of collective bargaining agreements under any circumstances or that prohibited the modification of retiree benefits under any circumstances.

In this hypothetical world, unions and retirees could of course voluntarily agree to modifications to the original terms that they were promised by their employer. This would happen, though, only in cases where the affected workers or retirees were convinced that the changes being proposed were truly necessary based on real financial exigencies of their employer. In effect, this "no modifications" rule would shift the decision-maker on the "necessary" question from the bankruptcy judge to the unions and retirees themselves. This would clearly represent a reallocation of bargaining power from the employer to its employees and retirees as compared to our current system. The more intriguing question is whether such a change would necessarily represent a reallocation of actual wealth.

That second question is one that I cannot answer with any confidence. The reason for my uncertainty is that even in a "no modifications" regime, the employer would always hold the final leverage of a piecemeal liquidation. If the company goes out of business, then even "ironclad guarantees" end up not being worth much.[99] As noted above, the bargaining dynamics would change. Even with these changed bargaining dynamics, however, would we end up with the same number of negotiated resolutions as we see now, except with a more favorable result for employees and retirees than we currently see? Or would we simply see more liquidations as the result of brinksmanship, as unions attempt to use their newfound leverage to compel employers to honor in full the promises that employers are currently allowed to modify with court approval?

The answer to these unknown questions would largely come down to the level of trust between the two parties at the negotiating table. If the trust level is like what we saw in last year's round of negotiations between Hostess Brands, Inc. and its unions, then the prognosis for such a brave new world would not be optimistic. In the Hostess bankruptcy, the debtor-in-possession made what it said was its "final offer" to its unions to preserve a reorganization possibility, but the unions either did

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[99] As the Sixth Circuit observed in approving the pre-bankruptcy VEBA trust that GM negotiated with the UAW for the company's retirees:

> If we decided for the sake of argument that the retirees were likely to win the debate [on vesting], any such victory would run the risk of being a Pyrrhic one because the cost of insisting on irreversible healthcare benefits might well be—and indeed almost certainly would be—the continuing downward spiral of the companies' financial position.

UAW v. GM Corp., 497 F.3d 615, 632 (6th Cir. 2007). Along the same lines, one UAW negotiating-committee member admitted that a VEBA was not the union's ideal outcome for retirees, "but we really didn't have much of a choice. If we didn't get our jobs, we lose everything and it wouldn't matter. We took what they gave us." K.O. Jackson, *Retirees Consider Effects of Chapter 11: Medicare Benefits Top List of Labor Concessions*, KOKOMO TRIB., April 30, 2009, http://www.kokomotribune.com/local/x518912550/Retirees-consider-effects-of-Chapter-11/print.

not believe the debtor or simply decided that they would rather have no deal than to continue working under the much-reduced terms that were offered.[100] In the end, Hostess converted its case from a reorganization to a liquidation, and those union workers were forced to look for other work.[101]

Short of the federal government putting new money on the table, the tragedy of the workers' and retirees' plight in these labor-bankruptcy scenarios is that the promises that were once made to them are only as good as the financial health of the employer that made the promises. Once upon a time, the federal government did put new money on the table in order to insure the defined-benefit pension promises that it was now undertaking to regulate. So how likely is it that Congress would agree today to expand the scope of the government's insurance umbrella to include additional labor-related obligations? To paraphrase Sarah Palin, and with the benefit of hindsight, the answer to that question may best be found in the question itself: "So how's that pension-insurance thing workin' out for ya?"[102]

The sad reality of bankruptcy, or even of companies failing outside of bankruptcy, is that we are always dealing at that point with an array of least-worst outcomes. When Delta airlines sought to terminate its defined-benefit pension plans, the retirees who would be affected by such a termination were understandably angry, and they expressed their frustration in a meeting with then-Chief Executive Gerald Grinstein. Grinstein told the retirees in response, "[i]t's a choice between what we propose and no company at all. We have no ability to borrow additional money. What we have is what we have."[103]

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[100] *See* Chris Isidore & James O'Toole, *Hostess Brands Closing for Good*, CNN MONEY, Nov. 16, 2012, http://money.cnn.com/2012/11/16/news/companies/hostess-closing/index.html (reporting Hostess blamed Bakers' union's strike and rejection of final contract offer for closing of its business operations).

[101] *See Hostess Reopening Plants, Without Union Workers*, ABC NEWS, April 26, 2013, http://abcnews.go.com/Business/twinkies-return-hostess-unions/story?id=19043854 (noting new buyer of bankrupt assets of Hostess Brands, Inc. plans to hire at least 1,500 workers for reopened plants, but workers will not be unionized).

[102] *See* Sarah Palin, Address at Tea Party Convention (Aired Feb. 6, 2010), *available at* http://transcripts.cnn.com/TRANSCRIPTS/1002/06/cnr.09.html.

[103] *See* Russell Grantham, *Delta's Grinstein Faces Retiree Groups*, ATLANTA J.- CONST., Oct. 29, 2005, *available at* 2005 WLNR 28769437. Yet another succinct and powerful statement concerning the least-worst nature of choices in bankruptcy was made by the bankruptcy judge in the United Airlines case when he allowed the airline to dump a defined-benefit pension plan onto the PBGC that was underfunded by $6.6 billion: "Bankruptcy generally involves choosing the least bad of a number of unfortunate choices . . . . The least bad choice keeps the airline functioning, keeps people employed, and is an alternative to the worst choice, which is a shutdown of the company." Mary Wisniewski, *Judge Allows United to Drop Pension Plan; Calls It "Least Bad of a Number of Unfortunate Choices"*, CHI. SUN-TIMES, May 11, 2005, *available at* 2005 WLNR 27636286.

LESSON NO. 10: A LENDER'S WILLINGNESS TO LEND, BOTH INSIDE AND OUTSIDE OF BANKRUPTCY, CAN BE AFFECTED BY THE CREATION OF NEW PRIORITIES.

I have a second thought experiment concerning the protection of labor obligations that are owed by a failing company. Suppose that in addition to a rule that prohibited any forced modification of benefits or any rejection of collective bargaining agreements, the federal government added a "hot goods" protection to such claims similar to what the Fair Labor Standards Act currently provides for minimum-wage claims and overtime wage claims.[104] In other words, this thought experiment would create a super-priority for all labor-related claims, effective both inside and outside of bankruptcy, which would trump even the claims of secured creditors. What would be the consequences of such a change?

One positive consequence for organized labor is that labor claims would move to the front of the line, even in a case where an employer was forced into a piecemeal liquidation. That's the good news. The bad news, however, is that the creation of such a large super-priority claim would cause lenders to shy away from lending in the first place to any firms that were likely to have large claims of this type. Because lenders can choose to whom they wish to lend, they will generally choose borrowers that have either sufficient collateral or reliable cash flow to make the lender comfortable about its prospects for eventual repayment of its loan.

Even the federal government itself, when it assumed the role of debtor-in-possession lender in the GM and Chrysler cases, did everything it could to bolster its priority position in advance of lending, even if it meant subordinating existing and sympathetic priority claimants. Most notably, in both of these cases, the U.S. Treasury insisted that the originally agreed-to VEBA arrangements the two automakers had structured with their retirees to cover future medical benefits had to be significantly restructured in a way that took money away from the retirees.[105] The irony, of course, was that the main reason these retirees were getting the VEBA trusts in the first place was that a *different* branch of the federal government—Congress—had given the retirees a special bankruptcy priority to these benefit claims some two decades earlier.

With its own money now on the line, however, the federal government was willing to reduce—indeed, insisted on reducing—the effectiveness in these cases of the priority that Congress had itself created. From the retirees' vantage point, it probably felt like they were being told, "we're from the government, and we're here

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[104] *See* 29 U.S.C. § 206 (2006).

[105] In the GM case, the U.S. Treasury insisted that GM pay at least half of the $20 billion that GM was obligated to pay to the retiree-benefit VEBA under the pre-bankruptcy settlement in common stock, rather than in cash, as was originally promised to the retirees. *In re* Gen. Motors Corp., 407 B.R. 463, 478 (Bankr. S.D.N.Y. 2009). In *Chrysler*, the U.S. government told Chrysler before it filed chapter 11 that in order for Chrysler to get a $6 billion pre-bankruptcy bailout loan, at least 50% of the funding for the retiree-benefit VEBA had to come from New Chrysler's equity, which again represented a reduction in funding from what retirees had originally negotiated. *In re* Chrysler LLC, 405 B.R. 84, 92 (Bankr. S.D.N.Y. 2009).

to hurt you." Of course, in reality it was nothing personal against the retirees.[106] That's just how lenders are, even if they are sometimes from the government.

CONCLUSION

As a new bankruptcy-labor bill gets introduced in Congress to address the latest round of high-profile bankruptcies that have occasioned millions of dollars in lost retiree benefits and in broken collective bargaining agreements,[107] it is hard not to feel a sense of déjà vu. This is where we were 25 years ago, and sections 1113 and 1114 were supposed to be the answers to these types of tragedies. Given that these twin Code sections have not worked as effectively as employees and retirees had originally hoped, it is only natural that those representing worker and retiree interests might look to Congress again for a new generation of legislative solutions to the vexing intersection of labor and bankruptcy law.

Perhaps the last round of bankruptcy reforms did not go far enough in creating a level playing field for labor in its ongoing struggles with management. That is an understandable story for organized labor to tell its members, especially in light of several recent big-stakes bankruptcy cases where union workers or retirees have ended up seeing labor promises being broken by a bankrupt employer yet again. For my part, I don't pretend to know enough about this difficult and complex area to say with confidence that labor's interpretation of events, and its proposed remedy for this latest round of bankruptcy setbacks for its members, is necessarily wrong.

What I do wish to accomplish in this article is to offer an alternative story, and one that Congress ought to at least consider as it perhaps gears up for another round of labor-bankruptcy fixes. I proposed ten lessons above for Congress to keep in mind about the labor-bankruptcy intersection, but I think that the heart of my observations from following this area for a couple of decades can actually be summed up in two "meta-lessons."

First, just because a crisis manifests itself in the bankruptcy forum does not necessarily mean that the crisis is a bankruptcy problem that can be solved with a bankruptcy solution. This first meta-lesson would suggest that if Congress wants to fix a perceived labor-bankruptcy problem, it ought to at least consider giving its favored claimants a form of leverage that will not be limited to the bankruptcy forum. That way, such a fix will not create a perverse incentive for companies to avoid using bankruptcy as a way to reorganize a struggling enterprise.

Second, any new action that Congress triggers in a largely zero-sum game such

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[106] Indeed, if the government had not come to the rescue with its bailout loans, it is far from clear that the automakers had any other viable route to avoid liquidation, which obviously would not have been in the interests of the retirees.

[107] Protecting Employees and Retirees in Business Bankruptcies Act of 2013, H.R. 100, 113th Cong. (2013) (amending title 11, United States Code, to improve protections for employees and retirees in business bankruptcies).

as bankruptcy will have an equal and opposite reaction. When you give more relative wealth to one party in a setting like bankruptcy, then you take away wealth from another. At some point, if that other party has a choice, it will opt for another process or find another route to achieve the same ends that bankruptcy might have. This second meta-lesson, I believe, helps to explain the rise of section 363 sales over traditional plans of reorganization. Outside of bankruptcy, it also helps to explain the movement of employers away from offering defined-benefit pension plans and open-ended retiree medical benefits.

My fear is that if Congress ignores these meta-lessons, any new "reform" in this area will simply be a variation of what failed to do the job the last time. Even more troubling is the prospect that an additional layer of bankruptcy-specific priorities will further erode the overall effectiveness of the bankruptcy forum as an efficient vehicle for preserving the going-concern value of struggling businesses. If that is the end result of the next labor-bankruptcy reform effort—not really helping labor that much, but in fact hurting the bankruptcy process—then that could prove to be an even worse outcome than my opening metaphor of rearranging deck chairs on an already-sinking ship.