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Amend Bankruptcy Code To Add Oversight For CBA Changes

By **Kenneth Rosen** (June 17, 2020, 1:49 PM EDT)

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As more companies file for Chapter 11 amid the pandemic, expect to see more filings focus on reducing labor, legacy and environmental costs as key to a successful reorganization.

This theme will come from debtor management hoping to mask broken promises of performance improvement.

It will be heard behind the scenes from secured lenders and investors that have placed too much debt on the debtor or relied too much on underperforming management.

Of course, one way to improve the bottom line is to reduce leverage, which immediately improves profitability and cash flow. But that often requires concessions and contributions that equity holders are unwilling to make.

Consequently, under pressure from lenders and equity holders, debtors will seek to reject or renegotiate collective bargaining agreements, or CBAs, and legacy benefits. Labor is the first place in the budget from which debtors will seek a subsidy — often only after key employee retention plans for senior management have gotten board approval.

Secured lenders can do a big "favor" for the debtor by mandating that the debtor reject or renegotiate CBAs as a condition to continued financing.

Then, management can blame its lenders for the fire-drill timeline within which to complete negotiations or obtain a ruling by the court.

Politics make it unlikely that the creditors committee will oppose reducing labor and legacy costs. Committees often sit on the sidelines reluctant to choose sides or make enemies. Plus, anything that enhances valuation is viewed by the committee as a big positive.

And the banks will sit by, not looking to make enemies, and relying on the debtor and the mandates of the debtor-in-possession financing order.

Shareholders are pleased for the debtor to be under extreme pressure and remain silent.

The idea is to ram a collective bargaining rejection process through the bankruptcy court as quickly as possible while claiming that "Rome is burning" and that the success or failure of the Chapter 11 case is wholly dependent upon renegotiation of the CBAs.

The court is often placed in a position of great discomfort. A goal of Chapter 11 is to preserve jobs and going concern value and so the court is squeezed between wanting to protect the rights of employees for whom jobs are critical in periods of high unemployment while at the same time wanting to facilitate a reorganization.

The judge may be of the view that reducing compensation and benefits or modifying work rules is

painful, but it is better than risking the alternative.

Chapter 11 is perceived as a good forum in which to renegotiate CBAs. A debtor seeking to reject a CBA or modify retiree welfare benefit obligations is required to first satisfy the procedural and substantive requirements set forth in Sections 1113 and 1114 of the Bankruptcy Code.

The list of the requirements includes the requirements that the company must provide the union or other authorized representative with complete and reliable information about the company; make a formal proposal to the union to reject and modify the CBA or the retiree benefits; and meet in good faith with the union in an attempt to negotiate the changes.

The CBA can be rejected, or the retiree benefits modified, only if the union/other authorized representative rejects the proposed changes and the bankruptcy court ultimately finds that the changes are "necessary" for the debtor's reorganization.

However, in many instances, labor costs are not the real problem, or they are only one of several problems. The debtor may be carrying too much indebtedness. The indebtedness may be from a prior leveraged buyout or acquisition. Shareholders refuse to invest more capital in order to pay down debt; nor do they want to give up equity. And, in many instances, management has simply failed to achieve the goals that it promised would be transformative in order for the debt to be serviced.

Section 1114 motions are also typically fast-tracked and the union often is at a disadvantage because the debtor has had months to orchestrate its crisis.

However, bankruptcy judges should be reluctant to expedite the Section 1114 process.

The remedy, instead, is for the court to have the benefit of someone akin to an ombudsman or public advocate — someone able to provide the court with an impartial view as to the cause of the debtor's need for reorganization, the appropriate remedy, and how the cost — or blame? — should be allocated.

Reducing wages or benefits for union employees solely in order to increase value for the benefit of equity holders and lenders is unjustified.

An examiner functioning as a public advocate or ombudsman should determine whether the relief sought is reasonable, necessary and equitable given the relative contributions proposed to be provided by secured lenders and by equity holders. Often, Section 1114 relief is sought before the final terms of a plan of reorganization even are known.

All parties are more likely to be reasonable if they know that an examiner will be looking over their shoulders. In order to better assure that the resolution of Section 1113 or Section 1114 motions is fair and equitable to all parties in interest and in order to assure that the public interest is protected, the Bankruptcy Code should be amended to require the appointment of an examiner with the limited scope of responsibilities described above upon the filing of a motion to reject CBAs or to modify benefits.

The threat of appointment of an examiner will cause all parties — not just the debtor and labor — to work harder toward a fair and equitable resolution of the debtor's financial difficulties before filing motions.

In an economy where unemployment is reaching a level not seen since the Great Depression, it is especially unreasonable for labor to bear a disproportionate portion of the cost of a debtor's reorganization.

Instead, the cost should be borne first by the parties who are responsible for the problem and the parties who have the most to gain from its resolution: lenders, which provided more debt than was justified, and equity holders, which have the upside.

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