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A New Union Suit

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It's like a bad old movie. Unions and management negotiate lucrative wages and benefits in good times. When business goes south, the company demands cuts, the union rejects them, and the company slides into bankruptcy -- often blaming the union for an onerous collective bargaining agreements, or CBAs.

In such cases, unions may play a key role in the resulting bankruptcy, mostly by negotiating wage and benefit cuts. Successful in-court restructurings of **UAL Corp. Northwest Airlines Corp.**, and **Hawaiian Airlines Inc.**, among others, all hinged on labor accepting concessions.

And unions have also played major roles in reviving companies or reinvigorating industries. Witness the role played by the United Steelworkers, which worked with buyout king Wilbur L. Ross Jr. when he bought five bankrupt steel companies, combined them to create International Steel Group Inc., then sold it off to Ispat International NV (now **ArcelorMittal**) for $4.5 billion in 2004.

But over the past year, the atmosphere has changed: Unions have become more prominent players, both before and after a filing -- from actively influencing negotiations to helping shape exit strategies. That heightened interaction is turning out to be at least as combative as more traditional union pre-bankruptcy activism.

Examples abound. In the case of trucker **Alvan Motor Freight Inc.**, the Chapter 11 trustee sought and was granted conversion to Chapter 7 in August so that a liquidation could occur and creditors could be paid off. That decision came after the International Brotherhood of Teamsters attacked debtor plans to jettison a CBA. The United Steelworkers, whose work stoppage in 2005 led to **Asarco LLC**'s filing, is now defending the company against former parent **Grupo Mexico SAB de CV** after coming to terms on a new contract that requires union recognition for the copper producer's exit. **NexBank SSB** purchased bankrupt Marcal Paper Mills Inc. in January but not before coming to terms with steelworkers, who demanded that the buyer pick up the CBA. And in Vallejo, Calif., 3 unions are appealing a judge's ruling to let the city's Chapter 9 petition stand, arguing that a budget deficit doesn't meet the requirements for such a filing.

Why the sudden union activism in bankruptcy cases? Unions have arguably grown more sophisticated as conditions in a number of labor-dominated industries deteriorated. More specifically, tight credit markets have made it difficult for debtors to exit bankruptcy without a viable financing agreement in place. Even the savviest of bankruptcy lenders continue to reduce risk by placing into credit agreements strict timelines by which a company must file a reorganization plan or sell assets. Couple this with the October 2005 amendment to the U.S. Bankruptcy Code that curtails how long a debtor controls its destiny, and bankrupt companies often find themselves in a race against time as they restructure.

As pressures increase, unions gain more leverage. Financing or equity investments to bring a company out of bankruptcy are often predicated on a debtor gaining concessions from unions. And while debtors have extraordinary powers under Section 1113 of the federal Bankruptcy Code to reject their collective bargaining agreements, unions are increasingly successful in resisting such attempts.

All of that has created opportunities for unions to play starring roles, as exemplified in the three case studies that follow. Unions were instrumental in the liquidation of Performance Transportation Services Inc., forced a key change in how **Frontier Airlines Holdings Inc.** finances its operations while in Chapter 11 and helped broker a deal with a private equity firm that may salvage **Interstate Bakeries Corp.**

In particular, the Interstate Bakeries bankruptcy demonstrates how a union can fundamentally shape a bankruptcy case. "I've worked on a lot of bankruptcies in the steel industry, but [IBC's was] the most difficult because of management's inability to get its unions on board," says the financial adviser to the Teamsters in the IBC case, Michael Locker of **Locker Associates Inc.** "No investors wanted to deal with this bankruptcy without labor concessions."

Performance Transportation

Section 1113 figures prominently in the saga of Performance Transportation, which debtor counsel Tobias Keller of **Jones Day** characterizes as "a stare-down between the lenders and the unions."

Just 10 months after exiting Chapter 11 protection with a $185 million financing package, auto transporter PTS hauled itself back to the U.S. Bankruptcy Court for the Western District of New York in Buffalo on Nov. 19, 2007, with a deal to sell itself to its main rival, formerly bankrupt **Allied Holdings Inc.**, for $67 million.

In the middle of the deal was **Yucaipa Cos. LLC**, the Los Angeles private equity firm controlled by Ronald Burkle. Yucaipa owned 74% of PTS coming out of its first bankruptcy. It also controlled Allied. According to Keller, the presence of union-friendly Yucaipa emboldened PTS during the first bankruptcy to "deal with the [original equipment manufacturers] and major customers" and not its unions. Yucaipa's counsel, Robert A. Klyman of **Latham & Watkins LLP**, did not return calls.

The Teamsters' counsel, Fred Perillo from **Previant, Goldberg, Uelmen, Gratz, Miller & Brueggeman SC**, says PTS' financial projections convinced Yucaipa that concessions from the Teamsters weren't needed. But, according to Perillo, the projections were "wildly off the mark."

Court filings by second-lien lender **D.E. Shaw Laminar Portfolios LLC** allege, and attorneys in the case agree, that Yucaipa did not "meaningfully" negotiate the necessary concessions with the Teamsters between the two bankruptcies.

"Instead, the Yucaipa-appointed directors of PTS chose to file the [second bankruptcy] with an eye toward effectively obtaining wage cuts from the IBT, not for the benefit of PTS' estate, but for the sole benefit of Allied and the newly merged entity Yucaipa would form," D.E. Shaw argued in court filings. Counsel to D.E. Shaw, Daniel Brockett from **Quinn Emanuel Urquhart Oliver & Hedges LLP**, did not return calls.

Immediately before the second bankruptcy, Keller says, PTS had a preliminary term sheet with Allied for a sale.

But the deal collapsed almost as quickly as it was put together. Judge Michael J. Kaplan rejected the sale's proposed bidding procedures on Dec. 3, less than a month into the case, because, as Keller puts it, "the secured creditors were not comfortable with the term sheet." Two days later, Allied terminated the nonbinding letter of intent.

The terms of PTS' $15 million debtor-in-possession loan from **Black Diamond Commercial Finance LLC**, one of its secured prepetition lenders, required the company to close a sale of its assets by early April. But its labor contracts were perceived as "the largest major economic variable" to potential bidders, according to one attorney in the case.

With this cloud hanging over its head, PTS finally began to discuss with its union the concessions that would be necessary to save the company. Black Diamond, meanwhile, pushed the court to force PTS to establish a so-called independent plan committee to oversee the formation of a reorganization plan in the event that labor issues prevented the company from finding a buyer.

While Kaplan did not appoint such a committee, he did rule that PTS had to hold a board meeting to discuss the formation of a plan and "the status and direction" of the company's labor talks. During the May 23 meeting, Black Diamond said it would provide PTS with additional financing (the $15 million DIP expired on May 19). But getting supplemental credit would depend, in part, on PTS rejecting its Teamsters' contracts under Section 1113(e). Typically, Section 1113 requires that a debtor make a good-faith proposal to its unions to modify a CBA as necessary to craft a successful reorganization plan.

According to attorneys for both PTS and the Teamsters, however, the parties had been negotiating concessions, and the notion of using 1113 was never discussed. But two days before a May 31 expiration date for the Teamsters' master contract, "PTS literally jumped up and left negotiations," according to Perillo. "Typical of them, they file 1113 at the end of the day so [we] can't respond."

Perillo says there was no dire liquidity crisis at the time and PTS was "strong-armed" by its lender. "The law [under Section 1113] is clear," he notes. "You can't reject a [labor] agreement after the expiration date."

But, under the emergency motion standards of the code, which PTS was seeking by filing an 1113(e) motion, a bankruptcy judge can allow a debtor to immediately reject a CBA if the company believes it would otherwise collapse.

Interestingly, though PTS filed its 1113(e) motion on May 29, only two days before the Teamsters' contract was set to expire, its special labor counsel, **Reed Smith LLP**, had drafted a CBA motion at least two months earlier, according to an application for fees the firm filed publicly with the court. The lead counsel at Reed Smith, Paul Singer, did not return calls.

"It's puzzling that they were drafting [1113] motions but never came to us with a proposal" prior to seeking such relief from the court, Perillo says. "It seems that they drafted the papers so they could drop a bomb on the union in May."

Nonetheless, Kaplan on June 4 allowed PTS to boost its DIP by $2.5 million, to $17.5 million, and granted interim approval to the CBA motion, opening the way for PTS to enact 15% wage concessions. An attorney at the hearing says the judge reasoned that PTS needed the financing on which the 1113(e) motion was predicated and that the worst-case scenario for the unions was to have their wages cut for a few weeks but have the opportunity to renegotiate at a later date.

The Teamsters certainly didn't see it that way. "PTS was an abuse of the code because the emergency was completely manufactured," Perillo says. "But the judge was amenable to the pressure."

Still, the Teamsters had a trump card, albeit not of their own making. The amended DIP contained a covenant seldom used in postpetition financings that would trigger a default if a work stoppage at PTS occurred for more than 24 hours. This covenant was a key provision, considering that the Teamsters had already threatened such a strike if the court approved PTS' motion to reject the CBA "with the objective of causing the permanent closing" of the debtor.

On June 9, two days after Kaplan rejected PTS' attempts to halt a work stoppage by filing a motion for injunctive relief, the Teamsters, as promised, began striking.

Black Diamond immediately declared PTS in default of the DIP, terminated the loan and declared the $17.5 million due immediately. The lender also withdrew the use of its cash collateral, crippling PTS' operations.

PTS no longer had cash or employees to operate its business and ceased operations on June 13. Shortly thereafter, Black Diamond called for the court to convert the case to a Chapter 7 liquidation to preserve whatever value was still left.

The bottom line? "Creditors frequently have their own views about how a labor negotiation will go," Keller says. "PTS was directed by the lenders, and it set up a confrontation between our lenders and investors and the union."

In the end, Yucaipa was left with nothing. Black Diamond and PTS' other secured lender, **Goldman Sachs Credit Partners LP**, were left picking up scraps. And the union? According to an attorney for the Teamsters, "virtually all" of the 1,200 or so of its members who worked for PTS have since found jobs at rival companies.

Frontier Airlines

At Frontier Airlines, the Teamsters, not the debtor, didn't want to come to the negotiating table. At the center of the controversy again was a DIP loan and Section 1113. Since filing for Chapter 11 on April 10, Frontier has accused its Teamsters union, which represents some 435 of the airline's 5,000 employees, of holding up talks over labor concessions by insisting that Frontier release confidential information that would threaten the company's survival.

Frontier says the Teamsters resisted attempts to sign confidentiality agreements, while the union argues that proposed agreements were too restrictive and didn't allow the union to share important information with its members.

The animosity caused Frontier to jettison a $75 million DIP proposal from **Perseus LLC**, in part because the Teamsters and the Frontier Airline Pilots Association argued that the loan was a back-door tactic to reject its CBAs. A covenant in the DIP required Frontier to deliver to Perseus "new or revised [CBAs] ... containing concessions necessary to meet labor cost reductions."

The Teamsters called the structure of the loan "a blatant attempt to circumvent" 1113 by attempting to "bootstrap contract rejection onto their DIP motion and receive the benefit of the more lenient standard."

Instead, Frontier is now financing its case with a $75 million DIP from members of its official committee of unsecured creditors. But the battle with its unions is far from over. In mid-September, the airline moved to eliminate 130 Teamsters jobs by filing a 1113 motion. The Denver-based airline, which has already laid off more than 600 employees, says the cuts would save the airline $5.6 million annually and was necessary because its business plan calls for the company to reduce $35 million a year from total labor costs.

The airline says that absent relief under 1113, realizing such savings would be "all but impossible" and the airline would have "little hope for survival." Not surprisingly, even the company's second DIP requires Frontier to gain these union concessions by Nov. 15.

Interstate Bakeries

The Chapter 11 case of Kansas City, Mo.-based Interstate Bakeries Corp., which has been ongoing since Sept. 22, 2004, in many ways encapsulates the problems that befell PTS and Frontier. The Twinkies and Wonder Bread baker has seen at least one investor walk and its own reorganization plan foiled because of its inability to harmonize with the labor unions that accounted for 26,000, or 81%, of its 32,000-person work force. IBC entered bankruptcy with an estimated 500 different labor contracts, 400 of which were with one of two unions, the International Brotherhood of Teamsters and the Bakery, Confectionery, Tobacco Workers and Grain Millers International Union.

According to one restructuring professional in the case who spoke on condition of anonymity, the conflicting structure of most of IBC's labor contracts was a huge impetus. Terms of the different contracts made IBC's operations inefficient. "It cost the company almost 3 times as much in employment costs to get its product baked and delivered to stores than its competitors," he says.

Still, about 18 months into the case IBC had renegotiated and ratified more than 99% of its contracts with the Teamsters, with a projected cost savings of $15 million per year for five years for the debtor. "We knew we had a difficult task. We were setting out to do what most people believed was impossible," says Richard Volpe, the director of the Teamsters' Bakery and Laundry Conference, who negotiated many of the new contracts himself. "We visited locals in small towns and big towns, and in 18 months we were able to negotiate concessions to almost 100% of the contracts."

Interim CEO Tony Alvarez from crisis management firm **Alvarez & Marsal LLC** was running IBC then, but in June 2007, the company installed Craig Jung in the top post. He immediately reopened all the renegotiated contracts, asking, says Volpe, for additional cuts, rollbacks on healthcare coverage and the right to outsource work to nonunion employees. Court filings indicate that Jung's proposal sought about $65 million in further union concessions.

IBC did file a few 1113 motions seeking to reject CBAs with certain local unions, but jettisoning all of the CBAs would have left IBC with no contracts for 25,000 of workers and likely would have rendered the company unable to operate.

Also, because Section 1113 essentially mandates that a court evaluate every contract individually, "IBC had a daunting task," says Previant's Perillo, who is also representing the Teamsters in the IBC case. "The court couldn't simply throw its hands up and say, 'I don't like union contracts, so I'm going to ratify them all.' "

With leverage on its side, the Teamsters in September 2007 broke off talks with IBC. But with its other major labor union, the bakers union, on board, IBC, that October, proposed a reorganization plan that contemplated swapping $450 million in debt for equity and new notes and included a $400 million exit financing facility from **Silver Point Finance LLC**. The financing, of course, was contingent on IBC reaching an agreement with the Teamsters.

But the Teamsters would not come back to the table, still seething over the additional concessions IBC was seeking and the company's decision to shut down its Southern California bread division, which cost more than 1,000 union jobs, half of which, Volpe says, belonged to the Teamsters.

"It was an attempt to beat us over the head with a two-by-four," says Locker. Adds Volpe: "We walked out of the negotiations. As far as the Teamsters were concerned, they could liquidate." (And, in fact, Judge Jerry W. Venters of the U.S. Bankruptcy Court for the Western District of Missouri scolded the union for public statements to that effect, Perillo says.)

The union also knew IBC needed it to get out of bankruptcy. No investor, Silver Point included, would put money into the company without an agreement with the unions.

Enter Yucaipa. In early November, the union-friendly PE firm teamed with rival baker **Bimbo Bakeries USA Inc.** and proposed buying IBC. The proposal valued IBC at $580 million at the time. But Bimbo in December dropped out, and with no partner, Yucaipa did, too.

The Teamsters then took the lead, reaching an agreement in February with private equity firm **Ripplewood Holdings LLC** to fund a plan to bring IBC out of bankruptcy. IBC endorsed the proposal, and after initially balking, so did senior lenders including **Monarch Alternative Capital LP** and **J.P. Morgan Chase Bank NA**. Under the plan, filed on Oct. 4, Ripplewood will provide a $130 million equity investment by purchasing 17% of new common shares for $44.2 million as well as $85.8 million of fourth-lien secured notes convertible into 33% of new shares. Ripplewood will also receive Series A warrants with a strike price of $12.50, representing 15% of the new common stock.

IBC will fund its exit from bankruptcy with a $125 million senior secured revolving credit facility led by **General Electric Capital Corp.** and a $339 million first-lien term loan from Silver Point and Monarch**.** These lenders will collect 17% of new shares as well as Series B warrants with a $12.50 strike price (equal to 1.9% of common stock) and Series C warrants with a strike price of $10 (equal to 2.8% of common stock) in exchange for providing the financing.

Terms of the financing mandate that IBC exit bankruptcy by Feb. 9, but IBC's union locals must ratify CBA modifications already agreed upon by the national union representatives before confirming the plan. The parties do not expect the local ratifications to be an issue.

"The secureds here are taking paper and investing back into the company," says one professional involved in the plan discussions. "This company could not be saddled by a new huge debt by taking out the secureds. The lenders staying in and taking paper was the essential issue."

Volpe says the Teamsters are making "major concessions" in the Ripplewood deal and confirmed that the Teamsters and bakery workers will both take equity in the reorganized IBC. And the company's complicated organized labor contract structure is expected to eventually be consolidated into one master contract for each union, once the individual contracts themselves expire, attorneys say.

"The union was looking for a worthy buyer who understood the need for a true turnaround in this company, not just getting it out of bankruptcy," Locker says. "[Ripplewood] has a lot of good ideas and a lot of good managers with experience [in this industry]. That gave us a lot of confidence."

IBC represented another milestone when it comes to the unions' increasing involvement in the hand-to-hand combat of bankruptcy cases. To be sure, few have snared their fair share in a bankruptcy by sitting on their hands. And no one can accuse the unions of that.