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EMPLOYEES, PENSIONS, AND GOVERNANCE IN CHAPTER 11

DAVID A. SKEEL, JR.*

In Bankruptcy and Workers: Risks, Compensation and Pension Contracts, the excellent Article that anchors the section of this symposium concerning the treatment of employees in bankruptcy, Richard Ippolito explores the full range of pension risks that an employee faces in the event of a financial downturn.¹ Focusing principally on defined benefit pension plans—that is, pensions that promise employees a specified return when they retire—Ippolito suggests that the best justification for protecting part but not all of an employee’s benefits if the employer later terminates its pension plan is strategic: if employees face a risk of loss in the event of termination, they are less likely to attempt to divert value from the company’s shareholders.² Ippolito explores in detail the pension risk faced by employees at various stages of their career, pointing out that mid-career employees have the most to lose if their employer terminates a defined benefit plan.³ He also offers a compelling explanation for the dramatic shift away from defined benefit plans to the defined contribution approach, and describes ways that defined contribution plans could replicate the risk profile of the traditional defined benefit pension.⁴

The risk that a worker’s retirement security will be jeopardized by her employer’s financial distress is one of the most pressing employment issues that arise in the Chapter 11 context.⁵ Few who saw interviews with Enron or WorldCom employees, after the companies’ bankruptcies wiped out their pensions, will ever forget their plight. But pensions were not the

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² Ippolito argues that workers—particularly if they are unionized—“can act in concert and may find it optimal to hold up stockholders midway in the contract,” but that their pension exposure in the event of bankruptcy discourages this kind of opportunism. Id. at 1259.

³ Id. at 1263.

⁴ Id. at 1285–90 (shift away from defined benefit plans); id. at 1265–69 ("stock bonus" alternative to defined benefit).

⁵ I say that the issues “arise in” Chapter 11, rather than calling them “Chapter 11 issues,” because many of the issues that Ippolito explores are not bankruptcy-specific. Pension plans can be terminated outside of bankruptcy as well as in, and the principal concerns are the same in both contexts. But bankruptcy is often the field on which the crisis unfolds.
only thing that these employees lost. Most also lost their jobs, as Enron and WorldCom laid off thousands of workers before and during their Chapter 11 reorganization efforts. The combined loss devastated the financial lives of many.

The workers who lost their jobs and pensions stand in striking contrast to another group of employees: those that the company wishes to keep on the job. Not only do Chapter 11 debtors invariably pay these “wanted” employees in full, they often design special pay packages to persuade the employees to stay. This too is a crucial part of the employment story in Chapter 11; a part that has implications both for the treatment of employees who stand to lose their jobs and pensions, and for corporate governance in Chapter 11 more generally.

This Comment will briefly consider how both groups of employees fare in Chapter 11 and focuses in particular on the relationship between employment issues and the Chapter 11 restructuring process. This Comment argues that firms should not be prevented from laying off workers when they file for bankruptcy, but that the existing protections for employees’ pension dollars, past due wages, and benefits are inadequate.

As contrasted with the bread-and-water prospects of employees who are laid off, the special treatment of employees the company hopes to retain raises obvious and important fairness concerns. I will argue that pay-to-stay bonuses, Key Employee Retention Plans (“KERPs”), and related forms of special treatment can be justified as essential to corporate governance in Chapter 11, but I will also emphasize that the fairness concerns must be part of the equation.

Part I of this Comment describes the treatment of individual employees who are laid off shortly before or after a company files for Chapter 11 and contrasts this with the approach taken in France and other European countries. Part II considers the employees that a firm wishes to retain and the efforts firms have made to give them special treatment. Part III focuses on pensions, describing the defined contribution revolution and bankruptcy’s effect on these and defined benefit plans. Part IV explores the status of collective bargaining agreements, an issue that flared up in

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7. See infra notes 26–28 and accompanying text.
8. Throughout this Comment, I use the term “restructuring” broadly, to encompass both traditional negotiated sales and the asset sales that characterize a large percentage of recent cases.
9. As should already be clear, this Comment is in part a commentary on Professor Ippolito’s analysis of pension risk, but it also takes a more expansive perspective, assessing the full run of employment issues in Chapter 11.
the 1980s and has been profoundly affected by recent developments in the
governance of Chapter 11 cases. Part V is a brief conclusion.

I. SHORT END OF THE STICK: BANKRUPTCY’S (LIMITED) WAGE PRIORITY

In order to minimize the disruption to employees, the bankruptcy or
insolvency laws of many countries put significant limitations on layoffs in
the event a company initiates insolvency proceedings. For instance, the
French insolvency laws make it very difficult to lay off employees, and the
trustee in a Swedish insolvency case is required to take the interests of
workers into account as part of the restructuring process.\footnote{See, e.g., Per Stromberg, Conflicts of Interest and Market Illiquidity in Bankruptcy Auctions: Theory and Tests, 55 J. Fin. 2461, 2646 (2000) (describing Swedish approach and noting that France, the United Kingdom, Germany, and Finland also require special attention be paid to employees).}

For individual employees who are not covered by a collective
bargaining agreement, Chapter 11 looks quite different.\footnote{The treatment of unionized employees is discussed infra Part IV.} Not only are there few restrictions on the company’s ability to lay off employees, but employees are not even guaranteed that they will receive the full amount the company owed them as of bankruptcy.

To appreciate the general treatment of employees, start with the issues
of back-due wages, severance pay, and related benefits. If the company
owes back wages to an employee, this obligation is entitled to a modest
special priority: the first $4,925 owed to the employee for wages or
severance pay earned within ninety days of bankruptcy is treated as a
priority claim.\footnote{11 U.S.C. § 507(a)(3) (2000).} The Bankruptcy Code also allows the employee to apply
this priority to missed contributions to the employee’s pension plan if the
priority is not used up by back wages.\footnote{Id. § 507(a)(4). The priority thus amounts to a total of $4,925, which is applied first to wages and then to any unmade pension contributions.} Other than this limited priority, however, individual employees are not given special treatment. They are lumped with the company’s other general creditors, and are thus entitled only to “bankruptcy dollars”—that is, a pro rata share of what they are owed.\footnote{Although the discussion in the text focuses on wages, severance, and benefits owed before bankruptcy, a related issue concerns the treatment of severance rights in the event an employee is laid off during the course of the Chapter 11 case. The Second Circuit held in In re Straus-Duparquet, Inc., 386 F.2d 649 (2d Cir. 1967), that the severance benefits must be treated as an administrative expense and paid in full. Other courts have treated the benefits as an unsecured claim, and still others focus on the purpose of the severance agreement. For an extensive analysis of the caselaw, see J. Benjamin Earthman, Illusory Protection: The Treatment of Severance Packages in Business Bankruptcies, 5 U. PA. J. LAB. & EMP. L. 33 (2002).}
In a few cases, bankruptcy courts have taken matters into their own hands and raised the ceiling for employees’ special priority. Most notably, in both WorldCom and Enron, the bankruptcy court authorized payments significantly over the statutory limit for employees’ pre-petition wages.\textsuperscript{15} The sentiment is understandable. Because the limited priority applies not only to past due wages, but also to severance pay, employees who are fired before bankruptcy may lose both their job and the funds that might otherwise have tided them over. The most obvious solution to this problem is to increase the ceiling for the priority. A similar but more nuanced approach would treat severance promises separately, and give the entire benefit package priority treatment. The intuition here is that $4,925 is adequate for past-due wages alone, but that severance benefits are designed to compensate employees for the human capital they have at risk in their job and should be paid in full.\textsuperscript{16}

Preventing a company from laying off employees, however, or significantly burdening the decision, would seriously interfere with the restructuring process.\textsuperscript{17} A rule that prevented or restricted layoffs would have three problematic effects. First, if companies knew they would not be able to lay off employees in the event of financial distress, they would be less likely to hire new workers in the first instance. A no-layoff rule, in other words, would have a chilling effect on hiring. Second, if the no-layoff rule applied only in bankruptcy, companies would try to resolve their problems without filing for bankruptcy, thus forgoing whatever benefits the bankruptcy process offered.\textsuperscript{18} Finally, for those companies that did file for bankruptcy, the inability to reduce the company’s labor force could cripple the effort to restructure.

One can imagine ways to attempt to offer more protection for employee jobs without putting an undue burden on the reorganization process. The no-layoff requirement could be framed as a presumption rather than a mandate—a presumption the court could override if the company showed that layoffs were essential to the company’s survival.\textsuperscript{19}

\textsuperscript{15} See, e.g., Shawn Young & Jared Sandberg, WorldCom Can Pay Full Severance, WALL ST. J., Oct. 2, 2002, at B4 (full severance benefits); Young, supra note 6, at A1 (noting that bankruptcy judge in the Enron case authorized up to $13,500 in severance pay per employee, over twice the statutory limit).

\textsuperscript{16} Ideally, the severance protection would apply outside of bankruptcy as well as in.

\textsuperscript{17} As noted, I use the term restructuring broadly, to encompass the full range of outcomes in Chapter 11, from traditional reorganizations to asset sales.

\textsuperscript{18} The reverse is also true: if it is easier to lay off employees in bankruptcy than outside of the insolvency process, firms have an incentive to use bankruptcy to shed workers.

\textsuperscript{19} In effect, this rule would give non-unionized employees protections that are analogous to those that union employees have under a collective bargaining agreement. The treatment of collective
But even this more limited rule would have each of the effects I have just described. One response that does make sense and does not require any statutory change, as discussed in more detail below, would be to give non-unionized employees their own committee in cases where significant layoffs are at issue. The consequences of restricting a company’s ability to make adjustments to their workforce in bankruptcy suggest that committee representation, together with modest changes to the U.S. priority structure, is a better strategy than imposing new restrictions on the company’s ability to restructure its workforce in Chapter 11.

II. WANTED WORKERS: FIRST DAY ORDERS, PAY-TO-STAY AND KERPS

The message of the Bankruptcy Code’s special priority provisions is that employees who are owed back wages are entitled to a limited priority, but otherwise are treated like any other general creditor, in situations where the firm plans to shut down or lay the employee off. Employees that the firm wishes to keep on the job almost invariably continue to get paid. This simple fact holds true even with respect to unpaid pre-petition wages. Although unpaid wages in excess of the priority limit theoretically are unsecured claims, corporate debtors are routinely permitted to continue meeting their payroll as part of the “first day orders” submitted to the bankruptcy judge. This means that back wages are paid in full, as are wages earned after the company files for bankruptcy.

The closely related practice of seeking, as part of the first day orders, to pay key suppliers in full recently came under scrutiny in a high profile decision arising out of the Kmart bankruptcy. Kmart defined a vast array of its suppliers as “critical,” and with the bankruptcy court’s blessing paid

bargaining agreements is described in Part IV, infra.

20. See infra Part IV.

21. See supra notes 12–14 and accompanying text.

22. “First day orders” are requests that a debtor makes at the outset of the case to, among other things, continue making payroll, to have access to its cash collateral, and to pay key suppliers. For discussion of first day orders, which are one of the reasons that many firms began taking their bankruptcy cases to Delaware in the 1990s, see, for example, Marvin Krasny & Kevin J. Carey, Editors Reply to an Anonymous Letter: Why is Delaware the Venue of Choice for Philadelphia-Based Companies?, THE LEGAL INTELLIGENCER, Mar. 22, 1996, at 9; Marcus Cole, “Delaware is Not a State”: Are We Witnessing Jurisdictional Competition in Bankruptcy?, 55 VAND. L. REV. 1845 (2002).

23. As noted earlier, if an employee continues to work after the bankruptcy petition is filed, and is laid off only later, some courts require that the severance rights be treated as an administrative expense and thus given priority. See supra note 14.

24. In re Kmart Corp., 359 F.3d 866 (7th Cir. 2004).
a staggering $300 million of pre-petition obligations in full.\(^\text{25}\) Pointedly noting that the practice of giving special treatment to critical vendors has no explicit support in the Bankruptcy Code, the Seventh Circuit suggested that such payments are impermissible unless the debtor can show they will “enable a successful reorganization and make even the disfavored creditors better off.”\(^\text{26}\) Even if the \textit{Kmart} decision augurs a shift toward a more skeptical treatment of critical vendor claims, it is unlikely to discourage corporate debtors from paying their pre-petition obligations to employees they wish to retain. This is as it should be. Not only are the retained employees essential to the reorganization process, but attempting to stop the company from paying them in full would be a fool’s errand; firms would simply find other ways to make up for the lost wages.

In many recent cases, corporate debtors have done far more than just pay the back wages of their “wanted” employees. Starting in the late 1980s, companies began crafting “pay-to-stay” arrangements to encourage key employees to remain with the company, and to give the high level executives an incentive to reorganize quickly.\(^\text{27}\) Often, the executives are promised a bonus which is linked to the speed of the reorganization process or the value of the company at the time it reorganizes.\(^\text{28}\) More recently, this strategy of promising bonuses has moved well beyond a handful of top executives. Under KERPs, which are crafted in nearly every major case, bonuses are promised to a wide range of the company’s employees.\(^\text{29}\)

What should we make of the now-standard practice of requesting bonuses for a subset of “key” employees? Pay-to-stay arrangements have proven extremely controversial in several cases—including Polaroid, which dropped its original plan after vociferous protest.\(^\text{30}\) And some lawyers believe that they should be prohibited altogether, based in part on a perception that the executives of a troubled firm often do not have alternative job possibilities and are unlikely to jump ship.\(^\text{31}\)

\(^{25}\) \textit{Id.} at 868–69.  
\(^{26}\) \textit{Id.} at 872.  
\(^{28}\) See, \textit{e.g.}, \textit{id.} at 928 n.42 (describing WorldCom and Kmart bonus schemes that provided for bonuses that were larger if the case was confirmed quickly).  
\(^{29}\) \textit{Id.} (describing WorldCom’s KERP).  
\(^{31}\) This is based in part on a conversation with a prominent bankruptcy lawyer.
The problem with this reasoning is that the employees who are most likely to leave are those who have the opportunity to do so. Prohibiting pay-to-stay could prevent firms from retaining employees they need most. In many cases the employees with bonus-laden contracts are new managers who were brought in prior to bankruptcy to oversee the restructuring effort. A prohibition on pay-to-stay would seriously complicate this practice. In addition, pay-to-stay arrangements have played a valuable role in counteracting managers’ incentives to drag out the Chapter 11 proceedings. Managers whose compensation is linked to the speed of the reorganization process will look at the restructuring process quite differently than those who simply receive a traditional salary.

Although these considerations suggest that KERPs and pay-to-stay arrangements should be permitted, the fairness concerns cannot simply be ignored. To some extent, the problem can be addressed through the moral suasion of employee complaints and other informal means. The prospect of a deeply hostile workforce may pressure the company to revise its plan, as Polaroid did. But moral suasion alone is not enough. Courts should exercise careful scrutiny before approving a proposed KERP. A KERP or pay-to-stay arrangement should only be approved if it is consistent with the pay received by employees of comparable companies, includes performance-based incentives that are linked to the success of the restructuring effort.


33. After this Comment was written, an amendment dealing with pay-to-stay plans was added to the bankruptcy reforms that Congress appears likely to enact in Spring 2005. In addition to restricting the size of permissible bonuses, the new provision would require the company to show that an executive whom it proposed to give a pay-to-stay package had received an offer of employment elsewhere. The benefit of this strategy is that it attempts to distinguish between executives who genuinely might jump ship and those who do not have realistic alternative job possibilities. One problem, however, is that forcing executives to seek a concrete alternative offer could distract them from the restructuring effort. More importantly, the provision could invite strategic behavior both by debtors and by their competitors. Debtors may simply adjust their executives’ salaries rather than proposing bonuses, for instance. If debtors do attempt to offer bonuses, on the other hand, competitors might decline to make formal offers to executives in order to complicate the debtor’s reorganization. See S. 256, 109th Cong. § 331 (2005).

34. Skeel, supra note 27, at 928.

35. Under 11 U.S.C. § 363, court approval is required for KERPs, since they are the “ordinary course of business.”
restructuring process, and provides incentives for the employee to actually stay on the job.36

III. THE TREATMENT OF EMPLOYEE PENSIONS IN BANKRUPTCY

Wages, vacation pay, sick leave, and bonuses are only part of what employees have at stake when a company files for bankruptcy, of course. Their other great concern is the status of payments that have been made or promised under a pension plan. What can they count on, and what is at risk in bankruptcy?

To answer this question, we must first consider the sea change that has taken place in employer-sponsored pensions over the past twenty years. Prior to 1980, the vast majority of companies that offered pensions to their employees used the “defined benefit” approach, where each qualifying employee was promised a specified annual payout when the employee retired. During the 1980s, however, an increasing number of employers adopted or shifted to a very different approach, commonly referred to as “defined contribution.”37 Under a defined contribution plan, the employer gives each employee a menu of options (usually stock and bond-based mutual funds, and often other options as well) and contributes on a regular basis to the options the employee has chosen.38 The employer guarantees the contribution but not the payout. The payout depends on the success of the employee’s investments.

The cascade from defined benefit to defined contribution is an important part of the story Richard Ippolito tells in Bankruptcy and Workers.39 Ippolito attributes the shift to several political decisions made during the 1980s.40 “In the early 1980s,” he points out, “the IRS issued a new ruling that dramatically altered the defined benefit pension contract [by permitting plan sponsors to] take excess assets into corporate profits” if they terminated their pension.41 The ruling triggered a wave of

36. For further discussion of these issues, see, for example, id. at 943–49.
37. See Ippolito, supra note 1, at 1295 (“In 1980, defined benefit plans cover thirty-eight percent of private workers and eighty-two percent of covered workers. By 1998, the picture is dramatically different. Traditional defined benefit plans cover only about sixteen percent of private workers, and only one-third of covered workers.”); see also AMERICAN BENEFITS COUNCIL, PENSIONS AT THE PRECIPICE: THE MULTIPLE THREATS FACING OUR NATION’S DEFINED BENEFIT PENSION SYSTEM 6 (2004) (“The total number of PBGC-insured defined benefit plans decreased from approximately 114,396 in 1985 to 32,321 in 2002.”).
38. See Ippolito, supra note 1, at 1295.
39. Id. at 1251.
40. Id. at 1287.
41. Id.
“termination-for-reversions” over the next several years until Congress added a new tax for the assets created by the reversion. Many firms managed to evade the reversion tax, however, by creating a cash balance (or hybrid) plan, which functions like a defined contribution plan but qualifies as defined benefit because it guarantees a limited return.

Ippolito’s story is both compelling and persuasive. As a former chief economist at the Pension Benefit Guaranty Corporation, he knows whereof he speaks, and his article is the clearest and most insightful analysis of the pension revolution that I have seen. Indeed, my only real quibble is an interpretative one. Professor Ippolito suggests that when companies shifted their pensions in the 1980s, they were unlikely to expropriate value from their employees because they would be punished by the market for doing so: employees would demand higher wages to offset the risk of appropriation. Although I agree that companies cannot get away with this trick repeatedly, the regulatory changes did create, it seems to me, the opportunity for a one-time grab that diverted value from employees when plan sponsors first altered the terms of their plans.

How does bankruptcy fit into the pension picture? With defined contribution plans, the most serious risk is not directly related to bankruptcy at all: it is the risk that the value of the employee’s pension will plummet; either because the employee’s company failed or due to a

42. Id. at 1287–88 (IRS ruling); id. at 1288–90 (1986 reform taxing the reversion assets).
43. Id. at 1295 (describing the advent of cash balance plans).
44. Ippolito’s discussion of the nature of an employee’s risk in the event her company’s pension is terminated is equally insightful. He notes, for instance, that workers’ default risk decreases as their number of years at the company increases under the pension laws, but that older workers are no better protected than younger ones under a stock-based defined contribution plan. id. at 1299. Ippolito suggests that the treatment can be equalized by permitting employees to diversify an increasing amount of their defined contribution pension into low risk investments as their time at the company increases. Id. at 1294.
45. Id. at 1252.
46. The danger that managers and the shareholders they represent may manipulate the company’s pension to expropriate value from employees is a central theme of Margaret Blair’s comment for this symposium. Margaret M. Blair, The Great Pension Grab, 82 WASH U. L.Q. 1305 (2004).
47. Here, as throughout this Comment, I focus on the consequences of a bankruptcy filing by the company. If the employee herself files for bankruptcy, a crucial question is whether her pension dollars are part of the bankruptcy estate and must be distributed to creditors, or are exempt from the bankruptcy. The Supreme Court has held that “ERISA-qualified” plans are protected from the employee’s creditors. Patterson v. Shumate, 504 U.S. 753 (1992) (holding that section 541(c)(2), which enforces any restriction on transfer that would be enforced under “applicable non-bankruptcy law,” keeps “ERISA-qualified plans out of the bankruptcy estate). Just what “ERISA-qualified” means isn’t entirely clear, however. It clearly protects a worker’s entitlements under a properly set up defined benefit plan. But courts have struggled to define when IRAs and other non-ERISA plans qualify. The bankruptcy legislation that Congress appears poised to pass addresses this question by providing an explicit exemption from the estate for all benefit plans that qualify for special tax treatment under the Internal Revenue Code. See S.256, 109th Cong. § 224 (2005).
broader market downturn. The employees of Enron and WorldCom lost well over a billion dollars when the firms collapsed, in large part because many had put far too much of their pension money in their company’s stock. 48 For many, this meant that both their job and the money that had been set aside for their retirement went up in smoke.

If lawmakers are serious about preventing future Enrons and WorldComs, they need to make several major changes. The first and most obvious step is simply to mandate that workers’ pension investments be properly diversified. 49 The benefits of diversification are well known, but the reality is that many workers still do not have adequately diversified portfolios. Just as fans pick their own team to win in the office NCAA basketball pool, for instance, many workers overinvest in their own firm. 50 Lawmakers could easily solve this problem by adopting mandatory diversification rules that prohibit workers from investing more than a relatively small percentage of their funds in any given stock.

Mandatory diversification alone would not address the risk of a broader collapse like the recent corporate scandals, however. This Comment is not the place to develop a detailed proposal for addressing this risk, but one solution would be to develop new strategies for investor insurance. Elsewhere I have outlined an insurance scheme that would protect investors of insured companies in the event that its manipulations lead to an accounting restatement. 51 A still–broader approach might even guarantee a small minimum return over time on each worker’s employer-based pension investments. 52 In each case, the intuition is this: because the stock market increasingly has become the investment of choice for savings, we need to consider ways to protect these funds, much as

48. See, e.g., Ippolito, supra note 1, at 1297 n.51 (discussing losses at Enron and citing CONG. RESEARCH SERVICE, THE ENRON BANKRUPTCY AND EMPLOYER STOCK IN RETIREMENT PLANS (2002)).

49. As Professor Ippolito also suggests, at least with respect to “older workers.” Ippolito, supra note 1, at 1298–1300.

50. The effect of directing pension money to the company’s stock is magnified by the fact that the worker already has a huge undiversified stake in the company—her career.

51. DAVID SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM 214 (2005). Contemporaneously to my initial development of this proposal, Joshua Ronen proposed a framework for private insurers to provide financial statement insurance. See, e.g., Joshua Ronen, Post-Enron Reform: Financial Statement Insurance and GAAP Re-visited, 8 STAN. J. L. BUS. & FIN. 39 (2002); see also Lawrence A. Cunningham, Choosing Gatekeepers: The Financial Statement Insurance Alternative to Auditor Liability, 52 UCLA L. REV. 413 (2004) (analyzing and extending the Ronen proposal). The private insurance proposal is intriguing, but governmentally provided insurance would avoid the risk of gaps in the insurance market. There also is an important governmental interest in protecting the savings of ordinary Americans.

52. Skeel, supra note 51, at 213–14.
Congress did with bank accounts by putting deposit insurance in place in the 1930s.53

With defined benefit plans, the most pressing issue is whether a company can invoke the “distress termination” provisions of the pension laws, and thus impose on employees the burden of reduced pension benefits.54 In one sense, the question is not bankruptcy-specific at all. A company must satisfy one or more of four tests to justify a distress termination of its pension plan, and none of the tests is tied solely to a bankruptcy filing.55 As a practical matter, however, the determination whether to permit a distress termination—thus imposing on employees the burden of reduced pension benefits—routinely takes place in the bankruptcy court.

In several high-profile cases, such as the United Airlines bankruptcy, there have been bitter complaints about the company’s request to terminate its pension plan. “It is tempting,” as Ted Janger has noted, “to blame bankruptcy law for seemingly allowing United Airlines to walk away from its promises.”56 But the reality, Janger points out, is that Chapter 11 “provides employees and retirees with [several] important protections” that would not be available outside of bankruptcy.57 To ensure that employees are adequately represented, the bankruptcy court is required to appoint a representative—either a committee or “an authorized representative.”58 The same provision also provides a detailed roadmap for negotiations between the authorized representative and the company. Moreover, as in analogous distress termination contexts outside of bankruptcy, the pension plan cannot be modified in Chapter 11 unless the

53. Id. at 213.
54. Another crucial question, though it is tangential to the analysis of this Comment, is whether the Pension Benefit Guaranty Corporation’s claims to pension contributions owed by the company are priority claims, or should simply be treated as unsecured claims. For a thoughtful analysis, see Daniel Keating, Chapter 11’s New Ten-Ton Monster: The PBGC and Bankruptcy, 77 MINN. L. REV. 803, 825–40 (1993); DANIEL L. KEATING, BANKRUPTCY AND EMPLOYMENT LAW § 4.3-4.8 (1995).
55. See, e.g., William G. Beyer, Bankruptcy Reorganization and the Pension Benefit Guaranty Corporation 4 (Feb. 15, 2004) (unpublished manuscript) (characterizing the tests as “[l]iquidation in bankruptcy or insolvency proceedings”; “[r]eorganization in bankruptcy or other insolvency proceedings” and termination is necessary to a successful reorganization; the Pension Benefit Guaranty Corporation determines that the company cannot “continue in business unless the plan is terminated”; or “[p]ension costs have become unreasonably burdensome due solely to a declining workforce”).
57. Id. The provision that addresses the pension issues discussed below is 11 U.S.C. § 1114 (2000).
court concludes that it is essential to the continued operations of the company.\textsuperscript{59}

Although balancing workers’ pension rights with the survival of a company like United would be a delicate task for any court, bankruptcy judges are better positioned than most to conduct the balancing. Questions such as the likelihood of successful reorganization are issues that arise in every Chapter 11 case.\textsuperscript{60} Bankruptcy judges are also familiar with potential conflicts such as the tension between older and retired workers, whose principal concern is their pension, and younger workers who may be comparatively more concerned to see a reorganization that preserves their jobs. These are not easy issues, but Chapter 11 is the most sensible place to resolve the question of when a company should be permitted to terminate its pension plan without also going out of business. Moreover, the most important issue for many employees is not whether the plan can be terminated, but whether the termination benefits are too low. If the termination benefits were more generous, the stakes in the negotiations between a company and its employees would not be nearly as high.

\section*{IV. Bankruptcy and Collective Bargaining Agreements}

The final issue, collective bargaining agreements, overlaps with and has followed a similar trajectory to defined benefit pension arrangements. As with defined benefit plans, private-sector unionization has steeply declined in recent decades, and union strength is greatest in a handful of industries such as the airlines and car manufacturers.

Neither the Bankruptcy Code nor bankruptcy practice has reversed this trend in any meaningful way. Indeed, the modern history of the intersection between collective bargaining rights and bankruptcy began with a Supreme Court decision that was widely viewed as making it easier to reject a collective bargaining agreement if a company filed for bankruptcy.\textsuperscript{61} Congress subsequently amended the Bankruptcy Code to tighten the requirements for rejecting a collective bargaining agreement.\textsuperscript{62}

\begin{footnotesize}
\begin{enumerate}
\item[59.] \textit{Id.}
\item[60.] \textit{See, \textit{e.g.}, id. § 1129(a)(11) (calling for determination that confirmation is not likely to be followed by liquidation or additional reorganization).}
\end{enumerate}
\end{footnotesize}
But, a company still is likely to find it easier to reject a collective bargaining agreement while it is in bankruptcy.63

In recent years, the leverage of unionized employees has been further eroded by changes in the nature of Chapter 11 governance. The most dramatic development of the past decade has been the increasing use by lenders of their debtor-in-possession (“DIP”) financing agreements to dictate the governance of the Chapter 11 case.64 Sometimes this influence is direct, as when a prospective lender insists that the debtor bring in a chief restructuring officer, or the DIP financing agreement requires that the debtor negotiate a reorganization plan by a specified date. But DIP financing agreements provide more subtle forms of leverage as well. By imposing strict cash-flow requirements as a condition for disbursements, the lender can force the debtor to liquidate assets or sharply reduce its costs. If the debtor is an airline or a steel company, the most important expense is likely to be the firm’s obligations under a collective bargaining agreement.65 In these cases, the DIP financing agreement adds a new party to the bilateral stalemate between a firm’s managers and its employees; along with this comes an extremely credible threat that the company will be liquidated unless the firm’s employees make concessions under their collective bargaining agreement.66

The developments I have just described raise serious questions about the “team production” approach Lynn LoPucki develops in this symposium and in other recent work.67 The team production model characterizes the various constituencies of a company—its shareholders,
suppliers and other creditors, and employees—as members of a team. In addition to any contractual rights, the team members expect to receive a portion of any surplus generated by the firm. In the team production model, it is the role of the board of directors to determine how any surplus benefits are divided. In bankruptcy, LoPucki claims, the “members of the board of directors, acting as fiduciaries, decide which of these claims to recognize and how much to pay the claim holders.”

As a description of actual bankruptcy practice, this model vastly overstates the leverage enjoyed by the directors of a Chapter 11 debtor. As just noted, in many cases, the DIP financing agreement places dramatic constraints on the directors’ handling of the restructuring process. The DIP financing agreement, not directorial discretion, is now the principal governance lever in Chapter 11. From a normative perspective, moreover, it would be an enormous mistake to give directors as much discretion as LoPucki attributes to them. If directors had the authority to favor whichever constituency they please, they would be insulated from any meaningful oversight, as Adolph Berle famously pointed out seven decades ago.

Given that directors’ hands are tied, and that they have only a limited ability to represent potentially vulnerable constituencies such as employees who may be laid off, should employees be given another representative to serve as a counterweight? The unionized employees that are the principal focus of this section are fully represented by union representatives. But with non-unionized companies like Enron, there is a compelling argument for setting up an employees’ committee in any case where significant layoffs or benefit cuts are likely to be at issue. Because the employees may not be coordinated in any meaningful sense, and their interests are quite distinct from those of the ordinary creditors who are represented by the creditors’ committee, it makes sense to give them separate representation.

68. See LoPucki, Team Production, supra note 67, at 749–52.
69. Id.
70. Id. at 767.
72. Skeel, supra note 27, at 917–19 (describing DIP financing and pay-to-stay as the most important new developments in bankruptcy).
73. Adolf A. Berles, Jr., For Whom Corporate Managers Are Trustees: A Note, 45 HARV. L. REV. 1365 (1932).
74. For a similar argument, see Donald R. Rorobkin, Employee Interests in Bankruptcy, 4 AM.
Coordinated representation does not necessarily mean that employees can prevent layoffs or stop pay and benefit cuts. The ratcheting down of labor protections in industries that historically have provided generous employee wages and benefits, such as the airlines, is inevitable in the competitive markets of our era. But committee representation would give employees a unified voice in the restructuring process.

V. CONCLUSION

This is a very difficult era for many employees in bankruptcy. If their company files for bankruptcy, they face the risk of losing their jobs and some or even all of their retirement savings. For “wanted” employees, on the other hand, the picture looks quite different. They are now offered attractive compensation packages to encourage them to stay on the job.

Using Richard Ippolito’s analysis of default risk and other pension issues as a starting point, this Comment argues that employees should be given more protection in several respects. The priority for pre-bankruptcy wages and severance benefits should be substantially increased, and lawmakers should provide more protection of employees’ retirement savings through mandatory diversification requirements and, ideally, some form of pension insurance. Particularly given the increasing leverage of post-petition lenders in Chapter 11, this Comment also argues that non-unionized employees should be given committee representation in cases where layoffs or pay cuts are a significant issue. Corporate debtors should not be prevented from laying off workers or scaling back wages in Chapter 11, however, due to the perverse effects that no-layoff rules have in the context of financial distress.

This Comment suggests that the treatment of “wanted” employees is best viewed as a governance issue. Not only has the use of KERPs and pay-to-stay arrangements encouraged crucial employees to continue working at the firm, it also has counteracted many of the problems that plagued Chapter 11 in the 1980s. Managers who are rewarded for reorganizing promptly are less likely to drag out the Chapter 11 process. But the new pay packages can be abused, and they raise serious fairness concerns. Therefore, these new arrangements should be subject to scrutiny to ensure that they are actually designed to achieve their goals.