MANAGEMENT GAINS, CREDITOR LOSSES
FROM LABOR SETTLEMENTS IN CHAPTER 11

Paper Submitted to the New York Bar
Association CLE Program:
When Worlds Collide: Labor and
Bankruptcy Law in the 21st Century

May 22, 2007
New York City

By Thomas Moers Mayer
Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, New York 10036
212-715-9169
tmayer@kramerlevin.com
The “labor transformation cases” – chapter 11 cases where the debtors seek to terminate collective bargaining agreements, pension plans and retiree medical benefits, or “OPEB”\(^1\) – are usually cast as titanic struggles between management, on the one hand, and labor, on the other. Certainly the litigation plays that way. The company moves to terminate or modify collective bargaining agreements under section 1113 and retiree medical benefits under section 1114. The unions respond. Company and unions negotiate. The court acts. The union strikes, or does not strike. The parties settle. The company reorganizes or liquidates.

On the sidelines stand those with chips on the table -- the creditors. No one asks whether and how the process will benefit them.

And yet, if the process does not benefit unsecured creditors, who does it benefit? For whom does management fight with labor? Who benefits – who should benefit – from the sacrifices extorted at great pain from workers and retirees? Creditors, creditors, always creditors and only creditors. Shareholders have no part. Sections 1113 and 1114 both provide that any modification to labor and retiree agreements must treat all parties in the case “fairly and equitably,” and these magic words require sacrifices from creditors.\(^2\) If creditors are sacrificing, shareholders by definition should recover nothing.

\(^1\) Other Post Employment Benefits.

\(^2\) “The requirement that the debtor assure the court that "all creditors, the debtor and all affected parties are treated fairly and equitably." Code § 1113(b)(1)(A), is a relatively straightforward one. The purpose of this provision . . . 'is to spread the burden of saving the company to every constituency while ensuring that all sacrifice to a similar degree’”. Truck Drivers Local 807 v. Carey Transportation Inc., 816 F.2d 82, 90 (2nd Cir. 1987) (quoting In re Century Brass Products, Inc., 795 F.2d 265, 273 (2d Cir.) (discussing legislative history), cert. denied, (1986)).
The debtor’s mantra is that its managers and professionals focus solely on “benefit to the estate”. This provides cold comfort to creditors. There are transactions that “benefit the estate” while damaging every party with an interest in the estate—except management. To take a ridiculous example, an insolvent debtor-in-possession could contract to buy a business generating $20 million per year in EBITDA\(^3\) and worth (at a 5x multiple) $100 million, in return for $200 million in common stock of the reorganized company. Such a transaction “increases the value of the estate” but damages every creditor by diluting every creditor’s stock ownership in the reorganized company. It is likely to benefit management, if management’s bonuses are tied to EBITDA, and the debtor’s financial advisor, if the advisor’s bonus is tied to total enterprise value ("TEV").\(^4\)

Labor and retiree settlements can look a lot like the foolish asset purchase described above— that is, the cost of obtaining concessions from labor unions, and the cost of terminating retiree medical benefits, is dilution.

This paper examines the dilutive effect of labor and retiree settlements.

That such settlements may have been dilutive is in no way a criticism of organized labor or retirees. Labor unions are supposed to get better deals for their members and retirees, and section 1113 and 1114 were enacted to make rejecting collective bargaining agreements (and retiree medical benefit plans) more difficult than rejecting other executory agreements.

---

\(^3\) *Earnings Before Interest Taxes Depreciation and Amortization.*

contracts.\textsuperscript{5} Creditors should not be surprised if unions use their leverage under the statute and in collective bargaining to obtain superior results for their members and retirees.

Nor does the dilutive nature of certain labor settlements reflect any undue solace to workers and retirees. They are unsecured creditors too\textsuperscript{6} – and undoubtedly wish they weren’t. Workers would certainly prefer to retain their collective bargaining agreement rather than trade certain wages and benefits for common stock which, though dilutive, is of uncertain value. Retirees would rather retain their medical benefits than receive common stock in a VEBA trust to pay for an uncertain level of medical care. Workers, retirees and the unions who represent them do not pick these fights in chapter 11. Management does. The immediate issue is the moral hazard faced by management and the debtor’s professionals, whose compensation may increase from deals that hurt creditors, workers and retirees. The larger issue is strategic. Where unsecured claims look to receive high recoveries – where bonds are trading over 50 cents, almost certainly where they are trading over 80 cents –management’s efforts to extort sacrifices from labor and retirees at the cost of diluting creditor recoveries may not be in the interest of either those who sacrifice or those who are diluted. Creditors, workers and retirees may have more in common than may first appear.

\textsuperscript{5} Official Committee of Unsecured Creditors v. Tower Automotive, Inc. , 2006 U.S. Dist. LEXIS 91958 at *15 (S.D.N.Y. Dec. 15, 2006) ("[S]ection 1114 . . . specifically provides retirees with rights not afforded general unsecured creditors") (upholding a section 1114 settlement which guaranteed retirees a recovery of 20% of their claims against an appeal by the Committee, which argued that other creditors had no such guaranty).

\textsuperscript{6} F.V. Steel & Wire Co. v. Houlihan Lokey Howard & Zukin Capital, L.P. 350 B.R. 835, 841-42 (E.D. Wisc. 2006) (upholding investment bankers’ fee based on distributions to unsecured creditors, including distributions to retirees).
Section 1114 Settlement and Creditors

Assume a debtor spending $20 million per year on retiree medical expenses. Under Financial Accounting Statement 106 ("FAS 106"), the retiree medical expenses represent an actuarial liability of $480 million. The debtor moves to terminate its retiree medical plan under section 1114. The debtor trades at approximately 6 times EBITDA (the “value multiple”, or “V”). The debtor settles with the retirees by allowing a claim of $480 million – the full amount of the FAS 106 liability -- at a time when claims against the Debtor are selling for about 50 cents (the claims selling price, or “P”). To the extent the market is valuing the debtor at a multiple of EBITDA, the benefit of the settlement is $120 million (the $20 million in savings times 6) and the claim is $480 million. That ratio – 120/480, or 25% -- is dilutive because it less than the 50-cent trading price of the bonds. Another way to make the same point is to compare the cost of the settlement using the price of the bonds ($240 million: the $480 million claim times 50 cents on the dollar) against the benefit ($120 million).

The market may be wrong when it values the benefit at 6 times current savings, as discussed below, but whether the market is right or wrong, however, EBITDA and TEV unquestionably have increased. If bonuses for managers and bankers are tied to EBITDA and TEV (and I do not know whether they were, in the case which provided this example) the transaction can increase the personal income of managers and bankers while hurting all parties in interest – the retirees, who would have preferred retaining their benefits, and the creditors, who want to avoid dilution.

The arithmetical relationships are worth studying.
The value of terminating retiree medical benefits is the annual payments saved, multiplied by the EBITDA multiple. If the claim for terminating retiree medical benefits is the same as the FAS 106 liability, the claim will be the present discounted value of the annual payments saved over a long period – 30 years, for instance. The present discounted value of any 30-year annual level payment stream can be expressed as a multiple of the annual payments, as shown in the following table (using $100,000,000 as an example to keep the math simple):

<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Present Discounted Value of $100mm per year Over 30 years ($mm)</th>
<th>Multiple: PDV/$100mm</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>$1,537</td>
<td>15.37x</td>
</tr>
<tr>
<td>6%</td>
<td>$1,363</td>
<td>13.63x</td>
</tr>
<tr>
<td>7%</td>
<td>$1,228</td>
<td>12.28x</td>
</tr>
<tr>
<td>8%</td>
<td>$1,114</td>
<td>11.14x</td>
</tr>
<tr>
<td>9%</td>
<td>$1,017</td>
<td>10.17x</td>
</tr>
<tr>
<td>10%</td>
<td>$ 933</td>
<td>9.33x</td>
</tr>
<tr>
<td>11%</td>
<td>$ 869</td>
<td>8.69x</td>
</tr>
<tr>
<td>12%</td>
<td>$ 805</td>
<td>8.05x</td>
</tr>
<tr>
<td>13%</td>
<td>$ 749</td>
<td>7.49x</td>
</tr>
<tr>
<td>14%</td>
<td>$ 700</td>
<td>7.00x</td>
</tr>
</tbody>
</table>

Thus the present discounted value of $100 million per year at a 5% discount rate is $1.537 billion or 15.37x. In other words, the claim from terminating retiree medical benefit plans using a 5% discount rate, assuming constant annual cost, would be approximately 15.37 times the current annual cost of retiree medical benefits.

So long as the market values the company based on the simple algebra of value multiple times this year’s EBITDA, unsecured creditors benefit from the termination of retiree medical benefits.
medical benefits only if the \( V \) value multiple times savings exceeds the \( C \) claim multiple times savings, multiplied by trading \( P \) price of the claims:

- \( \text{annual savings} \times V > \text{annual savings} \times C \times P \)
- Because annual savings are on both sides of the equation, it can be simplified to:
  - \( \text{annual savings} \times V > \text{annual savings} \times C \times P \text{,} \)
  - or: \( V > C \times P \text{,} \)
  - and by the same token: \( V/C > P \text{,} \)

Stated in English, the algebra shows that if unsecured retiree benefit plans represent enforceable claims against the debtors (an assumption discussed below), a multiple-of-current-savings valuation will view the settlement as increasing unsecured creditor recoveries only when the ratio of the value multiplier to claim multiplier is greater than the cents-on-the-dollar price of the claims. Because \( V \) is almost always less than \( C \)\(^7\), the advantage to unsecured creditors shrinks as the price of unsecured claims \( P \) rises and turns negative once \( V/C \) is less than \( P \). If the value multiple is 6x and the claim multiple (based on a discount rate of 5%) is 15.37x, the break-even point is 6/15.37 or 39%. In other words, terminating retiree medical benefit plans using a 5% discount rate will diminish creditor recoveries if such recoveries would otherwise be greater than 39%.

\(^7\) The Value multiplier is related to the company’s weighted average cost of capital, which includes a high equity component as well as a low [tax advantaged] debt component. The claim multiplier is based on a debt-based discount rate. The WACC should be higher than the debt-based discount rate except in highly leveraged capital structures where the debt component of the WACC is very high and tax deductibility of interest reduces capital costs more than the increase caused by the higher price of equity capital. This is unlikely to be the case in any chapter 11 plan.
A more immediate application of this formula suggests that if claims are trading at more than 39 cents on the dollar, termination of retiree medical benefits should depress the price of the claims.  

The foregoing analytical framework may understate the value of terminating retiree medical benefits because it does not account for medical inflation. In calculating FAS 106 liability, the debtor’s actuary will use an assumed (and disclosed) medical inflation rate, which we will assume for sake of argument is 8%. Therefore dividing the FAS 106 liability by the current year’s cost appears to overstate the Claim multiple because costs are assumed to rise by 8% each year. A more appropriate way to calculate the value of eliminating retiree medical benefit savings may be to inflate the current annual cost by the annual inflation rate for 30 years, and discount each year’s predicted (and inflated) medical cost back to present value using the debtor’s weighted average cost of capital (“WACC”) which we will assume, for illustrative purposes, is 15%. Because medical costs are inflated at 8% per year and then discounted back to present value at 15%, the net discount rate is difference between the two, or 7% -- yielding a Value multiple, per the table above, of 12.28x. Using this framework, the formula yields a

---

8 The foregoing assumes that a company with retiree medical benefits trades at the same 6x value multiple as a company without such benefits. In a report on retiree medical benefit buyouts for American automobile manufacturers, Goldman Sachs considered the question of multiple expansion. Goldman Sachs did not yet see proof that elimination of retiree medical benefit increases a company’s value multiple, although Goldman Sachs was prepared hypothesize an increase of “one turn”, i.e., in this example, from 6 to 7. GOLDMAN SACHS (AMERICAS AUTOMOBILES), POSSIBLE OPEB FUNDING DEALS MAY BE MORE BARK THAN BITE, ESPECIALLY FOR FORD (March 21, 2007). At a 7x multiple, the break-even point would be 7/15.37, or 45 cents on the dollar.

9 The debtor will often predict a relatively high inflation rate for the immediate future (e.g., 9%), dropping to a lower rate (e.g., 5%) when medical inflation is predicted” to “level off” in, say, five years. The assumption that medical inflation will eventually decrease is, as yet unproven. With a few exceptional years immediately following federal cost containment legislation in the 1990s, medical costs have usually exceeded the predicted cost of inflation. On the other hand, companies offering retiree medical benefits are increasingly imposing caps which transfer the risks of inflation to beneficiaries.
break-even point of 12.28x/15.37x, or about 80% -- that is, terminating retiree medical benefit plans is accretive to creditor recoveries if creditors would otherwise receive less than 80 cents on the dollar.

The algebra illustrates a larger point. Long-term contractual obligations – in this case, retiree medical benefits, but they could be pensions, or even long-term obligations under joint ventures, licenses and supply contracts – are all, in effect, disguised leverage, convertible by rejection in bankruptcy into the equivalent of a bond at a discount rate that is a \textit{debt} discount rate. The benefit of rejection is always measured by \textit{WACC} discount rate. The ratio of the WACC-related multiple to the debt-related multiple appears to set a threshold for the benefit of contract rejections and appears to be, in this economic environment, about 80%. The foregoing conjecture deserves inquiry beyond the scope of this paper.

\textbf{Section 1113 Settlement and Creditors.}

Assume a company moves to reject its collective bargaining agreement under section 1113. The collective bargaining agreement has three and a half years to run. After a full hearing, perhaps a ruling, perhaps a strike, the debtor and the union settle on a new contract which saves the debtor $280 million per year over the next three and a half years and allows to the union an unsecured claim of $2.1 billion. Again, unsecured claims are selling at 50 cents. (The foregoing is an example drawn from a recent case in which the author was not involved. The conclusions drawn should be not be viewed as critical of negotiations or negotiators in that case, which involved issues and circumstances not known to the author and may well have justified settlements that are puzzling to outsiders.)
This transaction looks like it increases creditor recoveries. If the company is valued at 6 times EBITDA, the market will value $280 million in labor savings as worth $1.68 billion in incremental enterprise value. The claim created is worth only $1.050 billion. A closer look, however, raises questions.

As Harvey Miller said more than 20 years ago, a section 1113 proceeding merely accelerates the expiration of a collective bargaining agreement and the union’s right to strike. (This is still true unless the employer is governed by the Railway Labor Act and files for chapter 11 in the Second Circuit.10)

If the collective bargaining agreement had three and half years to run, the true savings from the section 1113 proceeding are actually only $280 million times 3.5 – not times the EBITDA multiple of 6. The end result is that the debtor paid $1.050 billion on the effective date of the plan to save $980 million over three and half years11 -- and to give the reorganized debtor the advantage of starting from a lower bargaining position in three-and-a-half years.

**Section 1113 Settlement and Workers.**

The new contract is for three and a half years, and for that period labor has given up $280 million a year – or $980 million over four years. But workers also received new stock (in respect of its $2.1 billion claim) equal to $1.050 billion immediately. The $1.050 billion in

---

10 *In re* Northwest Airlines, 2007 U.S. App. LEXIS 7244 (2nd Cir. March 29, 2007) (where union did not appeal termination of collective bargaining agreement under section 1113, such termination did not, under the Railway Labor Act, give the union the right to strike or take other job actions.)

11 The claim of $2.1 billion exceeded the $980 million in wage and benefit sacrifices for historical reasons. Approximately a year prior to the bankruptcy, the union had made substantial sacrifices in return for common stock, which was rendered worthless by the subsequent bankruptcy. The union therefore insisted on receiving a claim to compensate it for the sacrifices made prior to bankruptcy in return for stock made worthless by the bankruptcy. The unsecured creditors committee chose not to object.
new stock is worth far more than the present value of $280 million per year over three and a half years.

The Debtor and union can even agree to minimize the taxes workers would otherwise pay on the $1.050 billion as follows. The union transfers its $2.1 billion claim to the Debtor. The Debtor sells the claim into the market for $1.050 billion, which the Debtor then pays, to the extent permitted by law, into a 401K or comparable tax sheltered vehicle as an employer contribution, turning the balance over to the individual workers.

In sum, the union has clearly obtained for its members a settlement worth more than the wages and benefits they surrendered. As noted in the introduction, this is praise, not criticism for the union – it’s what the union is supposed to do. The most the company can argue is that the settlement cost creditors less than a strike, but the argument has limited force. If the union’s ability to strike allows the union to obtain a settlement in excess of its legal rights, then perhaps the company should rethink its decision to terminate the collective bargaining agreement and give the union such bargaining power. As noted above, management, not union, picks the fight in chapter 11. Outside of chapter 11, would management pay $1.050 billion today in order to buy labor savings of $980 million over three years? The settlement in this example is clearly “beneficial to the estate” but detrimental to creditors.

Section 1114 Settlement and Retirees.

The FAS 106 liability for the retirees’ medical benefits was $480 million – calculated at a discount rate set at approximately the rate for AA-rated corporate bonds, or somewhat more than 5%. However, the average rate of return on a balanced portfolio of stocks and bonds is clearly greater than 5.5%. Most companies assume a rate of return of at least 8% for their pension portfolios. GM assumes a rate of return of 9%, and has in fact done
considerably better. Using a “prudent investor” rate of 9% instead of the AA-corporate rate of 
considerably more than 5% would reduce the FAS 106 liability dramatically. Another way of 
putting this is that a $480 million FAS 106 retiree medical benefit liability could be “defeased’.
or paid in full, assuming a 9% discount rate, by purchasing stocks and bonds with an aggregate 
value of approximately $320 million. Since the $480 million claim is selling for 50 cents on the 
dollar, or $240 million, the retirees suffer genuine hardship – but not as great as would first 
appear. They are not losing half their $480 million in benefits, or $240 million. They are losing 
the difference between the value of their benefits using a 9% discount rate, or about $320 
million, and the $240 million value for the claim. Total loss: $80 million.

This is effectively what is happening in Delphi. General Motors is assuming a 
massive liability for retiree medical benefits that it has already guaranteed in return for several 
billion dollars in cash and stock under the proposed Delphi plan. At first blush, GM is taking a 
major loss. However, the retiree medical benefit liabilities are calculated using a low discount 
rate (6%), while GM, as noted above, makes more than 9% on the assets in its pension plan.

Nor is this necessarily the end of the story for the retirees. Most retiree 
settlements result in the establishment of a “VEBA12” trust, which means the $480 million claim, 
and the $240 million proceeds of that claim, are held in the VEBA trust to fund retiree medical 
benefits. VEBA’s are often described as a way to make retiree medical benefits “non-recourse” 
to the company. That is technically true. However, a powerful union has the ability to bargain 
for additional and increased contributions to the VEBA each time its collective bargaining 
agreement expires. For example, Wilbur Ross’ International Steel Group bought Bethlehem 
Steel and LTV Steel assets without assuming their retiree medical benefit plans – but in the next

12 Voluntary Employee Benefit Association.
bargaining cycle, ISG agreed to establish and fund a VEBA for Bethlehem Steel and LTV Steel retirees. Thus as long as a union has sufficient bargaining power to demand additional funding for its retirees, a VEBA will not, in any economic sense, be truly “non-recourse”\(^{13}\).

The foregoing should not be interpreted as minimizing the damage incurred by retirees from termination of their retiree medical plans. Prior to termination, a retiree had a health plan he or she could rely on. After termination, the retiree has nothing more than access to a trust with less access to group coverage than the employer. The only point of this section is that the low discount rates used to calculate retiree medical benefit obligations leads to a claim that could, in theory, be defeased at a much lower amount.

**How Creditors Can Fight Back.**

We have seen that management can structure labor settlements to reduce creditor recoveries and enrich managers. Creditors can acquiesce, or they can fight.

The first battle is and should be over management compensation. New section 503(c) poses almost insuperable obstacles to management bonus and severance plans. If management wants its bonuses and severance, it needs creditors’ support. Creditors should make the most of their new-found leverage by insisting that management bonus plans depend not merely on EBITDA but on recoveries to unsecured creditors – or, at least, that management bonuses diminish as claims increase. This is what happened in Dana Corporation. The Official Committee of Unsecured Creditors defeated Dana’s first management bonus plan, and only acquiesced a modified (and lower) bonus plan after Dana agreed that increases in claims would diminish management bonuses.

\(^{13}\) The recent Goodyear settlement included a pledge by the United Steelworkers not to seek additional funding for the VEBA.
The second battle should be over the amount of the claims, in particular retiree medical benefit claims. These claims can be challenged on at least three fronts: the enforceability of the claims under non-bankruptcy law, limitations on allowance of claims under applicable Bankruptcy Code provisions, and the calculation of the claim using a higher discount rate.

The enforceability of claims for retiree medical benefits depends on the exact nature of the promise by the company to its retirees. Assume the company has explicitly, clearly and unqualifiedly reserved the right to terminate or modify retiree medical benefits in the retiree medical benefit plan. FAS 106 compels the company to report the full actuarial amount of the promised benefits even if the company has reserved the right to terminate them, but the company nevertheless has the legal right, under applicable non-bankruptcy law, to terminate its retiree medical benefits without liability. Where a company would have no liability for terminating retiree medical benefits outside of chapter 11, it should have no liability for terminating retiree medical benefits inside of chapter 11.

The reservation of rights is often unclear. Collective bargaining agreements generally preclude any changes to retiree medical benefits during the term of the collective bargaining agreement. Less clear is whether a retiree’s right to future benefits becomes fixed at retirement under the terms of the current CBA, or is subject to future bargaining. Courts in most jurisdictions have interpreted such collective bargaining agreements as providing retiree medical benefits only during the term of the collective bargaining agreement, so that the employer is free, at the termination of the collective bargaining agreement, to modify or eliminate the retiree’s medical benefits. However, the Sixth Circuit – with jurisdiction over Michigan, Ohio, Kentucky and Tennessee – found an “inference” that such a collective bargaining agreement makes an
irrevocable promise of lifetime retiree medical benefits. Thus unionized companies in the Sixth Circuit, including most automobile plants and major steel companies, may face serious litigation from retired union members if they modify their retiree medical benefits outside of bankruptcy. In Dana Corporation’s bankruptcy, the unions accused the debtor of manufacturing venue in the Southern District of New York in order to escape Sixth Circuit law that would otherwise have applied to Dana, which is based in Toledo.

The law on rejection of collective bargaining agreements under section 1113 has recently become even more obscure. In 1984, the Supreme Court in *NLRB v. Bildisco & Bildisco* held that collective bargaining agreements were subject to easy rejection under section 365. Rejection under section 365 produced a general unsecured claim for the difference between wages paid post-rejection and wages promised for the life of the rejected contract. Congress quickly reversed *Bildisco* and made modification of collective bargaining agreements more difficult by enacting section 1113. The history and spirit of section 1113 indicate that union members are entitled to a claim for wages and benefits lost under section 1113. However, the Second Circuit in Northwest Airlines recently held that termination of a collective bargaining agreement under section 1113 did not constitute a “breach,” and thus Bankruptcy Judge

---

14 United Auto., Aerospace, and Agric. Implement Workers of America v. Yard-Man, Inc., 716 F.2d 1476 (6th Cir. 1983) (when parties to a CBA contract for benefits that accrue upon achievement of retiree status, it is likely that the parties intended that such benefits continue throughout retirement).

15 Dana created a basis for venue in New York by incorporating a New York subsidiary weeks before the filing.


Gropper felt bound to deny allowance of any claim for rejection: No breach, no claim.\(^\text{19}\) It is not clear whether *Northwest Airlines* can or will be limited to its peculiar facts.\(^\text{20}\) Some courts have also limited collective bargaining agreement claims to one year’s lost wages under section 502(b)(7),\(^\text{21}\) just as lease claims are limited under section 502(b)(6).

Finally, creditors can seek to reduce the allowed amount of retiree medical benefit claims by challenging the discount rate used to calculate such claims. As noted above, no court has yet written a decision on how to calculate claims arising from the termination of retiree medical benefit claims (there appears to be only one reported decision allowing claims for terminated or modified retiree medical claims\(^\text{22}\)), but there are decisions dealing with a related topic -- the allowance of claims for pension benefits. In those cases, the PBGC sought to use a discount rate set by its own regulations with reference to rates charged by surety bond companies for assuming pension liabilities. These very low rates inflate the PBGC’s claim. Two courts of appeals have rejected such rates in favor of a “prudent investor” rate that is much higher, thereby


\(^{20}\) Northwest Airlines was governed by the Railway Labor Act, which does not apply to most debtors. However, the Second Circuit’s analysis of “abrogation” instead of “breach” does not appear to rest on the Railway Labor Act. *See also* Southern Labor Union, Local 188 v. Blue Diamond Coal Co., 160 B.R. 574 (E.D. Tenn. 1993) (finding no claim from breach of collective bargaining agreement.). Prior to *Northwest Airlines*, most courts had assumed that termination or modification of a collective bargaining agreement would indeed create a claim. Truck Drivers Local 807 v. Carey Transp., Inc., 816 F.2d 82, 93 (2d Cir. 1987).


drastically reducing the PBGC’s claim.23 If the same reasoning applies to retiree medical benefit claims, those claims will be sharply reduced to the benefit of unsecured creditors. It must be noted, as a counterpoint, that the retirees (or the unions that represent them) have a counterattack available: They can argue that the medical inflation rate used to determine FAS 106 liability is too low.24

**CONCLUSION**

To date, no court has rejected a labor settlement as damaging to creditors. In cases where creditors are looking at pennies on the dollar, there is no need to consider the issue. Where $P$ is very small, the $V/C$ ratio can also be very small. But when creditor recoveries rise above 50 cents and certainly above 80 cents, a labor settlement can be very dilutive and courts must pay attention. In negotiations over management compensation in Dana Corporation’s chapter 11 case, debtors counsel tried to dismiss creditor concerns about dilution by arguing that section 1113 and 1114 relief can be obtained only if necessary to save the company, so that the alternative is liquidation. That is not true. With the exception of the Third Circuit25, courts have granted section 1113/14 relief to enhance the profitability of the debtor, not merely to avoid its liquidation.26 To revisit the hypothetical posed at the beginning of this paper, a company can always increase the absolute amount of its profits and TEV by purchasing a $100 million

---


24 See footnote 9.

25 Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074 (3rd Cir. 1986).

26 *In re* Mile Hi Metal Systems, Inc. 899 F.2d 887, 892-93 (10th Cir. 1990) (citing cases).
business for $200 million in stock. That transaction makes no sense. Neither does a labor settlement that returns $100 million in value to the estate at the cost of allowing claims expected to recover $200 million. Creditors must watch carefully to prevent this damage from occurring, especially in cases where such transactions boost the personal compensation of those who negotiated them.