Important Questions and Answers about Section 1113 – Motion to Reject Labor Contracts in Bankruptcy

Q. What can happen to our contracts in Chapter 11 bankruptcy?

A. Under Section 1113 of the Bankruptcy Code, the debtor may ask the bankruptcy court for authority to reject labor contracts, and by means of this process the Company can seek to modify any provision in a labor contract. If the Court approves the motion and allows the Company to reject a labor agreement, the Company is then authorized to implement its proposal. The major results of an rejected labor agreement are threefold: 1) the Company imposes the terms and conditions of employment contained in the last proposal the Court determines is relevant ; 2) there is no labor agreement in effect, but the union is still the authorized representative and the company has an obligation to negotiate with the union; and 3) the union has a right to strike.

However, before the debtor can obtain rejection of a labor contract it must go through a negotiation and litigation process. First, a proposal must be provided to the relevant union prior to the company's filing the motion to reject in court. Hostess provided a proposal to the IBC-IBTNNC on the date of the bankruptcy filing. Among the statutory requirements are that the proposal must provide only for "necessary" modifications that are "necessary" to permit reorganization and assure "fair" and "equitable" treatment of all parties (see below of more discussion on these requirements). The Company must also provide the union with relevant information needed to evaluate the proposal. Then, within 2-3 weeks of filing this motion, during which negotiations take place, a full-scale bankruptcy court hearing is held where all interested parties can be heard. The hearing must take place within the 2-3 weeks unless the Company agrees otherwise. Negotiations often continue during the hearing. If no settlement is reached, the court's decision on rejection of contracts will be made within 30 days of the start of the hearing unless the debtor agrees to extend this period.

Under Section 1113 (e) of the Bankruptcy Code, the Company may seek emergency short-term relief on an expedited basis without a full negotiating process if the court finds that the relief is "essential" to the continuation of business or to avoid "irreparable harm" to the bankruptcy estate. Hostess has not filed for 1113 (e) or given any indication that it intends to do so.

Q: How have the requirements of Section 1113 been interpreted by the courts?

A: Unfortunately, the Second Circuit, the highest appeals court other than the Supreme Court which sets the law for bankruptcy courts in New York, like the Hostess Brands bankruptcy court, has been sympathetic to companies in interpreting Section 1113.

Necessary: Most courts have interpreted "necessary" as relating to a company's long-term financial health and as not limited to bare-bones financial relief. The fact that the union made concessions in the past, or that the company may have made mistakes in the past, while potentially relevant to the court's overall consideration, have not, unfortunately, been considered bars to further concessions if the statute's requirements are met.

Fair and Equitable: Many courts have concluded that "fair" and "equitable" does not necessarily mean "equal" or "equivalent" treatment compared to salaried employees, other union employees, or other creditors. The mere fact that some management may receive benefits under an incentive plan, for example, while relevant to the court's overall consideration, has not in the past been a basis for most courts to deny a company's request for concessions as unfair, particularly where the court in question has approved the plan.

Good Cause: In considering the union's conduct, courts look to whether the union bargained in good faith, whether the union offered any reason for rejecting the company's proposal other than its view that the proposed modifications were excessive, and whether the union counter-proposed an equally effective set of modifications which provided comparable savings.

Q: When is Hostess likely to seek relief under Section 1113?

A: Hostess announced at the outset of the bankruptcy filing that it would very quickly file a motion to reject all labor agreements in effect with local unions affiliated with the IBT and local unions affiliated with the BCT. It provided a proposal on the date it filed for bankruptcy and under a schedule approved by the Court, it will file its motion on January 25. Because the Company has agreed that the hearing can begin more than 3 weeks after the motion is filed, a hearing on the motion dealing with IBT and BCT locals has been set for March 5.

Under its scheduling order the Company will seek to modify its labor contracts with unions other than those affiliated with the BCT and IBT in a second stage, with motions filed by March 28 and a hearing within 30 days.

Q: What happens next?

A: We have demanded negotiations over the proposal and our professional advisors are reviewing it. Between now and March 5 we intend to work hard and in good faith to both protect our members and try to reach an agreement with Hostess.

Q: What if negotiations are not successful?

A: As discussed above, if no agreement is reached, the Bankruptcy Court will have to decide on the motion to reject. If the Court grants the motion, the Company will be authorized to implement an offer and there will be no contracts in effect. If a strike is authorized we would be free to strike the Company with all that entails. If the motion is denied, we would expect revised demands from the Company.