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Hostess Brands, Inc. Bankruptcy

Workouts and Reorganizations – Professor Kuney

Spring 2013

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Part I: The 2004 Bankruptcy¹

Chapter 1: Introduction

In 1930, the Hostess Corporation² began as the Interstate Baking Corporation (IBC). In Kansas City Missouri, flour, wheat, and grain marched from machines as workers placed sliced white squares into Wonder Bread's iconic yellow, red, and blue packaging.³

Hostess grew from its small town beginnings into a large corporation thanks in large part to its innovation in its product lines as well as growth through the acquisition of its competitors. By the end of 2012, "Hostess [was] one of the largest wholesale bakers and distributors of bread and snack cakes in the United States [and] operate[d] 36 bakeries, 565 distribution centers, approximately 5,500 delivery routes and 570 bakery outlet stores throughout the United States."⁴ In more recent years, however, the now gigantic company had lost its innovative edge and failed to effectively transition with the changing tastes of its consumers. Likewise, with the acquisition of constituent companies, Hostess had acquired a multitude of diverse workers and ad hoc union agreements that rendered the already large company increasingly more unwieldy.⁵

The importance of Hostess's unionized labor force to its operations cannot be overstated. Indeed, Hostess's operations relied on labor-intensive processes "involving, among other things, complicated and extensive local route delivery systems" throughout the United States.⁶ According to Brian Driscoll, Hostess's CEO at the time of its 2012 bankruptcy filing, in order "to staff this labor-intensive network, [Hostess] employ[ed] approximately 19,000 people, *of*

¹ The 2004 docket for the Hostess bankruptcy contains 12735 documents. A large percentage (possibly as much as 65%) of these documents appear to be procedural in nature. This underscores the procedural nature of bankruptcy.

² Ralph Leroy Nafziger founded what later became Hostess Brands, Inc. in 1930 as Interstate Bakeries Corporation in Kansas City, Missouri: <http://www.privco.com/private-company/hostess-brands-inc-Narrative> (last visited April 23, 2013). In order to mark a change in the company and promote identification with its most iconic brands, the company changed its name to Hostess Brands in 2009 upon its exit from Chapter 11 bankruptcy. Despite several name changes, the acquisition of a variety of other companies, and the creation of multiple subsidiaries, for convenience and ease of understanding, the company that became Hostess Brands, Inc. will be referred to as "IBC" when discussing the company before its 2009 exit from bankruptcy and will be referred to as "Hostess" when discussing the company from 2009 until its liquidation in 2013.

³ <http://www.kwch.com/business/kwch-timeline-the-history-of-hostess-20121115,0,810729.story> (last visited January 29, 2013).

⁴ Affidavit Hostess CEO Day 1 motions.

⁵ *Id.*

⁶ *Id.*

which 83% [were] members of unions who [were] subject to 372 collective bargaining agreements.”⁷ (Emphasis added). “[Hostess’s] unionized employees belong[ed] to 12 separate unions, but the overwhelming majority (nearly 92%) of [Hostess’s] unionized workforce [were] members of the International Brotherhood of Teamsters (the “IBT”) or the Bakery, Confectionery, Tobacco Workers & Grain Millers International Union (the “BCT”).”⁸ By sheer number, these two unions dominated representation of Hostess’s entire labor force, and Hostess’s eventual demise was the almost immediate consequence of its failure to reach an “agreement with striking workers [from one of these unions] on concessions to help the company emerge from its second bankruptcy.”⁹

At the time of the writing of this work, some of Hostess’s biggest competitors and certain private equity firms are seeking to purchase the iconic brand in the same manner that Hostess built its empire.¹⁰ In some of the most recent bankruptcy developments, Hostess has closed its doors to customers and opened itself for bidding.¹¹ As of April 15, 2013, the majority of Hostess’s brands and assets had been sold to several different purchasers for a total price of over \$860.3 million.¹² The aggressive and numerous bids and final purchases for its constituent brands prove that the Hostess brand is valuable, but that management issues and unyielding labor issues that arose before Hostess’s first filed for bankruptcy in 2004, and were still present when Hostess again filed for bankruptcy in 2011, exemplify that the corporation never quite fixed what was broken in order to operate successfully.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ <http://www.bloomberg.com/news/2013-03-19/hostess-judge-approves-asset-sales-of-over-800-million.html> (last visited April 19, 2013).

¹¹ Hostess filed for Bankruptcy January 11, 2012. *See* voluntary petition. A plan of reorganization was developed and court approval was granted. Unions went on strike on November 8, 2012, shortly thereafter, the company was unable to move forward and a motion was granted to wind down the company and later sell the constituent parts in section 363 sales.

¹² <http://www.reuters.com/article/2013/03/19/us-hostess-twinkies-sale-idUSBRE92I0XQ20130319> (last visited April 23, 2013); <http://www.bloomberg.com/news/2013-04-09/hostess-approved-to-sell-drake-s-to-little-debbie-maker.html> (last visited April 19, 2013).

Hostess Timeline¹³

1925: Continental Baking Company buys Taggart Baking, maker of Wonder Bread. Continental Baking Co. becomes the largest bakery in the U.S.

1930: Continental baker James Dewar creates the Twinkie. Wonder Bread becomes the first large-scale baker to sell loaves of pre-sliced bread. Interstate Baking Company (“IBC”) is formed in Kansas City, Missouri.

1934: Wonder Bread is introduced at the World’s Fair in Chicago.

1937: IBC merges with Schulze Baking Company, Inc. The surviving company keeps the Interstate Baking Company name.

1942: The Continental Baking Company unit in Akron is closed for more than three months as part of a labor union dispute between the American Federation of Labor (AFL) and the Congress of Industrial Organizations (CIO).

1943: IBC purchases Supreme Baking Company of Los Angeles.

1947: Mascot Twinkie the Kid¹⁴ is introduced. IBC introduces white Sno Balls; takes three years for the company to add the cream filing and the distinctive pink color.

1950: IBC sponsors *The Howdy Doody Show*, reinforcing the Twinkie’s status as a ubiquitous lunchbox treat.

1954: IBC acquires Ambrosia, Remar, and Butter Cream Cake Companies.

1959: The AFL-CIO Bakery and Confectionery Workers Union wins the fight to become exclusive bargaining agent for Continental employees in Akron.

1960: IBC acquires various competitors including Supreme Baking Corporations, Kingston Bakery.

1967: IBC introduces Ding Dongs and Ho Hos.

1969: Interstate Bakeries Corporation changes its name to Interstate Brands Corporation.

1970: Continental Baking Company introduces Beefsteak brand.

1975: Data Processing Financial and General Corporation (“DPF”) acquires Interstate Brands Corporation.

¹³ Cake Wreck: Hostess from Icon to Bust: How the Baker Went from the Lunchbox to a Series of Bankruptcy Courts, <http://money.cnn.com/galleries/2012/news/companies/1207/gallery.hostess-timeline.fortune/index.html>, (last visited January 28, 2013). <http://www.fundinguniverse.com/company-histories/interstate-bakeries-corporation-history/> (last visited April 23, 2013); <http://www.ohio.com/news/hostess-timeline-1.351001>. (last visited January 28, 2013).

¹⁴ http://www.huffingtonpost.com/2012/11/16/twinkie-the-kid-dead-obituary_n_2143736.html (last visited April 23, 2013).

1978: “The Twinkie Defense” is coined during the trial of Dan White, who binged on junk food before killing San Francisco’s mayor and city supervisor Harvey Milk. The defense consisted of the claim that the binge resulted in a blood sugar spike that caused White to lose control of himself, a form of diminished capacity. He was convicted and spent 5 years in jail before being released and committing suicide in 1985.

1981: After being sold by DPF, Interstate Brands Corporation changes its name back to Interstate Bakeries Corporation.

1987: Management (and a group of investment bankers) decided to take the company private using a leveraged buyout. IBC Holdings Corporation was formed to purchase all of IBC’s outstanding stock. The resulting company’s name was IBC Holdings Corporation. IBC Holdings Corporation buys Merita Bakeries a division of the American Bakeries Company.

1991: IBC Holdings Corporation changed its name back to Interstate Bakeries Corporation in May, prior to going public again by selling stock in July. IBC raised \$250 million in stock sales, most of which was used to pay down current debts.

1995: IBC acquires Continental Baking Company, the country's largest wholesale baker since 1925, for \$330 million in cash plus stock. IBC becomes the nation’s largest bakery company.

1997: United States Department of Justice (the “DOJ”) orders IBC to divest itself of certain operations because of antitrust issues. In compliance with that order, the company sells its Butternut Bakery facility in Chicago.

1998: IBC purchases the John J. Nissen Baking Company of Biddeford, Maine, Drake’s of New Bedford, Massachusetts, and My Bread Company of New Bedford, Massachusetts. IBC’s sales in 1998 surpasses the \$3 billion mark. IBC spends almost \$100 million on new operations, including a 280,000-square-foot facility in Biddeford, Maine, one of the largest bakeries in the world, and a Toledo bakery with a capacity of 250,000 loaves of bread a day.

1999: Hillary Clinton approves the inclusion of Twinkies in the Millennium Time Capsule, alongside Ray Charles’s sunglasses and a piece of the Berlin Wall. The Twinkies are removed, however, because of rodent concerns.

2004: Citing pressure from carb-conscious consumers, rising ingredient costs, and climbing expenses for employee pensions and health care, IBC files for bankruptcy under Chapter 11.

2007: Grupo Bimbo makes an offer to purchase IBC for \$580 million during the first bankruptcy proceedings (the bid was outside of any official Section 363 sales). However, IBC declined to accept the bid from Grupo Bimbo and eventually emerged from bankruptcy in 2009.

2008: Twinkies are packaged in 100-calorie “Twinkie Bites” in an attempt to appeal to a more health conscious public.

2009: IBC exits bankruptcy as a private corporation under the name Hostess Brands, Inc. (“Hostess”) after a \$130 million equity investment by Ripplewood Holding’s, over a \$100

million in concessions to wages and benefits from the labor unions, and over \$300 million in loan forgiveness from its senior creditors.

2010: Craig Jung, CEO, left Hostess and is replaced by Brian Driscoll.

2011: Hostess loses \$341 million and requires an additional \$40 million investments from Ripplewood and an additional \$30 million in loans from Silver Point and Monarch, its senior creditors. Hostess ceases making payments into the Multi-Employer Pension Plans.

2012: Greg Rayburn becomes the Hostess's CEO (the sixth in a decade). In January, Hostess again files for Chapter 11 bankruptcy. In November, employees nationwide strike, causing Hostess management to file a motion to wind down the company.

2013: Hostess sells its various brands to several different competitors for an amount of over \$860 million.

History of Brands

Because Hostess is an umbrella brand to so many iconic American baked goods, you might be opening a cellophane package or spreading peanut butter across a slice of whole wheat bread without knowing that you are indeed a Hostess customer.¹⁵ The market for carbohydrates filled with something tasty gave rise to the following acquisitions or creations of these familiar cakes and breads: Chocodile, Ding Dong, Dolly Madison, Drakes, Ho Hos, Hostess Cupcakes, Merita Breads, Nature's Pride, Sno Balls, Suzy Q, Twinkies, Wonder Bread, Yodels, and Zingers.¹⁶

¹⁵ A list of the many bakeries that Hostess owns are listed on page four of the 2012 Bankruptcy Docket Schedule 1 and include: Armour and Main Redevelopment Corporation; Baker's Inn Quality Baked Goods, LLC; Baker's Inn; Brown's Bakery; Butter-Nut Bakeries; Colombo Bakery; Continental Baking Company; Cotton's Holsum; Cotton's Holsum Bakeries; Di Carlo Bakery; Dolly Madison Bakery; Drake's Bakery; Eddy's Bakery; Grandma Emilie Brown's Bakery; Holsum Bakery; Hostess; Hostess Bakeries; IBC Hostess Services, LLC; Interstate Brands West Corporation; Interstate Brands Companies; J.J. Nissen Bakery; Merita Bakeries; Millbrook Bakeries; Mrs. Cubbison's Foods, Inc.; My Bread Bakery; New England Bakery Distributors, LLC; Parisian Bakery; San Francisco French Bread Company; Sunbeam Bakery; Sweetheart Bakery; Standish Farms; Weber's Bread; Wonder Bakeries; Wonder/Hostess Bakeries.

¹⁶ <http://www.bloomberg.com/news/2012-12-14/hostess-union-challenges-wind-down-management-bonus-plan.html> (Last visited January 29, 2013). Order all Hostess treats here: <http://www.freshchocodiles.com/> (Last visited January 29, 2013).

The Best Thing Since Sliced Bread¹⁷

In the 1930s, Wonder Bread was the first to introduce the “1.5 pound loaf, a jump over the existing one-pounders of the time . . . [and was] the first to the shelf with sliced bread.”¹⁸ Additionally, Wonder Bread packaging provided an extended shelf life, and, as a result, Wonder Bread became a food staple for Americans.¹⁹

During World War II, the United States government strongly suggested that Interstate Bakeries Corporation, (“IBC”) enrich Wonder Bread with nutrients otherwise lost in the manufacturing process, and IBC complied.²⁰ One postwar advertisement for the new enriched bread included the slogan: “Builds strong bodies 12 ways!”²¹ The modern version of Wonder white bread is enhanced with nutritional ingredients and qualifies for Women Infant and Children, commonly known as WIC, funding.²² IBC also offers a variety of wheat bread products as well as its traditional white bread.

¹⁷ “The common phrase, ‘the best thing since sliced bread,’ as a way of hyping a new product or invention may have come into use based on an advertising slogan for Wonder Bread, the first commercial manufacturer of pre-wrapped, pre-sliced bread.” <http://www.theatlantic.com/health/archive/2012/02/how-the-phrase-the-best-thing-since-sliced-breadoriginated/252674> (Last visited January 29, 2013).

¹⁸ <http://blogs.smithsonianmag.com/smartnews/2012/11/the-life-and-death-of-wonder-bread/#ixzz2KiAFXHLA> (Last visited January 29, 2013).

¹⁹ Listen to the audio interview for: <http://ttbook.org/book/carolyn-wyman-history-wonder-bread> (Last visited January 29, 2013).

²⁰ <http://ttbook.org/book/carolyn-wyman-history-wonder-bread> (Last visited January 29, 2013).

²¹ *Id.* The “12 Ways” slogan refers to the 12 nutrients that are added to Wonder Bread. “Two slices of Classic Wonder Bread provide the following daily values of vitamins and minerals: 2 percent of vitamin C, 8 percent of riboflavin, 10 percent of vitamin D, thiamine, niacin, folic acid, zinc, iron, vitamin E, vitamins B6 and B12 and 30 percent of calcium. Two slices of Classic Wonder Bread provide the same amount of calcium as an 8 oz. glass of whole milk. Classic Wonder Bread contains nine of the essential vitamins and minerals needed by the body.” Read more: <http://www.livestrong.com/article/291345-wonder-bread-nutritional-information/#ixzz2OqMnwrJO> (Last visited April 23, 2013).

²² WIC is a program that enables women to buy nutritional food at a lower rate similar to the food stamp program. See New York State list of WIC approved foods. http://www.health.ny.gov/prevention/nutrition/wic/acceptable_foods_card.htm (Last visited January 31, 2013). See background on WIC, <http://www.fns.usda.gov/wic> (Last visited January 31, 2013).

The Cake Business

Twinkies

When IBC was founded in 1930 in Kansas City Missouri, shortcakes were typically filled with strawberries during strawberry season.²³ In contrast to this standard practice, IBC's founder, James Dewar, decided to inject his shortcakes with banana crème filling and priced the cakes at two for a nickel.²⁴ Dewar coined the name Twinkie as he was driving down a highway and saw a billboard advertising "Twinkle Toe" shoes that looked a lot like his shortcakes; the Twinkie name was born.²⁵ In 1944, World War II banana rations caused IBC to switch the banana crème filling to the now popular vanilla crème filled Twinkie, and the modern Twinkie had finally come into being.²⁶

Drake's Cakes

According to Famous Foods, a website that documents iconic American foods, "Newman E. Drake baked his first pound cake in Brooklyn in 1888 and sold them by the slice. Drake's popularity grew and the Drake's brand with it, supplying such favorites as Drake's Coffee Cake, Devil Dogs, Yankee Doodles and Ring Dings."²⁷

Baking Inefficiencies

Each of the cake businesses and bread businesses have similar operations. Wheat, flower, sugar and other ingredients go into machines, food comes out, food is packaged, packages are put on trucks and delivered to respective retail, wholesale, or other distribution outlets. However, IBC frequently failed to create a shared-service platform or downsize its redundant operations when it acquired new businesses because of long-standing agreements and contracts of the target-brands that IBC purchased. For this reason, the underpinnings of its first bankruptcy were set in motion: redundant operations, increased costs, and an inability to create synergy through shared services laid the foundation for its financial trouble. That "trouble" is further detailed in Chapter 2, and is referred to throughout this work as, "The First Chapter 11 Bankruptcy."

²³ "Hostess: Makers of Twinkies files for Bankruptcy." Associated Press, January 11, 2012, sources: legal. Available at <http://hosted.ap.org/interactives/2012/hostess/content.swf>. (Last visited January 31, 2013).

²⁴ *Id.*

²⁵ *Id.*

²⁶ The banana rationing was immortalized in the popular World War II song "Yes We Have No Banana's." Once "[Hostess] switched to vanilla crème[,] it was popular so [Hostess] never changed back." <http://www.kitchenproject.com/history/twinkie.htm>. (Last visited January 31, 2013).

²⁷ <http://www.famousfoods.com/drakes.html>. (Last visited January 31, 2013).

Chapter 2: The First Chapter 11 Bankruptcy (2004-2009)

Filing for Bankruptcy

On September 22, 2004, IBC and its subsidiaries filed petitions for relief under Chapter 11 of the Bankruptcy Code on September 22, 2004 in the Western District of Missouri.²⁸ At the time, IBC was one of the largest bakers and distributors in the United States employing approximately 25,000 employees. IBC operated 45 bakeries and over 800 distribution centers. IBC, headquartered in Kansas City, Missouri, included the following companies: Butternut Bakeries, Colombo Bakery, Continental Baking Company, Cotton's Holsum Bakeries, Di Carlo Bakery, Dolly Madison Bakery, Drake's Bakery, Eddy's Bakery, Holsum Bakery, Hostess Bakeries, Interstate Brands Companies, Interstate Brands West Corporation, J.J. Nissen Bakery, Merita Bakeries, My Bread Bakery, San Francisco French Bread Company, Sunbeam Bakery, Weber's Bread, Wonder Bakeries, and Wonder/Hostess Bakeries.

Throughout the bankruptcy, presided over by the Honorable Jerry W. Venters,²⁹ IBC was represented by attorneys from both Kasowitz Benson Torres & Friedman LLP and Skadden, Arps, Slate, Meagher & Flom LLP.³⁰ Kurtzman Carson Consultants served as the claims agent, the Creditors Committee was chaired by Hadn Automotive Warehouse, and the Official Committee of Unsecured Creditors was headed by Kutak Rock, LLP.

²⁸ Voluntary Petition. Interstate Bakeries Corporation, Docket No. 4:04-bk-45814 (Bankr. W.D. Mo. Sept 22, 2004).

²⁹ Judge Venters, originally from Bentonville, Arkansas, received his juris doctorate degree from the University of Missouri Law School. His professional career includes time as a reporter for the St. Louis Post-Dispatch, a Missouri Supreme Court Information Officer, and an attorney in private practice in Jefferson City, Arkansas. He was appointed as a bankruptcy judge in 1999 to the Western District of Missouri, and he served as the Chief Bankruptcy Judge of that district from 2004 to 2008. <http://www.mow.uscourts.gov/judges/venters.html> (Last visited April 24, 2013).

³⁰ See Application for Order Under 11 U.S.C. §§ 327(a) and 329, Authorizing Employment and Retention of Skadden, Arps, Slate, Meagher & Flom LLP and affiliates as attorneys for Debtors-In-Possession. <http://www.kasowitz.com/> (Last visited April 24, 2013); <http://www.skadden.com/> (Last visited April 24, 2013). Kasowitz Benson Torres & Friedman LLP is a nationally known firm with 375 lawyers and offices in New York, Houston, Atlanta, San Francisco, Miami, Silicon Valley and Newark. The firm specializes in complex commercial litigation. Skadden, Arps, Slate, Meagher & Flom was established in 1948 and currently has 23 offices around the world. In April 2013, Skadden ranked first as Principal Counsel for M&A transactions by value according to *The American Lawyer's* annual "Corporate Scorecard."

20 Largest Unsecured Creditors³¹

IBC's twenty largest unsecured creditors during the 2004 bankruptcy and those creditors' respective claims are as follows:

Highbridge International LLC	Convertible Note	\$35,000,000
Isotope Limited	Convertible Note	\$35,000,000
AG Offshore	Convertible Note	\$10,500,000
Shepherd Investments Int. LTD	Convertible Note	\$10,500,000
Cereal Foods	Trade	\$8,642,221
Stark Trading	Convertible Note	\$5,000,000
Horizon Milling	Trade	\$4,850,750
AG Domestic	Convertible Note	\$4,500,000
ADM	Trade	\$4,109,900
Cargill	Trade	\$3,644,723
Campbell-Mithun	Trade	\$3,640,175
Con Agra Flour	Trade	\$3,354,662
Innovative Cereal Systems	Trade	\$2,572,971
Bartlett Milling	Trade	\$2,572,971
Accenture	Trade	\$2,017,614
American Yeast	Trade	\$1,727,646
Fleischmann's Yeast	Trade	\$1,612,565
Bunge Foods	Trade	\$1,545,193
General Mills Inc.	Trade	\$1,512,407

First Day Motions and Other Filings

At the beginning of the case, following the petition, IBC filed a Notice of Designation as a Complex Chapter 11 Bankruptcy Case³² and a request to jointly administer all of the subsidiary bankruptcies in one case.³³ The docket for the 2004 bankruptcy would eventually include 12,734 filings before it was concluded.³⁴ Additionally, IBC filed several first day motions, which were

³¹ See 20 Largest Unsecured Creditors.

³² See Notice of Designation as Complex Chapter 11 Bankruptcy Case. Local Rule 1002-2 defines when and how a case can be designated as complex case. Complex cases require special scheduling and other procedures.

³³ See Application for an Order Requesting Joint Administration of Cases.

³⁴ See docket. An interesting aside—IBC's 2004 bankruptcy was filed prior to the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which applies to bankruptcy cases filed after October 17, 2005. BAPCPA introduced deadlines and requirements that were not in place previously,

necessary to keep the business operating under Chapter 11.³⁵ The court approved each of the following motions:

1. Emergency motion for order under 11 U.S.C. §§ 345, 363, 1107 and 1108 authorizing the continued use of existing bank accounts, business forms and checks, and cash management systems, continuation of intercompany transactions, and waiver of the investments and deposit requirements of 11 U.S.C. § 345(B);³⁶
2. Emergency motion for order under 11 U.S.C. §§ 105, 363, 364, and 549 for authorization to honor certain prepetition obligations to customers and continue customer programs;³⁷
3. Emergency motion for order authorizing but not requiring [IBC] to pay prepetition wages, salaries, and benefits and to honor benefit and compensation obligations as well as confirm that [IBC is] able to pay federal and state withholding and payroll taxes, and authorizing banks to honor prepetition checks for payment of [IBC's] prepetition employee obligations (A Bridge Order was issued September 22, 2004);³⁸
4. Motion for order under 11 U.S.C. §§ 363, 507 and 541 confirming authority to pay prepetition sales and use taxes;³⁹
5. Motion for order under 11 U.S. C. §§ 362, 365, 366, 503(b) and 507(a)(1) prohibiting utilities from altering, refusing, or discontinuing services on account of prepetition claims, establishing procedures for additional adequate assurance, and waiving the requirement of local rule 2015-2A;⁴⁰
6. Emergency motion for order under 11 U.S.C. §§ 105, 363(b), 506, and 546(b) authorizing payment of certain prepetition shipping charges;⁴¹
7. Emergency motion for interim and final orders authorizing [IBC] to obtain postpetition financing pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364(c)(1), 364(c)(2), 364(c)(3),

and had IBC's bankruptcy been filed after the enactment of BAPCPA, it could have significantly altered the process and the ultimate outcome.

³⁵ First day motions will be discussed in more detail in Chapter 5.

³⁶ See Emergency Motion for Order Authorizing Continued Use.

³⁷ See Emergency Motion for Order Authorizing The Debtors to Honor Certain Prepetition Obligations to Customers and to Continue Other Customer Programs.

³⁸ See Bridge Order (I) Authorizing But Not Requiring Debtors to (A) Pay Prepetition Wages.

³⁹ See Motion for Order Confirming Authority to Pay Prepetition Sales and Use Taxes.

⁴⁰ See Emergency Motion for Order Prohibiting Utilities From Altering.

⁴¹ See Emergency Motion for Order Authorizing Payment of Certain Prepetition Shipping Charges.

364(d)(1), and 503(b)(1), and utilize cash collateral pursuant to 11 U.S.C. § 3363 (A) Bridge Order was issued September 22, 2004), granting adequate protection to prepetition secured parties pursuant to 11 U.S.C. §§ 361, 362, and 363, and scheduling final hearing.⁴²

Through these motions, IBC was attempting to set the company up for a recovery and reorganization through a Chapter 11 plan.

Why IBC Filed for Chapter 11 in 2004

IBC blamed its 2004 bankruptcy filing on liquidity issues, declining sales, a high fixed-cost structure, rising employee healthcare and pension costs, and increased costs for ingredients and energy.

IBC's liquidity issues were mainly the result of its staggering debt burden—approximately \$860 million worth. The interest payments alone were crippling.⁴³ This massive debt load was the result of two major purchases by the company that were financed largely through loans. First, IBC purchased one of its largest competitors, the Continental Baking Company, for over \$330 million in 1995 followed by several other smaller acquisitions later in the 1990s. These purchases doubled the company's production facilities and employees, but they also significantly increased IBC's debt ratio.⁴⁴ Additionally, in the early 2000s, IBC bought back large amounts of its own stock, which further increased its debt as the company was essentially taking out a loan to buy back its own stock.

Because IBC grew through a series of mergers and acquisitions the company inherited various compensation and pension plans. The duplicitous activities led to a lack of synergy in corporate operations. For example, a bread-delivery truck and its respective worker, would deliver certain goods to one location, but that same worker was unable to also drop off cakes and other non-bread items because of grandfathered-in labor agreements. Ultimately, as part of its reorganization during the 2004 bankruptcy, IBC shut down 21 production facilities and cut its 35,000-employee workforce to approximately 18,000. Not even these reductions, however, balanced the costs of employee wages and benefits IBC's liabilities nor did they create a significantly improve IBC's operational efficiency.

⁴² Pursuant to Fed. R. Bankr. P. 2002, 4001 and 9014.

⁴³ *Id.*

⁴⁴ See http://www.huffingtonpost.com/david-macaray/labor-union-hostess-twinkies_b_2161368.html. (last visited April 5, 2013); <http://www.thefreelibrary.com/Interstate+Bakeries+Corp.+to+purchase+Continental+Baking+Co.-a015999739> (last visited April 20, 2013).

When energy prices and ingredients costs for flour and sugar rose in the late 1990s and early 2000s, they added further stress on the overleveraged and procedurally inefficient company.

When IBC filed bankruptcy in 2004, its share price fell from \$34/share to \$2.05/share. While nine of the company's 54 bakeries and more than 300 outlet stores closed during the bankruptcy, the company continued to operate as a debtor-in-possession.⁴⁵

IBC's 2004 bankruptcy brought to light several internal issues within the company. One incident involved Paul Yarick, IBC's Vice President and Treasurer from 1978 to 2004, who faced more than \$100 million in breach-of-duty and misconduct claims. The Securities and Exchange Commission brought charges against Mr. Yarick⁴⁶ based on his reported negligence that caused IBC to understate its workers compensation reserves by at least \$30 million. IBC indemnified Yarick and paid legal fees totaling \$56 million to defend him against these claims. The trustee in the 2004 bankruptcy case eventually paid these legal fees so that IBC could move forward with its reorganization plan. This incident was just one of the occasions that led the SEC to voice concerns about the accuracy of IBC's financial statements.⁴⁷

On November 2, 2004, several equity holders, known collectively in their motion⁴⁸ as "the Ad hoc Equity Committee"⁴⁹ filed a motion to request that the U.S. Trustee appoint an official committee of equity security holders.⁵⁰ The committee requested the appointment "to ensure the integrity of the bankruptcy process for shareholders and to assure their adequate representation..."⁵¹ In their motion, the committee claimed that IBC closed a private placement of \$100 million of senior subordinated convertible notes with a conversion price of \$10.10 per

⁴⁵ See <http://www.cspnet.com/news/snacks-and-candy/articles/court-confirms-interstate-bakeries-reorgplan>. (Last visited February 15, 2013).

⁴⁶ Complaint Cause No. 06-1029-CV-W-REL; Company's Payment on Officer's Behalf Isn't a 'Loss', U.S. Bank Nat'l Ass'n v. Fed. Ins. Co., 7 No. 13 WJNKR 9, October 29, 2010.

⁴⁷ See SEC Administrative Proceeding File No. 3-12515.

⁴⁸ Motion for the Appointment of An Official Committee of Equity Security Holders. The "Ad hoc Equity Committee" was comprised of the following equity holders: QVT Financial LP, Atticus Capital LLC, The Capital Group Companies, Sagamore Hills Capital Management, L.P., EagleRock Capital Management, LLC, Fidelity Management & Research Company, Gruss Asset Management L.P., Brandes Investment Partners, and Lampe, Conway & Company LLC.

⁴⁹ An ad hoc committee is a "Committee formed for a specific task or objective, and dissolved after the completion of the task or achievement of the objective." <http://www.businessdictionary.com/definition/ad-hoc-committee.html> (Last visited April 24, 2013).

⁵⁰ This action is allowed pursuant to 11 U.S.C. § 1102(a)(2).

⁵¹ See Motion for the Appointment of An Official Committee of Equity Security Holders.

share just 40 days before IBC declared bankruptcy. This stock price represented a 34.75% premium over the current stock price of \$7.50 per share, which would therefore imply an equity value of \$340 million dollars.⁵² The committee was very concerned that information that was being published to the shareholders was not an accurate representation of the actual financial standing of the company. Therefore, the equity holders felt that it needed to form an official committee because if there was equity in the company, it would need some form of protection from the actions of the current management and board of directors. The court granted the motion, saying that “[i]t is difficult to imagine a case more suited for the appointment of an official committee...”⁵³

A Target for Purchase

Potential buyers approached IBC throughout its 2004 bankruptcy. While IBC never expressly put itself up on an auction block, the company could not ignore the possibility that it was not strong enough to successfully reorganize and that a plausible outcome was a sale of the company. As evidenced by the language in several motions and court documents, both IBC and the court considered the possibility of a sale, however, IBC’s actions indicate it was not seeking such an outcome.⁵⁴ For example, Bimbo Bakeries USA, the U.S. division of the Mexican baking conglomerate Grupo Bimbo, which is one of the largest bakeries in the world, expressed interest in buying IBC. IBC, however, rejected their \$580 million offer, and after conducting further due diligence, Bimbo Bakeries USA indicated it would not increase its offer.⁵⁵ In addition to Grupo Bimbo’s interest, IBT along with Yucaipa Companies, a private equities holding company, also made a bid of \$580 million for IBC during the bankruptcy, but IBC rejected their offer as well.⁵⁶

There is some indication that IBC never seriously considered any of the potential purchasers’ bids. Indeed, IBC ultimately refused the offer from Yucaipa and IBT after citing a “lack of substance” in how they would reorganize the company.⁵⁷ At one point, Judge Venters

⁵² *Id.*

⁵³ *Id.*

⁵⁴ <http://www.zerohedge.com/news/2012-11-16/hostess-liquidation-curious-cast-characters-twinkietumbles> (Last visited April 5, 2013).

⁵⁵ See http://www.bakenet.eu/tiki-read_article.php?articleId=410. (Last visited February 28, 2013).

⁵⁶ See <http://www.kansascityfrontpage.com/KC-Business121607.htm>. See also Disclosure Statement with Respect to First Amended Joint Plan of Reorganization. Interstate Bakeries Corporation (IBC) (OTC:IBCIQ) have confirmed that it received a preliminary indication of interest from The Yucaipa Companies, LLC and The International Brotherhood of Teamsters describing a "possible plan of reorganization" for emergence of IBC from Chapter 11.

⁵⁷ See also <http://theunionnews.blogspot.com/2007/12/bankruptcy-judge-tilts-to-clinton-crony.html>. (Last visited February 28, 2013).

expressed frustration with IBC over its demand for details from potential purchasers when he stated that “[IBC was] in no position to complain about the absence of bids or proposals at this juncture, and they are certainly in no position to demand that potential bidders be put under an expedited and totally unreasonable deadline because of their frustrations with [IBT].”⁵⁸

On balance, selling IBC in 2008 for \$580 million could have been a good business decision, but then again, it might have been a bad one. There is also always a human element to every deal and those making the business decisions for IBC in 2008 did not have the benefit of hindsight. For whatever reason, IBC ultimately requested that the bankruptcy court approve its own reorganization plan over more than 30 different objections rather than sell the company. Those objections came primarily from unions, who did not want to alter or grant concessions to IBC in their collective bargaining agreements (“CBAs”). Ironically, if management had sold the company to a competitor, many of those arguments would be moot if the current workforce’s CBAs were not a part of the deal. Moreover, by proceeding out of bankruptcy, IBC workers had a place in factory lines at least for the foreseeable future and potentially indefinitely if IBC’s reorganization plan had successfully restructured the company into a profitable operation.

The Reorganization Plan

The plan of reorganization was confirmed on December 5, 2008⁵⁹ and became effective on February 3, 2009 after multiple extensions were requested both on the presentment of and the effective date for the plan of reorganization. On October 4, 2008, IBC filed an amended Plan of Reorganization and related Disclosure Statement with the U.S. Bankruptcy Court for the Western District of Missouri on October 4, 2008.⁶⁰ According to Business Wire, “[t]he filing of the Plan of Reorganization and related Disclosure Statement was made in connection with the plan funding commitments, announced on September 12, 2008, from an affiliate of Ripplewood Holdings L.L.C.[,] Silver Point Finance, LLC, and Monarch Master Funding Ltd.”⁶¹

⁵⁸ See <http://theunionnews.blogspot.com/2007/12/bankruptcy-judge-tilts-to-clinton-crony.html>. (Last visited February 28, 2013).

⁵⁹ See <http://www.cspnet.com/news/snacks-and-candy/articles/court-confirms-interstate-bakeries-reorgplan>. (Last visited February 14, 2013). The court found that the company had met the statutory requirements necessary to confirm the plan.

⁶⁰ See Joint Plan of Reorganization of Interstate Bakeries Corporation and Its Affiliated Debtors and Debtors-in-Possession Dated October 4, 2008. See also Disclosure Statement with Respect to Joint Plan of Reorganization of Interstate Bakeries Corporation and Its Affiliated Debtors and Debtors-In-Possession Dated October 4, 2008.

⁶¹ See <http://www.businesswire.com/news/home/20081006005959/en/Interstate-Bakeries-Files-Amended-Plan-Reorganization-Disclosure>. (Last visited February 15, 2013).

Indeed, IBC emerged from this first bankruptcy thanks almost entirely to a heavy infusion of financing and some not insubstantial concessions from the unions on wages and benefits. It did not, however, address most of the underlying problems that led to the bankruptcy filing in the first place, such as overly complicated work rules, flagging sales, and a now even further leveraged capital structure.

The financing that IBC had secured came from the following investors:⁶²

- IBC Investors I LLC, an affiliate of the private equity firm, Ripplewood Holdings LLC provided \$130 million, \$44.2 million for 4.42 million shares of IBC stock and \$85.8 million in new fourth-lien convertible secured notes. Ripplewood, LLC received control of the company (two-thirds of the equity) in exchange for its investment.
- General Electric Capital Corp. and GE Capital Markets provided \$125 million in a revolving loan.
- Silver Point Finance LLC⁶³ and Monarch Master Funding Ltd.⁶⁴ provided \$344 million as a term loan-secured credit facility.

Both before and after this infusion of capital, IBC's two largest secured lenders were Silver Point and Monarch. Silver Point, Monarch, and around 20 other lenders owned approximately \$450 million of the secured debt at the time of the filing in 2004. These companies forgave approximately half of this debt and exchanged the other half—\$225 million—for payment-in-kind loans.⁶⁵

One issue that plagued the IBC bankruptcy was the identification of 350 parties that were potential preference⁶⁶ targets. These preference claims against prepetition creditors were valued

⁶³ See <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited February 14, 2013).

⁶⁴ See <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited February 14, 2013).

⁶⁵ A payment-in-kind loan, sometimes referred to as a “PIK-note,” is a high-risk financing instrument that does not require the borrower to pay principle or interest to the lender between the drawdown date and the maturity date. See <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited February 14, 2013).

⁶⁶ A preference action is an action brought by the Trustee of a bankruptcy estate to recover payments made by the debtor to a creditor, in an amount greater than the creditor would receive in a Chapter 7 case, within 90 days prior to the filing of a bankruptcy petition or within one year if the creditor is considered an insider. See <http://definitions.uslegal.com/p/preference-action-bankruptcy/>. (Last visited March 19, 2009).

at over \$250 million dollars. IBC did not want to spend the money and resources to prosecute these preference claims. Additionally, in hopes of reorganization, IBC did not want to sue several of its critical vendors or trade creditors that were providing post-petition credit or who provided goods or services that were necessary for the continuation of operations.⁶⁷ To preserve their right to later pursue these funds, however, IBC had entered into tolling agreements with these prepetition preference creditors.⁶⁸

Labor contracts and labor costs were also a major issue in the reorganization of IBC. Future funding was dependent on the modification and acceptance of collective bargaining agreements.⁶⁹ Concessions on the part of 423 labor unions totaling about \$110 million allowed settlement agreements to be reached in support of the plan of reorganization. The Teamsters Bakery and Laundry Conference,⁷⁰ part of IBT,⁷¹ attempted negotiations with IBC, who at the time was the largest employer of Teamsters in the industry. Concessions aimed at keeping more than 9,000 jobs were negotiated and memorialized in the comprehensive IBC-IBT Modification Agreement, which contained the following provisions:

- Hourly employee wages were reduced by \$10.00 per week;
- Base pay for commission employees was reduced by \$110.00 per week;
- All employees shared in a Teamsters Equity Sharing Plan and received 7% of the IBC's total equity;
- IBC would establish a Profit Sharing Program for all union-represented, hourly paid, or non-exempt employees, of 10% of its net income;
- Health benefits would be adjusted to include:
 - A higher co-pay for prescription drugs;

⁶⁷ Bruce S. Nathan and Scott Cargill, Putting Preference Claims on Hold in the Wonder® Hostess® Chapter 11, 11 ABIJ 18 (December 2006).

⁶⁸ A tolling agreement is a contract between the debtor and the preference creditor where the creditor agrees that the, in this case, 2 year statute of limitations would be tolled and that the creditor would not raise the statute of limitations as a defense to a later lawsuit.

⁶⁹ See <http://www.cspnet.com/news/snacks-and-candy/articles/court-confirms-interstate-bakeries-reorgplan>. (Last visited February 15, 2013).

⁷⁰ Letter to Teamster members employed by Interstate Bakeries Corporation from Richard Volpe, Director, Bakery and Laundry Conference. See <http://www.ibtbakerylaundry.org/index.cfm>. (Last visited April 24, 2013).

⁷¹ 18,000 of the approximately 22,000 IBC employees were part of the International Brotherhood of Teamsters and bakery and Confectionery Works International Union of America. Leading up to this bankruptcy and the recovery, approximately 10,000 employees lost their jobs.

- An additional \$10 per week co-pay contribution for employees in the IBC Cigna Plan;
- An additional \$30 per week co-pay contribution for employees in the Taft-Hartley health and welfare plans;
- Re-entry into southern California, northern Washington, and Michigan bread markets would be considered by management and work previously performed by IBT workers will once again be assigned to IBT members;
- IBC maintained the right to convert transport hourly rates to trip rates (in other words, drivers could be paid either by the trip or by the hour); and
- Commissions due on the Dolly Direct Program (one of the incentive programs being offered to the unions) would terminate January 1, 2008.

In keeping with the absolute priority rule, because unsecured creditors were not paid in full, IBC's shareholders lost everything (their investment and any potential profits) in the reorganization. IBC cancelled all of its publicly traded shares as part of its conversion into a privately held company.⁷² As part of the reorganization, 60,000,000 shares of new common stock were authorized.⁷³ Of those 60 million shares, 4,420,000 were issued to the Term Loan Facility Lenders and another 4,420,000 were issued to equity investors.

Four and a half years after its initial filing, the bankruptcy case finally ended on February 3, 2009.⁷⁴ As part of its exit from bankruptcy, IBC became a privately held company under the direction of Craig Jung as its CEO. Eventually, the first bankruptcy case became officially "closed" as part of the second bankruptcy proceedings that are detailed in Part II of this work.⁷⁵

⁷² See Terms of New Common Stock.

⁷³ See Docket #11716; Exhibit F.

⁷⁴ Technically, the 2004 case remains pending in the United States Bankruptcy Court for the Western District of Missouri under jointly administered case number 04-45814. See Business Courier, February 4, 2009, IBC emerges from bankruptcy, <http://www.bizjournals.com/cincinnati/stories/2009/02/02/daily31.html>. (Last visited February 14, 2013). The timing of the ending of the case was extremely important because the debtor-in-possession financing was set to expire on February 9, 2009.

⁷⁵ See Docket #12734. Document unavailable from Bloomberg Law.

Part II: The 2012, Second Bankruptcy

Chapter 3: Lead up to “Chapter 22” Bankruptcy Filing

After wrapping up the 2004 bankruptcy, IBC changed its name to Hostess Brands, Inc. (“Hostess”) and attempted to reinvent itself. Hostess, however, was still plagued⁷⁶ by poor management, weak sales, an enormous debt burden, and unresolved labor issues. Together, this combination would prove too much to bear and eventually led to a second bankruptcy in 2012. Throughout the lead up to and through the second bankruptcy, management, the unions, the workers, and commentators spent a lot of time blaming one group or another. As Chief Executive Gregory Rayburn, a turnaround expert, was quoted as saying, however, “I think there’s blame to go around everywhere.”⁷⁷

Poor Management Decisions

While many commentators have accredited Hostess’s troubles on poor management decision-making, a somewhat more substantial assessment can be made by looking at some of the decisions that have been made by management since the 1930s. Hostess had grown its enterprise by merging with or buying competitors for the past 80 years. By 2009, this expansion scheme had left Hostess with 372 separate bargaining contracts for workers, 5,500 delivery routes, and a vast production system.⁷⁸ It therefore seems that throughout that time Hostess’s management had failed to consolidate its expansions or restructure its operations into a more efficient and effective organization.

It is important to remember in assessing the performance of Hostess’s management that the individuals in management positions were constantly changing.⁷⁹ Changes in upper level management typically involve a loss of time and money as a side effect. This loss occurs because when each successive manager comes into a company, the company loses forward

⁷⁶ See <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited February 14, 2013).

⁷⁷ See <http://online.wsj.com/article/SB10001424127887324556304578122632560842670.html>. (Last visited March 17, 2013).

⁷⁸ See <http://online.wsj.com/article/SB10001424127887324556304578122632560842670.html>. (Last visited March 17, 2013).

⁷⁹ For example, Hostess/IBC has had six different CEOs since 2002. These six CEOs are as follows: Charles Sullivan from 1989 to 2002, James Elsesser from 2002 to 2004, Tony Alvarez from 2004 to 2007, Craig Jung from 2007 to 2010, Brian Driscoll from 2010 to 2012, and Greg Rayburn from 2012 to liquidation in 2013. See http://www.nxtbook.com/sosland/mbn/2012_03_20/index.php?startid=9. (Last visited April 24, 2013).

momentum, as they have to be brought up to speed on operations and typically change methodologies and practices to suit their own styles.

As Hostess transitioned out of its 2004 bankruptcy in 2009, there were changes to the board of directors. John Cahill and Greg Murphy, two shareholders of Ripplewood, LLC, were granted seats on the new board; Cahill was named Chairman and Murphy was named Vice Chairman. The other members of the board included Craig Jung, Michael Duran, Chris Minnetian, Scott Speilvogel, David Reganato, and Andrew J. Herenstein.⁸⁰ In June of 2010, CEO Craig Jung left Hostess and was replaced by Brian Driscoll as the company's top officer.

Hostess also experienced significant attrition in the management ranks throughout its second Chapter 11 case. In March 2012, Kent Magill, Executive Vice President, General Counsel and Corporate Secretary for the Debtors, resigned from his position. In April 2012, David Loeser, Executive Vice President of Human Resources for the Debtors, resigned from his position. In May 2012, Gary Wandschneider, Executive Vice President of Operations for the Debtors, took a leave of absence. Then, as the writing on the wall became clear in September 2012, the following executives resigned: Steven Birgfeld, Senior Vice President and Chief Information Officer for the Debtors; Martha Ross, Senior Vice President, Controller & Corporate Audit; Leonard Singer, Senior Vice President and Assistant General Counsel; and Christopher Knipp, Senior Vice President of Corporate Human Resources. In each case, no new executives were hired, and the slack that remained as each of these individuals left had to be picked up by existing Hostess employees or third-party consultants.⁸¹

Perhaps the most vocal critics of Hostess's management were the unions, officials, and workers alike. In particular, the unions criticized management for not investing in the brand itself; for failing to modernize the plants;⁸² and for not servicing and replacing delivery trucks. In an official statement, IBT's Secretary-Treasurer, Ken Hall pronounced,

Hostess'[s] problems go back almost a decade. The company has clearly been mismanaged for quite some time. However, the workers should not suffer because of poor management and therefore, [IBT] tried everything in its power during the company's most recent financial difficulties to shape an outcome that would put Hostess on strong footing to be viable and preserve jobs.⁸³

⁸⁰ See Reorganization Plan. Craig Jung, CEO of Hostess; Michael Duran, a veteran private equity investor; Chris Minnetian, Managing Director and General Counsel, Ripplewood Holding; Scott Speilvogel, co-founder and Managing Partner of One Rock Capital Partners, LLC; David Reganato, Director at Hostess; and Andrew Herenstein, Managing Principal of Monarch Alternative Capital.

⁸¹ Disclosure_Statement_with_Reorganization_Plan.pdf, p. 29.

⁸² Management listed "aging infrastructure" as a reason for the bankruptcy in the Disclosure Statement.

⁸³ See <http://www.teamster.org/content/teamsters-statement-hostess-brands%E2%80%99-announcementcease>. (Last visited February 28, 2013).

Contrary to Mr. Hall's statement, however, Hostess's problems had been building for longer than just a decade. For the past 30 plus years Hostess had continued expanding while letting its operational and financial situation coast and without taking a hard look at how things could be more efficiently structured. In 1981, a computer leasing firm, DPF, had sold parts of the company and moved the headquarters to Kansas City.⁸⁴ Then in 1986, Purity Baking Company and Stewart Sandwiches were acquired. In 1987, the company acquired Landshire Food Products and went private before changing its name to IBC Holdings and buying the Merita/Cotton's Bakeries division of the American Bakeries Company. So, over the course of one decade, the company made significant changes through acquisitions, which expanded the company's geographic reach, overall size, number of brands, revenue, and costs. These changes, however, came without an accompanying adequate consolidation to infrastructure, union contracts, and operational processes. Later, in 1991, the company became public once again. At that time the company incurred the costs and responsibilities of being a publically traded company but again failed to effectively restructure its operations. Each of IBC's mergers grew the company, but many also brought an increase in debt and operational costs.

Weak Sales, Increased Costs, Poor Financial Performance

After the 2004 bankruptcy, Hostess, as a private company, was not required to file annual or quarterly reports with the SEC.⁸⁵ The information below on its financials, however, has been gathered from the company website and other news stories.

In 2008, IBC's revenue declined by 3.4% to \$2.8 billion from the previous year; the company posted a \$144 million dollar loss. Sales continued to drop by a modest 2% in 2009⁸⁶ just as IBC, now Hostess, came out of its first bankruptcy. Unfortunately, its exit from bankruptcy came during the recession of 2009 and 2010. Weak sales hit the fragile company hard. During the next three years, Hostess recorded sales of approximately \$2.5 billion each year.⁸⁷ For the 2010 fiscal year,⁸⁸ however, Hostess experienced a net loss of \$138 million, and

⁸⁴ One has to wonder why a computer leasing firm was running one of the nation's largest bakeries. *See* <http://www.fundinguniverse.com/company-histories/interstate-bakeries-corporation-history/>.

⁸⁵ While Hostess does not have to file reports with the SEC, according to the terms and conditions of debt agreements, the company is supposed to prepare audited financial statements. The last audited statements filed were for 2010. *See* <http://www.forbes.com/sites/quora/2012/11/21/did-hostess-go-bankrupt-in-2012-because-people-no-longer-find-twinkies-appealing/>. (Last visited March 17, 2013).

⁸⁶ *See* http://www.cbsnews.com/8301-505123_162-44040139/turning-around-twinkies-the-biggestmarketing-challenge-in-food-today/. (Last visited March 17, 2013).

⁸⁷ Net revenues for Hostess during those years are as follows: \$2.467 billion for the 53 Weeks ending on June 2, 2012; \$2.474 billion for the 52 Weeks ending May 28, 2011; and \$2.585 billion for the 52 Weeks ending on May 29, 2010. *See* Hostess Disclosure Statement. *See also*

by late 2011, sales were down almost 11% from 2008 and 28% from 2004 as Hostess posted a loss of \$341 million in fiscal 2011.⁸⁹

Weak sales were in part blamed on a change in consumer eating habits. American eating norms no longer considered it acceptable for a consumer to eat a snack cake that contained 180 calories, 6 grams of fat, 30 grams of carbohydrates, and 270 milligrams of sodium (one Hostess cupcake)⁹⁰ or a snack cake that contains 150 calories, 4.5 grams of fat, 27 grams of carbohydrates, and 220 milligrams of sodium (one Hostess Twinkie).⁹¹ Unfortunately for the ailing company, however, the Hostess name had become synonymous with sugary, sweet, snack cakes.⁹²

Add this general change in eating habits of US consumers to campaigns against childhood obesity, such as *Let's Move* sponsored by First Lady Michelle Obama, and it becomes clear that Hostess was fighting an uphill battle for sales of its most popular food items.⁹³ Despite this influence, however, sales of Twinkies alone still totaled \$68 million in November 2012.⁹⁴

<http://www.forbes.com/sites/quora/2012/11/21/did-hostess-go-bankrupt-in-2012-because-people-no-longer-find-twinkies-appealing/>. (Last visited March 17, 2013).

⁸⁸ A fiscal year is the twelve-month period used by companies for accounting purposes in issuing financial statements that do not necessarily correspond to a calendar year. Hostess Brands, Inc.'s fiscal years begin on June 1 and end on May 31.

⁸⁹ In 2011, Hostess had \$132 million in write-off of deferred debt issuance costs and debt discount.

⁹⁰ See <http://www.ichange.com/nutrition/how-many-calories-in/hostess-cupcake-individually-wrapped>. (Last visited March 17, 2013).

⁹¹ See http://www.calorieking.com/foods/calories-in-cakes-twinkies-golden-sponge-cake-with-creamy-filling_f-ZmlkPTc4MzM2.html.

⁹² See http://www.cbsnews.com/8301-505123_162-44040139/turning-around-twinkies-the-biggest-marketing-challenge-in-food-today/. (Last visited March 17, 2013). The association of the Hostess name with unhealthy snack foods that would plagued the company is somewhat ironic given the fact that IBC had changed its name to Hostess after the first bankruptcy specifically because it wanted to be more closely identified with those snack cake products.

⁹³ See http://www.cbsnews.com/8301-505123_162-44040139/turning-around-twinkies-the-biggestmarketing-challenge-in-food-today/. (Last visited March 17, 2013). See also <http://www.nytimes.com/2010/02/10/health/nutrition/10obesity.html> (Last visited April 24, 2013); <http://www.leadershipforhealthycommunities.org/index.php/first-lady-kicks-off-campaign-against-childhoodobesity-hiddenmenu-207> (Last visited April 24, 2013); <http://www.bostonglobe.com/business/2013/02/28/first-lady-anti-obesity-campaign-prompts-change/QPmben9tTDe8JklwAYWD1N/story.html>. (Last visited March 17, 2013).

⁹⁴ See http://www.cbsnews.com/8301-505123_162-57552335/hope-for-twinkies-as-hostess-union-go-tomediation. (Last visited March 17, 2013).

The Debt Burden

Hostess was under immense pressure due to its interest obligations even after Silver Point and Monarch had forgiven almost half of its debt in 2009. By early 2012, its debt measured approximately \$860 million.⁹⁵ Ripplewood, Silver Point, and Monarch had provided additional cash—\$40 million in the spring of 2011, and another \$30 million more in August of 2012—in hopes of keeping the company afloat long enough to negotiate a turn-around. In investing additional funds, Ripplewood was taking large risks by subordinating its debt to Monarch and Silver Point in exchange for additional equity in Hostess. Essentially, Ripplewood was doubling down on Hostess’s survival. Without a major change to operations that either increased Hostess’s revenues or a decreased its costs, however, this money merely prolonged Hostess’s existence without increasing its chances of recovery.

Unions and Pensions

During the 2004 bankruptcy, the unions made steep concessions that saved the company \$80 to \$100 million dollars a year.⁹⁶ Despite these concessions, many other underlying issues were not resolved between the unions and Hostess. Those issues resulted in financial repercussions that would be felt in the months preceding the second Chapter 11 filing in 2012.

Hostess participated in 40 multiemployer pension plans.⁹⁷ Unfortunately, many of the other employer companies that had also been paying into the plans had stopped supporting the plans either by choice or by closing their doors. The failure of other companies to pay into the plans put an increased burden on Hostess to contribute in order to keep the plans solvent. Annual contributions by Hostess to these plans equaled approximately \$103 million, a figure that does not include annual retiree medical obligations of approximately \$1.4 million. Eventually, this burden proved too much for Hostess to bear, and in August 2011, it stopped paying into

⁹⁵ There are significant discrepancies about the actual amount of the debt, but most reports place it somewhere between \$700 and \$900 million. See e.g. <http://online.wsj.com/article/SB10001424127887324556304578122632560842670.html#>. (Last visited March 17, 2013).

⁹⁶ See <http://online.wsj.com/article/SB10001424127887324556304578122632560842670.html>. (Last visited March 17, 2013).

⁹⁷ See <http://www.forbes.com/sites/quora/2012/11/21/did-hostess-go-bankrupt-in-2012-because-people-no-longer-find-twinkies-appealing/> (Last visited April 24, 2013). A multiemployer plan is “an employee benefit plan maintained under one or more collective bargaining agreements to which more than one employer contributes. These collective bargaining agreements typically involve one or more local unions that are part of the same national or international labor union and more than one employer.” See <http://www.ifebp.org/IFEBP/Templates/Open.aspx?NRMODE=Published&NRNODEGUID=%7bc99582e7-3b35-465d-ae14-f58df992d4e0%7d&NRORIGINALURL=%2fNews%2ffeaturedTopics%2fMultiemployer%2f&NRCACHEHINT=NoModifyGuest#1>. (Last visited March 17, 2013).

pension benefits altogether.⁹⁸ Not only was this cessation of payment a concern to the employees whose pension plans were not being funded, but non-payment also represented a breach of contract with the unions. Hostess attempted to use a DIP's bankruptcy power in breaking the contracts to avoid additional legal issues including damages, but this maneuver did nothing to improve relations with the workers who only saw that the company was reneging on the deal.⁹⁹

Hostess was a party to 372 separate [CBAs] with various union workers. Some of the requirements of these agreements included health and welfare benefits, increases in wages, and other benefits for the employees. Additionally, the agreements included different work schedules and rules for different workers.¹⁰⁰ For example, the IBT workers' CBAs had rules requiring separate drivers for deliveries of different types of snack cakes and breads that prevented the more efficient practice employed by Hostess's competitors of transporting all the products for each customer in the same truck. Instead of coordinating and combining routes and drivers, Hostess had overlaps in routes and duplicated truck transportation and maintenance costs, which the company could ill-afford.

⁹⁸ See http://www.nypost.com/p/news/business/hostess_filing_in_mix_PbYFRcu6zEHZw4NM0RAyVM. (Last visited March 17, 2013).

⁹⁹ See http://www.nypost.com/p/news/business/hostess_filing_in_mix_PbYFRcu6zEHZw4NM0RAyVM. (Last visited March 17, 2013).

¹⁰⁰ See <http://www.forbes.com/sites/quora/2012/11/21/did-hostess-go-bankrupt-in-2012-because-peopleno-longer-find-twinkies-appealing/>. (Last visited March 17, 2013).

Chapter 4: The Players in the Second Bankruptcy

This chapter identifies the people and the companies that played a significant role in the Hostess 2012 bankruptcy, the company's second bankruptcy in 8 years. The 2012 bankruptcy is referred to throughout this work as the 2012 Bankruptcy or the Second Bankruptcy.

The Debtor

Hostess Brands, Inc. is a Delaware corporation with its primary place of business located in Irving, Texas. In addition to the parent company filing for Chapter 11 in 2008, five of Hostess's fully owned subsidiaries filed separate bankruptcies that were joined into the same proceeding as the parent company. These five subsidiaries are IBC Sales Corporation, IBC Trucking, LLC, IBC Services, LLC, Interstate Brands Corporation, MCF Legacy, Inc.

These subsidiaries as well as the parent company had previously filed for relief under Chapter 11 in 2004 in the United States Bankruptcy Court for the Western District of Missouri., Accordingly, those cases that remained pending at the time of the 2008 bankruptcy proceedings, were jointly administered as case number 04-45814: IBC Sales Corporation (filed on September 22, 2004); Hostess Brands, Inc. (filed under name Interstate Bakeries Corporation on September 22, 2004); IBC Trucking, LLC (filed on September 22, 2004); IBC Services, LLC (filed on September 22, 2004); Interstate Brands Corporation (filed on September 22, 2004); and MCF Legacy, Inc. (filed under Mrs. Cubbison's Foods, Inc. on January 14, 2006)

Court and Administrators

Hostess's Second Bankruptcy proceeding was overseen by Judge Robert D. Drain,¹⁰¹ a United States Bankruptcy Judge for the Southern District of New York (White Plains). Judge Drain received his B.A. from Yale in 1979 and his J.D. from Columbia University School of Law in 1984. Prior to being appointed to the bench in 2002, Judge Drain was a partner in the Bankruptcy Department of the New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison.

Tracy Hope Davis¹⁰² was the United States Trustee appointed to this case. Ms. Davis joined the United States Trustees in 1997. She attended Rutgers Law School in Newark, New Jersey and then clerked for the Honorable Cornelius Blackshear, U.S. Bankruptcy Court, Southern District of New York. Following her clerkship, Ms. Davis practiced in New York City as a bankruptcy attorney.

¹⁰¹ www.nysb.uscourts.gov/content/judge-robert-d-drain. (Last visited February 17, 2013).

¹⁰² http://www.justice.gov/ust/eo/public_affairs/press/docs/2010/pr20100624.htm. (Last visited March 17, 2013).

Kurtzman Carson Consultants LLC (KCC)¹⁰³ served as the Claims and Noticing Agent. KCC was founded in 2001 and has offices in Tennessee, New York, and California.¹⁰⁴

Attorneys and Firms

There were a tremendous number of lawyers involved at every level of the Hostess bankruptcy case. Corinne Ball of Jones Day was the lead attorney for Hostess Brands, Inc.¹⁰⁵ Ms. Ball is a partner at Jones Day and co-manages the New York Office's Business Restructuring and Reorganization Practice. Notably, she has worked on other high profile reorganizations including: Chrysler; Worldcom; Loews; and VARIG Airlines. Additionally, she worked on acquisitions and workouts involving the Charlotte Bobcats, the Phoenix Coyotes, and the Detroit Redwings.¹⁰⁶

Other firms representing the debtor include Fredrick W.H. Carter of Venable, LLP as Special Employee Benefits Counsel; Ira L. Herman of Thompson & Knight, LLP; and Paul M. Hoffmann of Stinson Morrison Hecker, LLP.¹⁰⁷

The list of other attorneys and professionals involved in the case is too large to mention.

Unions

Hostess employed workers from 12 different unions¹⁰⁸ with approximately 15,000 members, 40 separate pension plans, and \$2 billion in unfunded pension liabilities involved in the Hostess bankruptcy. Most of the employees belonged to the International Brotherhood of Teamsters¹⁰⁹ or the Bakery, Confectionery, Tobacco Workers and Grain Millers International Union (BCT).¹¹⁰

¹⁰³ Motion to Authorize / Application for Entry of an Order Authorizing the Retention of Kurtzman Carson Consultants LLC as Claims and Noticing Agent for the Debtors and Debtors in Possession Nunc Pro Tunc to the Petition Date filed by Corinne Ball on behalf of Hostess Brands, Inc. (Ball, Corinne) (Entered: 01/11/2012).

¹⁰⁴ <http://www.kccllc.com/about-us/>. (Last visited March 17, 2013).

¹⁰⁵ Motion to Authorize.

¹⁰⁶ <http://www.jonesday.com/cball/>. (Last visited April 24, 2013).

¹⁰⁷ Order Authorizing Stinson Morrison Hecker.

¹⁰⁸ <http://www.limitedgovernment.org/brief19-6.html>. (Last visited January 28, 2013).

¹⁰⁹ Ken Hall, general secretary-treasurer of the Teamsters Union represented Hostess drivers in negotiations throughout the bankruptcy.

¹¹⁰ Frank Hurt, International President of Bakery, Confectionery, Tobacco, and Grain Millers International Union was the main representative of BCT throughout the bankruptcy.

The International Brotherhood of Teamsters (IBT)¹¹¹ was founded in 1903 and is led by General President James Hoffa, General Secretary-Treasurer Ken Hall, and a General Executive Board which is comprised of 17 vice presidents across North America. As one of the largest labor unions in the world, it represents 1.4 million members. There are approximately 1900 Teamster affiliates which include 440 U.S. Teamster Locals, 35 Canadian Teamster Locals, 573 Brotherhood of Locomotive Engineers and Trainmen (BLET) Locals, 635 Brotherhood of Maintenance of Way Employees Division (BMWED) Locals, and 205 Graphic Communications Conference Locals.

The Bakery, Confectionery, Tobacco Workers and Grain Millers International Union¹¹² is the result of the merger of the Bakery and Confectionery Workers International Union of America (organized in 1886) and the American Bakery and Confectionery Workers' International Union (organized in 1957) with the Tobacco Workers International Union (organized in 1895). The union is led by International President, David B. Durkee and International Secretary-Treasurer, Steve Bertelli. The union represents approximately 100,000 workers across the United States and Canada. The union web page contains updates on the current events effecting members of the union, including Hostess.¹¹³

Hostess Management and Investors

Management¹¹⁴

Brian Driscoll, Chief Executive Officer and President at the time of filing who leaves the company in March of 2012.

Gregory F. Rayburn, Chief Restructuring Officer and Member of the Board of Directors who replaces Brian Driscoll as Chief Executive Officer and President.

John Stewart, formerly of the Dr. Pepper Snapple Group, was named Chief Financial Officer and Executive Vice President of Hostess on October 26, 2010.

Michael D. Kafoure, Chief Operating Officer, President of Brands and Chief Operating Officer of Brands

Thomas S. Bartoszewski, Executive Vice President of Eastern Division – Brands

¹¹¹ See <http://www.teamster.org/>. (Last visited March 19, 2013).

¹¹² See <http://www.bctgm.org/>. (Last visited March 19, 2013).

¹¹³ See <http://www.bctgm.org/category/hostess-bankruptcy/>. (Last visited March 19, 2013).

¹¹⁴ Bloomberg Businessweek, Company Overview of Hostess Brands, Inc., site indicates that data is current as of the most recent Definitive Proxy. <http://investing.businessweek.com/research/stocks/private/board.asp?privcapId=30194>. (Last visited March 17, 2013).

Robert A. Campagna, Senior Vice President and Managing Director of Alvarez and Marsal

Kent B. Magill, Executive Vice President, Secretary, General Counsel, Vice President of Brands, Secretary of Brands and General Counsel of Brands

Robert P. Morgan, Executive Vice President of Wholesale Business Unit – Upper Midwest North Central and Northeast PCs

Steven V. Proscino, Executive Vice President of Wholesale Business Unit – Eastern Region

Jacques E. Roizen, Executive Vice President of Marketing

Richard C. Seban, Chief Marketing Officer and Executive Vice President

Board Members

Gregory F. Rayburn, Chief Executive Officer, President, Chief Restructuring Officer and Member of the Board of Directors.

John Cahill, Kraft Foods Group, Inc.

Robert Calhoun, Jr., Monitor Clipper Partners, LLC

Terry Peets, Ralphs Grocery Company

William Mistretta, University of Scranton

Philip Vachon, Liberate Technologies

Gregory Murphy, Ripplewood Investments, LLC

Investors

Ripplewood Holdings, LLC¹¹⁵ is a private equity firm that invested in Hostess as part of the 2004 bankruptcy and became its largest post bankruptcy equity holder. Tim Collins is Founder, Senior Managing Director, and Chief Executive Officer of Ripplewood Holdings, LLC. Mr. Collin's father was a teamster and he himself has political ties to certain unions.¹¹⁶ Tim Collins was one of the 19 founding members of Congressman Gephardt's New York State leadership committee, and Ripplewood and Hostess are major clients of Gephardt's consulting company, the Gephardt Group, which provides labor advisory services to unions that are typically represent employees at large companies. Tim Collins worked with former Congressman Gephardt, who was endorsed by 21 off the largest U.S. labor unions in his 2004

¹¹⁵ See <http://www.zerohedge.com/news/2012-11-16/hostess-liquidation-curious-cast-characters-twinkietumbles>. (Last visited January 28, 2013).

¹¹⁶ See <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited February 14, 2013).

election bid, to broker a deal with the Teamsters and secure Ripplewood's two-thirds equity share of the company.

Silver Point Capital is a hedge fund¹¹⁷ that specializes in providing assistance and credit-lines to distressed companies. The company was formed in 2002 by Edward A. Mule and Robert J. O'Shea in Greenwich Connecticut.¹¹⁸ Additionally, Monarch Alternative Capital LP is a hedge fund that was established in 2002 by Michael Weinstock and Andrew Herenstein that specializes in providing financing for distressed or bankrupt companies.¹¹⁹ These two hedge funds were also Hostess's largest secured creditors.

The following is a list of the equity security holders identified by Hostess in the bankruptcy petition.¹²⁰

- IBC Investors I, LLC – 45.60% equity interest
- IBC Investors II, LLC – 17.70% equity interest
- IBC Investors III, LLC – 5.26% equity interest
- Craig D. Jung – 2.06% equity interest
- Brian Driscoll – 1.66% equity interest
- Gephardt Group Labor Advisory Services – 0.19%
- SPCP Group, LLC – 12.28% equity interest
- Monarch Debt Recovery Master Fund Ltd – 6.14% equity interest
- Monarch Opportunities Master Fund Ltd – 2.03% equity interest
- Monarch Income Master Fund Ltd – 0.42% equity interest
- McDonnell Loan Opportunity Ltd – 5.41% equity interest
- Arrow Distressed Securities Fund, c/o Schultze Asset Mgmt LLC – 0.19% equity interest

¹¹⁷ A hedge fund, as defined by Investopedia, is “[a]n aggressively managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). Legally, hedge funds are most often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment. Investments in hedge funds are illiquid as they often require investors keep their money in the fund for at least one year.” See <http://www.investopedia.com/terms/h/hedgerefund.asp#axzz2NAAMliOQ> (Last visited April 24, 2013).

¹¹⁸ See <https://www.silverpointcapital.com/>. (Last visited March 17, 2013).

¹¹⁹ See <http://www.monarchlp.com/>. (Last visited March 17, 2013).

¹²⁰ See voluntary petition.

- Schultze Apex Master Fund, Ltd, c/o Schultze Asset Mgmt LLC – 0.02% equity interest
- Schultze Master Fund, Ltd., c/o Schultze Asset Mgmt LLC – 0.83% equity interest
- Mars & Co. Consulting, LLC – 0.21% equity interest

Creditor Committees

The following is a list of the creditor committees in the Hostess Brands, Inc. bankruptcy case.

Official Committee of Unsecured Creditors of Hostess Brands, Inc., et. al

- Joshua K. Brody, Kramer Levin Naftalis & Frankel LLP
- Paul B. O'Neill, Kramer Levin Naftalis & Frankel LLP
- Steven J. Reisman, Curtis, Mallet-Prevost, Colt & Mosle LLP
- Thomas Moers Mayer, Kramer Levin Naftalis & Frankel LLP

Official Committee of Non-Union Retirees of Hostess Brands, Inc.

Terminated: 01/17/2013

- Trent P. Cornell, Pedersen Houpt
- Brian M. Graham, Pedersen & Houpt

Official Committee of Retired Employees of Hostess Brands, Inc. and its Debtor Affiliates

- Trent P. Cornell, Pedersen Houpt

Major Creditors¹²¹

The creditors below represent the forty largest unsecured creditors in the bankruptcy case.

Bakery & Confectionery Union & Industry International Pension Fund	\$944,158,000
Central States, Southeast and Southwest Areas Pension Plan	\$11,817,000
Cereal Food Processors	\$8,530,000
Twin Cities Bakery Drivers Pension Fund	\$8,357,000
Western Conference of Teamsters Pension Plan	\$6,997,000
New England Teamsters & Trucking Industry Pension Fund	\$4,768,000
Automotive Industries Pension Plan	\$4,158,000

¹²¹ See voluntary petition.

Bakery Drivers and Salesman Local 550 and Industry Pension Fund	\$2,268,000
Cargill, Inc.	\$1,924,000
Bakery Drivers and Salesmen Local 194 and Industry Pension Fund	\$1,846,000
Comdata Corporation	\$1,700,000
Local 734 Pension Fund	\$1,415,000
Bloomer Chocolate Co.	\$1,299,000
Caravan Ingredients	\$921,000
ADM, Inc.	\$912,000
Philadelphia Bakery Employers & Food Driver Salesmens Union Local 463 & Teamsters Local 676 Pension Plan	\$891,000
United Sugars Corp.	\$858,000
Cleveland Bakers and Teamsters Pension Fund	\$830,000
Retail, Wholesale & Department Store International Union and Industry Pension Fund	\$766,000
Manpower, Inc.	\$754,000
Calise & Sons Bakery, Inc.	\$671,000
Delavau LLC	\$610,000
Accenture LLP	\$600,000
Blue Cross Blue Shield	\$581,000
I.A.M. National Pension Plan	\$566,000
Malnove Inc. of Nebraska	\$564,000
Manildra Milling	\$542,000
SAP America, Inc.	\$531,000
The Goodyear Tire & Rubber Co.	\$522,000
MSC Industrial	\$516,000
Waste Management National Service	\$504,000
Northern New England Benefit Trust	\$491,000
Central Pension Fund of the IUOE	\$486,000
Speedway Superamerica LLC	\$457,000
Southern California Bakery Security Fund	\$455,000
Ortran, Inc.	\$453,000
Berry Plastics Corp.	\$453,000
Bunge North America	\$427,000
Cloverhill Pastry Vending Corp.	\$426,000
CSM Bakery Products	\$425,000

Competitors and Potential Buyers

Flower's Foods

Flower's Foods is a company founded in 1919 by two brothers, William Howard and Joseph Hampton Flowers.¹²² Hailing from Thomasville Georgia, the company website provides Flower's areas of expertise: "Breads, Buns, and Rolls."¹²³ In 1968, the company went public. In the mid-1990s, the company acquired Keebler foods, and Mrs. Smith's, the largest cracker company and best selling frozen pie in America, respectively. In March of 2001, Flowers sold its investment in Keebler to Kellogg, and "[d]elivered \$1.24 billion to its shareholders."¹²⁴

McKee Foods

McKee Foods Corporation is a privately held, family-run company, headquartered in Collegedale, Tennessee, which is best known for Little Debbie snack cakes, Sunbelt snack cakes, and the Heartland bread lines.¹²⁵ The company has grown from a small three-person bakery in Chattanooga, Tennessee in 1934 to an international company that employs over 6,000 workers and generates revenues exceeding \$1 billion per year.¹²⁶ Its Little Debbie line of snack cakes are named after the founders' granddaughter, Debbie McKee, and the company's management actively strives to maintain the culture of a small family-run business, despite the company's size and success.¹²⁷

Grupo Bimbo

Grupo Bimbo, S.A.B. de C.V. is a Mexican baking company headquartered in Mexico City. The company has grown from one plant located in the Santa María Insurgentes region of Mexico City in 1945 to one of the world's largest bakeries with 153 plants and over 1,000 distribution centers located in 19 countries in North America, South America, and Asia.¹²⁸ The

¹²² http://www.flowersfoods.com/FFC_InvestorCenter/FLOoverview/CompanyHistory/index.cfm. (Last visited March 17, 2013).

¹²³ <http://www.flowersfoods.com/>. (Last visited March 17, 2013).

¹²⁴ *Id.*

¹²⁵ http://www.mckeefoods.com/Our_Brands/Default.htm. (Last visited March 17, 2013).

¹²⁶ http://www.mckeefoods.com/About_us/Company_History/Family-Owned_Business.htm. (Last visited April 20, 2013).

¹²⁷ http://www.mckeefoods.com/About_us/Company_History/Family-Owned_Business.htm. (Last visited April 20, 2013).

¹²⁸ <http://www.grupobimbo.com/ir/>. (Last visited April 20, 2013).

company employs over 127,000 people and has annual revenues exceeding \$173 billion.¹²⁹ Founded in 1994, Bimbo Bakeries USA is the company's American division, and is the largest baking company in the United States. The American division produces several well-known brands, including Arnold, Sara Lee, and Thomas'.¹³⁰ It was Bimbo Bakeries USA that placed a \$580 million dollar bid on IBC during its 2004 bankruptcy.

Other Characters

There are many other characters that play a role in the Hostess bankruptcy including the following:

- Charles Carroll, FTI Consulting, Inc.¹³¹ – Interim Treasurer and advisor. Additional personnel were also provided from FTI Consulting, Inc. to assist Hostess as a debtor-in-possession (DIP).
- Perella Weinberg Partners LP – Advisory and Asset Management firm working with Hostess to restructure its \$1.4 billion in liabilities.¹³²
- Gordian Group, LLC – Investment bank hired to represent approximately 6,000 workers and pensioners of the Bakery, Confectionery, Tobacco Workers and Grain Millers International Union during the sales of Hostess brands.¹³³
- Peter Kaufman – President of Gordian Group, LLC.
- Pension Benefit Guarantee Corp.¹³⁴ – federal agency taking responsibility for 2300 single-employer, unfunded Hostess pension plans.

¹²⁹ <http://investing.businessweek.com/research/stocks/financials/financials.asp?ticker=BIMBOA:MM>. (Last visited April 20, 2013).

¹³⁰ http://www.bimbobakeriesusa.com/about_us/our_history.html. (Last visited April 20, 2013).

¹³¹ See Motion to Employ and Retain FTI Consulting.

¹³² <http://www.pwpartners.com/advisory/selected-transactions/restructuring/> (Last visited April 4, 2013).

¹³³ <http://www.dispatch.com/content/stories/business/2013/01/22/pension-fund-hires-bank-to-overseehostess-sale.html>. (Last visited January 28, 2013).

¹³⁴ <http://www.institutionalinvestor.com/Article/2696150/PBGC-Assumes-Hostess-Brands-Plan.html#.UQaLgB1X3oI> (Last visited January 28, 2013).

Chapter 5: The Start of the Second Bankruptcy, “Bankruptcy II” and First Day Motions

The Voluntary Petition – January 11, 2012

Some three years after emerging from its first bankruptcy, on January 11, 2012, Hostess again filed a voluntary petition for relief under Chapter 11¹³⁵ of the United States Bankruptcy Code in Southern District of New York and was authorized to continue to operate its business pursuant to the Bankruptcy Code Sections 1107(a) and 1108.¹³⁶

On January 18, 2012, the United States Trustee appointed an official committee of unsecured creditors. In order to continue to operate after filing for Chapter 11, a debtor such as Hostess may need to obtain certain financing. Accordingly, On February 3, 2011, the Court entered a final order authorizing Hostess to obtain post-petition financing and provide adequate protection to pre-petition secured parties.¹³⁷

According to Gregory Rayburn, who was Hostess’s Chief Restructuring Officer from February 22, 2012 through March 8, 2012, an Asset Sale of the Cake Business was the best option for Hostess. Judge Drain agreed with Rayburn in his Order entered February 11, 2013, granting Hostess’s Motion for An Asset Sale of its Cake Business. Moreover, Judge Drain rejected the U.S. Trustee’s argument to appoint a trustee because conversion to a Chapter 7 would “be a disaster.”¹³⁸

¹³⁵ Voluntary Petition.pdf.

¹³⁶ *Id.*

¹³⁷ Order Approving Bidding Procedures.

¹³⁸ Hostess Begins Firings After Wind-Down Request Approved. Dawn McCarty and Phil Miliford, November 22nd 2012, Bloomberg News: “Drain rejected a request by U.S. Trustee Tracy Hope Davis to convert the Hostess case to a Chapter 7 liquidation from Chapter 11, which would have handed control over the asset sales to a trustee. Conversion ‘would be a disaster,’ Drain said.” Available at: <http://www.bloomberg.com/news/2012-11-22/hostess-judge-approves-wind-down-of-twinkie-maker.html> (Last visited April 24, 2013).

Hostess Financials on the Day of the Second Bankruptcy Filing¹³⁹

Type	Date Entered	Date Exited	Assets	Liabilities upon exiting Chapter 11 Bankruptcy
Chapter 11 Restructuring1	Sep. 2004	Feb. 2009	\$1,600,000,000	\$1,300,000,000
Chapter 11 Restructuring 2	Jan. 2012	Oct. 2012	\$980,000,000	\$1,400,000,000
Motion for Chapter 7 By US Trustee	Nov. 2012	Denied		

Simultaneously with its own bankruptcy filing, Hostess's five wholly owned, domestic subsidiaries also filed bankruptcy under Chapter 11; In one of the first day motions, the six individual debtors sought to consolidate their bankruptcies into one bankruptcy so that it could be jointly administered.¹⁴⁰

A "first day motion" is a self-explanatory name given to a motion filed at the beginning of a bankruptcy proceeding. First day motions, ("FDMs"), are frequently filed on the same day as the petition and are a common feature of virtually all Chapter 11 bankruptcies. Some of these motions are rather innocuous and little more than a formality, such as a *pro hac vice*¹⁴¹ application to allow an attorney licensed in another state to represent a party in the bankruptcy, while other FDMs can be quite contentious and have dramatic effects on the disposition of the bankruptcy.

In general, these motions occur on the same day as the filing because of the way the

¹³⁹ This report was generated by Kathryn Ganier through Priv.Co Software on January 28, 2013, Hostess Brands. Inc. fiscal year ends on May 31. Hostess disaggregated Inventories and Assets for sale on its 2012 Chapter 11 bankruptcy filing. Inventories excluding assets held for sale totaled \$55.8 million. Net Fixed Assets consisted of \$455.9 million of fixed assets and \$83.1 million of accumulated depreciation.

¹⁴⁰ Motion for Joint Administration.

¹⁴¹ *Pro hac vice*, which in Latin means "for this turn," is a legal term of art meaning that a lawyer is granted permission to practice law for one particular matter in a jurisdiction in which they are otherwise not licensed to practice. BLACKS LAW DICTIONARY, 1331 (9th ed. 2009).

Bankruptcy Code is structured. Under the Code, a debtor who retains control of their own operations, known under the Code as a “debtor in possession” or “DIP,” is greatly restricted in what kind of transactions it may undertake. For example, under Section 362 of the Code, prepetition claims against a debtor, with some exceptions, are placed under an automatic stay, including routine claims such as employee wages that were earned, but not yet paid, prior to the filing. As a result, prepetition claimants cannot collect on their claims outside of the bankruptcy proceeding and likewise, the debtor cannot pay some prepetition claims over other prepetition claims without court approval.

These restrictions against debtor payments of prepetition claims in the Code are designed to protect creditors as a class by stopping a debtor from siphoning off all remaining assets to preferred creditors or insiders during the pendency of the bankruptcy under the pretense that the debtor is running the day-to-day operations. Taken literally, however, the restrictions standing alone make it almost impossible for a DIP to actually run the business profitably, even in good faith. If the debtor cannot pay its workforce for work already performed, morale plummets, at a minimum. If certain key suppliers are not paid for delivered goods, they may choose to stop supplying the DIP, which could shut down the entire operation if the supplier is the sole or a major provider of a key resource. Therefore, the FDMs serve as the means by which the DIP can gain authorization to engage in transactions necessary to maintain the business that are otherwise prohibited by the Code.

DIPs typically file motions with the court to authorize the payment of certain pre-petition claims that range from: payments to certain lienholders; to keeping utility companies from shutting off power; to the maintenance of existing bank accounts and cash management systems. The motions are filed immediately along with the petition, or soon afterwards, so as to cause as little interruption to the daily operation of the business and prevent or limit the harm such an interruption could potentially have on a DIP’s ability to effectively reorganize. Under Rule 6003 of the Federal Rules of Bankruptcy Procedure, the bankruptcy court will not consider motions to pay prepetition claims during the first twenty days after the filing of a Chapter 11 petition “except to the extent necessary to avoid immediate and irreparable harm.” Therefore, in making these FDMs, a DIP must explain why the various motions are essential to keep the DIP from suffering irreparable harm, though, as many of these types of motions are fairly common and routinely granted, only unusual or contested motions require much explanation.

Hostess, like many DIPs, filed numerous FDMs immediately after filing its original petition.¹⁴² In addition to the petition, Hostess and its subsidiaries filed 36 first day motions on

¹⁴² In a document filed in support these motions, Hostess states that:

Generally, the First Day [Motions] have been designed to meet the primary goal of continuing [Hostess’s] postpetition operations in a manner that will maximize value to all stakeholders. As such, the[se motions] seek to: (a) foster a business as usual atmosphere; (b) promote confidence and maintain support among customers, distributors, employees, unions, vendors, service providers and certain other key constituencies; (c)

January 11, 2012, most of which were granted within two days of their filing. A large number of these filings were *pro hac vice* applications by the various parties' attorneys and motions to authorize the employment of various consulting groups. Some of the more important and substantive motions, however, included: a motion to pay certain essential suppliers,¹⁴³ a motion to enjoin utility companies from cutting off or altering their services to Hostess,¹⁴⁴ a motion to pay workers for prepetition wages,¹⁴⁵ a motion to pay certain prepetition lienholders,¹⁴⁶ a motion to continue certain cash management systems,¹⁴⁷ a motion to participate in certain ongoing customer programs that give rise to claims,¹⁴⁸ a motion to pay prepetition taxes,¹⁴⁹ and a motion for extended time in order to file Schedules and Statements and List of Physical Inventory.¹⁵⁰ While these motions are relatively routine, several have interesting aspects and are discussed in more detail below.

In its motion to pay certain "essential" suppliers, Hostess, seeks and is granted permission on January 13, 2012¹⁵¹ to pay suppliers who are either "(a) direct single source suppliers of goods (i.e., vendors that are the sole supply of goods necessary to produce

establish procedures for the smooth and efficient administration of these Chapter 11 cases; and (d) lay the groundwork for a successful restructuring of [Hostess's] liabilities.

If the First Day [Motions] are not granted on an expedited basis, [Hostess] will, among other things, not have access to cash and will be unable to fulfill many of their ongoing obligations to, among others, employees, customers, vendors, lessors and other service providers. Under such circumstances, [Hostess] will likely be unable to continue to operate their bakeries and distribute their goods to consumers. A lack of product on the shelves will harm the brand loyalty of [Hostess's] wholesale and retail customers who expect a regular supply of [Hostess's] products and, without which, will be likely to replace the [Hostess's] products with the products of [its] competitors.

CEO_Affidavit.pdf, pp. 27-28.

¹⁴³ Essential_Suppliers_Motion.pdf.

¹⁴⁴ Injunction_Against_Utility_Companies.pdf.

¹⁴⁵ Prepetition_Wages_Motion.pdf.

¹⁴⁶ Lienholder_Motion.pdf.

¹⁴⁷ Cash_Management_Motion.pdf.

¹⁴⁸ Customer_Obligation_Motion.pdf.

¹⁴⁹ Prepetition_Tax_Motion.pdf.

¹⁵⁰ Motion_for_Extended_Time.pdf.

¹⁵¹ Interim_Order_for_Essential_Suppliers.pdf. A final order authorizing the payment with virtually identical language as the interim order was later granted on January 27 after a hearing. Final_Order_Essential_Suppliers.pdf.

[Hostess's] products)" or "(b) direct large scale suppliers of goods (i.e., vendors that supply an amount of goods necessary to produce [Hostess's] products that would be difficult or impossible to replace)." ¹⁵² In other words, at Hostess's discretion certain suppliers are granted relief from the automatic stay and are entitled to payment up to a certain aggregate cap because their supplied good is so important to Hostess or Hostess is unable to obtain the good from another source and a failure to obtain that good would cause a severe disruption to the company and significantly hurt its ability to generate revenue and remain a going concern.

In a FDM, Hostess requested the court's approval for the authority to pay up to \$14 million in essential supplier claims, a paltry amount compared to the company's gross revenue in both 2011 and 2012 of approximately \$2.5 billion. Further, \$14 million amounted to less than 2.5% of Hostess's historical annual spend on goods and services, and was well within the range of typical requests for such payments. ¹⁵³ Indeed, if such suppliers were anything near "essential" to Hostess's operations, such a payment would certainly seem justified in maintaining Hostess as a more valuable going concern. Further, as is also typical, Hostess required that any supplier that was paid as an essential supplier pursuant to the FDM and the court's approval (in exchange for that payment of a prepetition claim), would guarantee that they would continue their business relationship with Hostess into the future on the same pre-bankruptcy terms. ¹⁵⁴

Another typical FDM is one that keeps the lights on. Hostess filed for an injunction to keep various utility companies from cutting off services to Hostess as a result of its bankruptcy filing. In addition to the injunctive relief, Hostess provided adequate assurances that it would pay the utility companies in the form of two weeks advanced pay based on historical averages. ¹⁵⁵ Hostess estimated that it is served by approximately 1,000 different utility companies and with a total average monthly obligation of \$4-5 million. ¹⁵⁶ Under Section 366 of the Bankruptcy Code, a utility company is not allowed to discontinue or alter its service to a debtor either because of the filing or because a claim is owed for services provided before the filing. A utility company may, however, alter or discontinue service if it is not provided adequate assurance of future payment within thirty days of the filing.

¹⁵² Affidavit_of_CEO.pdf. p. 33.

¹⁵³ <http://www.privco.com/private-company/hostess-brands-inc>; Affidavit_of_CEO.pdf. p. 34; Essential_Suppliers_Motion.pdf p. 14.

¹⁵⁴ Essential_Suppliers_Motion.pdf p. 16-17. Hostess also provided a mechanism in the motion whereby an essential supplier who was paid for prepetition claims but refused to agree to or later breached the guarantee would have their claim deemed an unauthorized post-petition transfer, allowing Hostess to recover the payment.

¹⁵⁵ Affidavit_of_CEO.pdf. p. 38-39.

¹⁵⁶ Affidavit_of_CEO.pdf. p. 38-39.

This particular motion to “keep the lights on,” unlike most of the other first day motions, generated some opposition. While originally intended to be heard within the first day before an interim order was granted pending a later final order, the U.S. Trustee asked that the hearing be postponed, and Hostess agreed to the request.¹⁵⁷ Therefore, instead of an expedited hearing with an interim order granted pending a later hearing and final order, the whole process was pushed back so that a revised proposed order was filed on January 19th and a hearing on the motion did not occur until January 26th.¹⁵⁸ As a result of the delayed timing, the newly purposed order pushed the time at which Hostess had to provide adequate assurance to the utility companies to forty days after the filing, and by the time of the hearing, various groups of utility companies had filed objections.¹⁵⁹

Integrus Energy Services, Inc. (“Integrus”) objected on the grounds that it was not a utility company within the meaning of the Bankruptcy Code but rather a “forward contract merchant” that sells electricity at contracted prices and that, due to the nature of its business, Hostess would need to pay it for two months in advance rather than Hostess’s purposed two weeks to provide adequate assurance.¹⁶⁰

The main objection to the motion, however, came on January 23rd when over thirty utility companies filed a joint objection on the grounds that under Hostess’s motion, they would receive payments after the thirty days required by the Bankruptcy Code and that two weeks advance payment was not sufficient to constitute adequate assurance.¹⁶¹ The next day, eight more utility companies filed a motion joining the earlier objection.¹⁶² Prior to the January 26th hearing on Hostess’s motion, Hostess was able to reach an agreement with the objecting utility companies reflected in Judge Drain’s January 27th order.¹⁶³ Though what exactly transpired between the parties is not in the record, Integrus does not appear on the order’s list of enjoined utility companies. The order provided Hostess with extra time past the Code’s thirty day limitation to provide adequate assurance and listed each utility company’s adequate assurance amount at approximately two weeks average historic cost.¹⁶⁴ The order, however, also provided

¹⁵⁷ Injunction_against_utilities_(revised_form) p. 2-3.

¹⁵⁸ Injunction_against_utilities_(revised_form) p. 2-3.

¹⁵⁹ Integrus_Objection.pdf; Virginia_Electric_Objection.pdf; Mass._Electric_Objection.pdf.

¹⁶⁰ Integrus_Objection.pdf.

¹⁶¹ Virginia_Electric_Objection.pdf.

¹⁶² Mass._Electric_Objection.pdf.

¹⁶³ Jan. 27 Order granting motion against utilities.

¹⁶⁴ The order does not list two weeks average historic pay as the standard adequate assurance amount, but the total of all the assurance amounts equals \$1,866,639.91 and Driscoll’s affidavit lists the average

for a procedure by which the utility companies could request additional payments in order to be adequately assured, and the order gave Hostess the ability to unilaterally agree to an increase in assurance of up to \$100,000 without court or creditor committee approval.¹⁶⁵

One final FDM that is worth examining in some detail is Hostess's motion to give itself authority to continue to operate or modify certain customer programs and pay prepetition claims arising from their programs at its sole discretion.¹⁶⁶ The motion was not particularly controversial and did not give rise to any objections, but the motion is interesting because customers are ordinarily not thought of as—but frequently are—creditors. Customers, however, as the lifeblood of any company, are critical to maintaining a profitable enterprise, and creating and maintaining goodwill with customers is essential for a company. In order to create that goodwill and increase its market share, Hostess engages in wholesale customer programs ranging from buying back damaged goods to agreeing to promotional agreements where Hostess will pay a wholesale customer who can increase its sales of Hostess products. Likewise, Hostess engages in various retail customer programs, such as issuing and honoring manufacturer's coupons for its products. Hostess estimates that cost of these programs to be \$28.4 million per year,¹⁶⁷ a small price to pay to maintain customer goodwill, and an interim order approving the motion without any modification was entered on January 13th.¹⁶⁸ The final order with identical substantive language to the interim order was signed on January 27th.¹⁶⁹

Although not a FDM per se, on the day of filing, Hostess also requested a scheduling order laying out the procedure for altering its various CBAs¹⁷⁰ with the unions and setting a trial date for this issue on February 27, 2012. This filing to create a timetable for the process was the beginning of a series of filings and hotly contested disputes that, at least in the popular press, will eventually become the defining aspect of the entire bankruptcy case.

monthly expenditures on utilities to be \$3-4 million. Therefore, if the total assurance amount equals two weeks costs, then multiplying the total assurance amount by two would lead to a four week or one-month estimate of about \$3.3 million which would be right in the middle of the one-month estimated range. Jan. 27 Order granting motion against utilities; Affidavit_of_CEO.pdf, p. 38-39.

¹⁶⁵ Jan. 27 Order granting motion against utilities.

¹⁶⁶ Customer_Obligation_Motion.pdf, p. 7.

¹⁶⁷ Customer_Obligation_Motion.pdf, p. 13.

¹⁶⁸ Interim order.

¹⁶⁹ Final order granting customer relief.

¹⁷⁰ Motion to Reject and Alter CBAs.

Chapter 6: The Reorganization Plan

Hostess's corporate officers, who at the filing of the bankruptcy petition had only been in place for slightly more than a year, developed the overarching plan outlined below to regain Hostess's long term viability. The business plan was premised upon an assumption that Hostess would be able to achieve what the officers termed a "competitive cost structure." The critical change in cost structure, as outlined in the plan, stemmed from the removal of some restrictive union work place rules and costly benefits provided for workers under the various CBAs. The removal of those rules would provide: relief from payments to underfunded pension plans; a reduction in medical benefit legacy costs; and a modernization of distribution systems. As a result, Hostess's management hoped operating costs would be reduced under a new competitive cost structure.

The steps in the reorganization plan as stated by the CEO in his affidavit in support of the first day motions included:

- a. withdrawing completely from multiemployer pension plans to achieve relief from the crippling costs of these plans that are, in large part, a result of the required funding of retirees whose former employers no longer contribute to the plans;
- b. addressing the Debtors' legacy health and welfare costs to achieve a substantial reduction in the cost of providing benefits to bring such costs in line with current competitive market costs;
- c. modifying the Debtors' existing collective bargaining agreements to relax work rules and obtain other relief necessary to both bring the Debtors' labor costs in line with that of their competitors and provide the operating flexibility necessary to respond to changing customer requirements for delivery and service;
- d. securing new capital investment to modernize and automate the Debtors' production and distribution operations; and
- e. restructuring the Debtors' capital structure to significantly reduce debt and related expense.¹⁷¹

In order to implement the reorganization plan, which seemed to focus primarily on extracting concessions from the unions to become profitable, Hostess set about using the bankruptcy proceedings and the authority of the bankruptcy court to bring the unions to the bargaining table to extract the sought concessions. The first step in this process was the

¹⁷¹ Affidavit_of_CEO.

scheduling motion mentioned in the previous chapter.¹⁷²

The other major aspect of Hostess's reorganization besides gaining concessions from the unions was to secure additional capital and restructure its debt. On February 3, 2012, the Court entered a final order,¹⁷³ authorizing Hostess to obtain post-petition financing pursuant to 11 U.S.C. §§ 105, 361, 362 and 364 and to utilize cash collateral pursuant to 11 U.S.C. § 363. Following this order, several of Hostess's current lenders, led by Silver Point and Monarch, provided another \$75 million to help maintain Hostess through the beginning of the bankruptcy.¹⁷⁴ At the same time, Perella Weinberg Partners, Hostess's restructuring advisers, hunted for new equity sources and potential buyers. Since no one would provide additional financing otherwise, this \$75 million DIP financing received a kind of super priority, placing it on top of the other secure loans and making it some of the first money paid out of the estate.

On October 10, 2012, after extensive negotiations with the unions, which will be discussed in more detail in the next chapter, Hostess finally filed its Joint Plan of Reorganization (the "Reorganization Plan").¹⁷⁵ The portion of the Reorganization Plan concerning the worker wages and benefits reductions called for an 8% cut on the wages of their employees and a 17% reduction in health and welfare benefits for union and non-union workers alike as well as a total cessation of contributions to the multi employer pension plans for two years.¹⁷⁶

The Reorganization Plan also called for Hostess's equity owners, including Ripplewood—which invested over \$150 million in equity ownership—to lose the entirety of their investment.¹⁷⁷ Furthermore, the Reorganization Plan proposed a reduction of at least \$1.6 billion of Hostess's unsecured debt, comprising substantially all of the company's unsecured obligation, while leaving approximately \$861 million in secured debt.¹⁷⁸ According to Hostess, "virtually all of [Hostess's] assets were encumbered [at the time of filing]."¹⁷⁹ Therefore, the

¹⁷² Motion_for_Scheduling_Order.

¹⁷³ Final DIP Order.

¹⁷⁴ Remember, this is in addition to the \$860 million in existing debt and \$1.4 billion in liabilities currently held by the company. See <http://management.fortune.cnn.com/2012/07/26/hostess-twinkiesbankrupt/>.

¹⁷⁵ Reorganization_Plan; Disclosure_Statement_with_Reorganization_Plan.

¹⁷⁶ Disclosure_Statement_with_Reorganization_Plan.pdf, p. 4.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

Reorganization Plan essentially called for the elimination without compensation of the claims of both the equity investors and the vast majority of the unsecured creditors.

Hostess's management hoped that the reduction in operating costs and interest from its debts would enable the company to accumulate enough liquidity to fund sorely needed capital improvement, such as modernizing its vehicle fleet and installing new inventory tracking software.¹⁸⁰ Less quantitatively, the company also sought to maximize its efficiency by "reducing excess baking capacity," "clos[ing] unprofitable bakery outlet stores," "modifying [its] pricing strategy," and generally streamlining its distribution system.¹⁸¹ The details for how exactly such desired efficiencies would be achieved, however, were somewhat lacking in the documents Hostess filed with the court.

No formal opposition to the Reorganization Plan was filed with the court. Likewise, the plan was never formally approved. Instead, events quickly unraveled after the filing of the Reorganization Plan, ultimately leading to strike called by BCT, a wind down of the business, and the sale of Hostess's constituent parts.

¹⁸⁰ *Id.* at 14-15.

¹⁸¹ *Id.*

Chapter 7: Strike

Unfortunately for Hostess, its financial situation and the cooperative sentiment that had originally existed among the parties increasingly deteriorated throughout the second bankruptcy. To begin with, the company's CEO, Brian Driscoll, left suddenly in March, barely two months after the initial filing. His reasons for leaving were not entirely clear, but Hostess's continued failure to increase revenue or reduce its debts coupled with growing tensions with the unions¹⁸² could have led him to believe that Hostess was a lost cause or that he personally was no longer able to right the ship. Whatever the reason for Driscoll's departure, Hostess was in crisis. The company's losses for fiscal 2011 were reported as \$341 million,¹⁸³ 2.5 times the loss posted in fiscal 2010, and at the start of 2012, as Hostess entered the second bankruptcy, its debt had grown to about \$860 million.¹⁸⁴ Due in large part to the substantial interest paid on this debt and various bankruptcy expenses, fiscal year 2012 was even worse than 2011. The company posted revenue of \$2.5 billion in the fiscal year 2012, almost identical to the revenue from fiscal 2011, but its costs had increased so dramatically that the company's net losses equaled \$1.1 billion, more than three times its losses from the year before.¹⁸⁵

As the company's financial situation became increasingly desperate, Hostess's board of directors elected Greg Rayburn as the company's new CEO to replace the vacancy left by Driscoll. Rayburn was an expert in restructuring high-profile distressed businesses who had been hired by Hostess as a consultant just nine days before being made CEO. Less than a month after taking over, Rayburn had to deal with a public relations nightmare that he had inherited from his predecessor. Several unsecured creditors informed the court that the previous summer, as the company was spiraling into bankruptcy, four of Hostess's top executives, including

¹⁸² On February 7, Hostess had asked Judge Drain to approve a generous new employment deal for Driscoll that gave him a base annual salary of \$1.5 million and potential cash incentives and "long-term incentive" compensation of up to \$2 million. Under the deal, even if Hostess liquidated or Driscoll was fired without cause, he would still get severance pay of \$1.95 million. When the Teamsters saw the court motion, however, Ken Hall, the union's secretary-treasurer, became irate and felt that Driscoll had played them by talking about "shared sacrifice" while giving himself a big raise. Hall says he confronted Driscoll over the phone and told him, "[i]f you don't withdraw this motion, these negotiations are done." Hostess withdrew the motion a few weeks after Driscoll left. <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/> (Last visited April 24, 2013); *See also* Motion to Assume.

¹⁸³ <http://www.privco.com/private-company/hostess-brands-inc.> (Last visited March 17, 2013).

¹⁸⁴ <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited March 17, 2013).

¹⁸⁵ <http://dealbook.nytimes.com/2012/11/16/hostess-brands-says-it-will-liquidate/>. (Last visited March 17, 2013).

Driscoll, had received raises of up to 80% of their earlier salaries.¹⁸⁶ The unions were even more incensed at what they described as management's continued practice of "looting" the company at the expense of the workers.¹⁸⁷

This type of raise for top executives during financial troubles, however, is not necessarily as sinister as it may initially appear. Executives of Fortune 500 companies receive raises during times of financial trouble fairly frequently.¹⁸⁸ The justification for such raises is usually along the lines of the following: when a company is in financial difficulty, managing the company becomes more stressful but the need for top talent is even more dire; therefore, the company needs to pay its top executives more in order to keep those executives while they fix the company. The irony or apparent unfairness of this logic is not hard to see, since the company's poor performance and financial circumstances are likely to be at least partially the fault of those same managers receiving the raises. How could executives who led the company into insolvency ever be worth so much that a company should pay extra to keep them? As Hostess's bankruptcy demonstrates, however, the calculus of a managers worth is rarely so simple, and a company's woes could be as much the result of a changing market, an unsustainable capital structure, enormous legacy costs, or even the fault of previous management as much as it is the fault of the managers receiving the raises.

Regardless of the actual motives for the raises—whether to keep strained talent from leaving, loot the company, or somewhere in between—news of the executive raises was a public relations nightmare for Hostess's management and completely eroded any good will or trust that may have still existed between management and the workers.¹⁸⁹ In an attempt to mitigate the

¹⁸⁶ http://www.huffingtonpost.com/2012/11/16/gregory-rayburn-raise_n_2147043.html. (Last visited March 17, 2013).

¹⁸⁷ <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited March 17, 2013).

¹⁸⁸ <http://online.wsj.com/article/SB10001424127887323830404578145182000348430.html#project%3Dpayout102012%26articleTabs%3Darticle> (Last visited April 24, 2013); <http://thinkprogress.org/economy/2012/11/19/1215811/hostess-executive-bonuses/>. (Last visited March 17, 2013).

¹⁸⁹ An interesting side note to the union outrage over the salaries paid to Hostess's executives is the pay received by the executives of union's own executives. No one individual union leader for either IBT or BCT receives benefits that exceed \$400,000. BCT, however, has only 58 employees but has 8 vice presidents receiving annual pay between \$161,000 and \$218,000 while its top two executives receive \$244,396 and \$262,654 respectively and the top ten employees combine for a total salary of almost \$1.8 million. Likewise, the two highest paid executives of IBT receive annual pay of \$372,489 and \$337,601. While perhaps not as high as the salaries received by Hostess's management pre-bankruptcy, the union executives are certainly being paid handsomely for their efforts. <http://www.unionfacts.com/lu/315/BCTGMI/0/> (Last visited April 24, 2013).

damage and repair good will, Rayburn announced that the annual salaries of Hostess's top four executives, including himself, would go down to \$1, and their original salaries would not be reinstated until January 1, 2013 or the company emerged from bankruptcy, whichever came first.¹⁹⁰

Despite Rayburn and the other managers' efforts, however, Hostess continued to burn cash, and it became increasingly clear in late 2012 that unless drastic actions were taken soon, the company would have to liquidate. In response, management turned again to the unions seeking new concessions in order to keep Hostess afloat, and informed the unions that if significant concessions were not agreed to, then the company would be forced to liquidate.

At this point, it is important to note the power dynamics and leverage among the various interested parties to explain each side's actions. The popular press tends to present the events of the second half of 2012 and the lead up to the strike as a struggle between the executives of Hostess and the unions. Depending on the author's opinion of unions, each article paints one side or the other as greedy, incompetent, and uncompromising.¹⁹¹ This view, however, is, at the very least, overly simplistic.¹⁹²

By late summer of 2012, only two camps truly had skin in the game, the unions and the hedge funds that held Hostess's senior debt.¹⁹³ The equity interest held by Ripplewood after their investment brought the company out of the first bankruptcy was so far underwater at this point that there was little hope they would receive any significant amount in a liquidation sale. As a result, Ripplewood did not even bother to send representatives to the negotiations. Likewise, the executives and directors of the company held no debt or only minor amounts of subordinate debt and many were drawing nominal salaries. Their financial interests, if any

¹⁹⁰ <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited March 17, 2013). Realistically, it is hard to imagine that even the most bullish predictions for Hostess would have it successfully reorganizing and exiting bankruptcy by January 1, 2013.

¹⁹¹ http://www.huffingtonpost.com/2012/11/16/gregory-rayburn-raise_n_2147043.html (mistakenly claiming Rayburn received the pre-bankruptcy raise that Driscoll received) (Last visited March 17, 2013); <http://voices.yahoo.com/blame-execs-not-unions-hostess-closing-11882098.html?cat=3> (accusing management of "fatten[ing] their wallets" while union members "struggl[e] to feed their kids.") (Last visited Mar. 17, 2013); <http://www.glennbeck.com/2012/11/16/ho-ho-noooo-union-forces-twinkies-out-of-business/> (accusing unions of deliberately creating unrest and costing its members jobs rather than having them take an 8% pay cut in order to promote president Obama) (Last visited March 17, 2013).

¹⁹² Many news articles in describing the crumbling of Hostess as predominately the fault of the greedy managers repeated the inaccurate report that Rayburn, instead of Driscoll, had given himself a large raise prior to Hostess's entry into the second bankruptcy, even though Rayburn had not even been employed by Hostess at the time.

¹⁹³ Under their post-petition financing agreement, the hedge funds would be the first creditors paid out of any funds from a liquidation of the company, even before the lawyers. [Order_for_Post-Petition_Financing](#).

existed at all, were to continue drawing a salary by maintaining the company for as long as possible or saving the company to recover at least some amount on their claims. Management's interest in preserving the company, therefore, was actually more in line with the unions than it was with the hedge funds, and toward this end, the managers acted mostly as mediators attempting to facilitate an agreement between the parties.

Negotiations between the two largest secured creditors, Silver Point and Monarch, and the two largest unions, IBT and BCT, centered around concessions by either party to forgive a significant portion of Hostess's debt or to renegotiate terms of the CBAs concerning pay, medical benefits, and pension funds respectively. The problems, however, came from the fact that both sides had already made similar concessions in the past and were not inclined to do so again, neither side trusted the other, and both sides held a nuclear bomb that could destroy the company.

For their part, Silver Point and Monarch had already written off half of the Hostess debt that they had held in 2009 along with providing a new secured loan of \$360 million in order to help get Hostess out of its first bankruptcy.¹⁹⁴ By fall of 2012, each hedge fund still held somewhere between \$50 and \$100 million in senior debt, between \$100 and \$200 million total. While the exact amount paid by the hedge funds for that debt is undisclosed, some sources estimate it to be somewhere between \$125 million and \$175 million, so while the hedge funds still had a substantial interest in getting the most out of the company possible, they were not likely becoming rich "feeding off" Hostess, as the unions bemoaned.¹⁹⁵ Their trump card was the ability to refuse to provide additional financing to Hostess and thereby force it into liquidation, which would likely still give them, as the senior creditors, a significant portion of their remaining investment back, and perhaps even a slight profit.

On the other side, IBT and BCT had already agreed to wage, health benefits, and pension concessions that amounted to annual savings for Hostess of around \$110 million back in 2008, without which Hostess would not have been able to emerge from its first bankruptcy.¹⁹⁶ Furthermore, by August of 2012 Hostess was already \$100 million behind on its multiemployer pension payments, and the unions, feeling that they had already sacrificed enough, were reluctant to grant any further concessions. Unlike the hedge funds, however, the unions were in a much weaker bargaining position. They too possessed a weapon of mass destruction in that they could call a strike and force the company into liquidation, which would certainly cost the hedge funds some money. Such an action, however, would also cost over 15,000 union workers their jobs while the hedge funds would still walk away with a substantial sum of money.

¹⁹⁴ <http://www.cnbc.com/id/49853653>. (Last visited March 17, 2013).

¹⁹⁵ <http://management.fortune.cnn.com/2012/07/26/hostess-twinkies-bankrupt/>. (Last visited March 17, 2013).

¹⁹⁶ <http://www.cnbc.com/id/49853653>. (Last visited March 17, 2013).

Turning to the negotiations with these power dynamics in mind, in September of 2012, the hedge funds demanded the unions accept modifications to the various CBAs under the Reorganization Plan that would amount to an 8% cut in wages and 17% in cuts to Hostess's health care contributions.¹⁹⁷ In return, all the unions as a group would receive a 25% share of the company's stock and a \$100 million junior claim in the bankruptcy, which would both be essentially worthless unless Hostess made a dramatic recovery. The hedge funds warned that if this new deal was not accepted, they would not provide Hostess another round of financing and the company would be forced to liquidate.

At some point in August, however, during the lead up to the deal offer, BCT's leadership had become so upset with the way negotiations were going that they left the negotiating table and stopped communicating with the hedge funds or management. This exit left IBT leaders as the sole major representative of the workers, and certainly did nothing to improve the relationships among the parties.¹⁹⁸

While remaining highly critical of Hostess's poor management and decrying the tactics of the hedge funds, IBT leaders recommended the deal and put the proposal before a vote of their membership, which passed by a narrow margin with 53% of the vote¹⁹⁹ in favor of the deal.²⁰⁰ BCT, however, balked at the offer. The leadership denounced the deal, and, when put before the union members for a vote, they rejected it with an overwhelming 92% of the votes cast.²⁰¹

It is somewhat unclear why BCT union members would vote so predominantly in favor of having their jobs taken away rather than accept cuts to their wages and benefits, especially

¹⁹⁷ <http://www.bloomberg.com/news/2012-11-19/hostess-judge-asks-for-mediation-sessions-over-strike.html>. (Last visited March 17, 2013).

¹⁹⁸ According to Rayburn, BCTGM stopped returning the company's phone calls altogether. <http://dealbook.nytimes.com/2012/11/16/hostess-brands-says-it-will-liquidate/>. (Last visited March 17, 2013).

¹⁹⁹ http://www.huffingtonpost.com/2012/11/16/hostess-liquidation-teamsters-bakers-union_n_2145851.html. (Last visited March 17, 2013).

²⁰⁰ Ken Hall in recommending the deal stated, "the objective was to preserve jobs. When you have a company that's in the financial situation that Hostess is, it's just not possible to maintain everything you have." <http://dealbook.nytimes.com/2012/11/16/hostess-brands-says-it-will-liquidate/>. (Last visited March 17, 2013).

²⁰¹ Frank Hurt, the union's president, when talking about the offer and vote is quoted as saying "our members decided they were not going to take any more abuse from a company they have given so much to for so many years. They decided that they were not going to agree to another round of outrageous wage and benefit cuts and give up their pension only to see yet another management team fail and Wall Street vulture capitalists and 'restructuring specialists' walk away with untold millions of dollars." <http://dealbook.nytimes.com/2012/11/16/hostess-brands-says-it-will-liquidate/>. (Last visited March 17, 2013).

when considered next to the vote by IBT members. Perhaps the union felt that management and the hedge funds were bluffing and would come back with a better deal.²⁰² Perhaps the members believed that a buyer of the company would purchase the entire company and keep the unionized workers along with their CBAs.²⁰³ What is clear is that the leadership of IBT had urged their members to vote for the deal, while the leadership of BCT had encouraged its members to vote against it. While the exact motives of leaders and members are debatable, the recommendations of the different union leaders certainly impacted each union's respective vote.

Despite the vote of BCT, on October 21, 2012, Hostess's management began implementing the cuts to wages and health benefits to the various CBAs. In response, on November 7 and 8, they received notifications from BCT and other affiliated unions that its workers would strike until the CBAs were restored. Then starting on November 9, BCT union members commenced strikes at twelve different Hostess bakeries where union members were employed. At another twelve bakeries, BCT and other unionized workers set up picket lines, which were honored by many of the union workers whose unions had not formally called for a strike. Over a dozen bakeries were able to remain operational to varying degrees as some employees continued to arrive at work and crossed the picket lines and some plant managers even attempted to keep bakeries open by filling in personally for striking workers.²⁰⁴

Despite these efforts, however, the strikes successfully closed many of the bakeries and disrupted operations to the point of prohibiting Hostess from being able to fulfill all of its customer orders. Suffering under the strike, Hostess's management issued an ultimatum on November 14, 2012 for workers to return to work by 5:00 p.m. on November 15 or face unemployment, as the company would be forced to liquidate.²⁰⁵ The strikes, however, continued

²⁰² According to USA Today, under the ensuing strike, the IBT union attempted to persuade BCT members to hold a secret ballot on whether to continue striking, warning that, based off their own experts' assessment of the company, Hostess's warning of liquidation was "not an empty threat or a negotiating tactic" but a certainty if the strike continued. <http://www.usatoday.com/story/money/2012/11/15/striking-workers-defy-hostess/1708127/>. (Last visited March 17, 2013).

²⁰³ It is also possible that the union leadership was concerned about the effect another round of concessions would have in terms of making the union look weak when it negotiated other CBAs with other employers. <http://www.usatoday.com/story/money/2012/11/15/striking-workers-defy-hostess/1708127/>. (Last visited March 17, 2013).

²⁰⁴ Wind_Down_Motion.pdf.

²⁰⁵ On the morning of November 15, Hostess's executives were gathered in the company's headquarters in Irving, Texas, in the hope that enough employees would return to work to resume production. By that point, workers were crossing the picket lines at most of the bakeries, but at least 10 of the bakeries still did not possess enough workers to resume operations. Around 7 p.m., after the 5:00 p.m. deadline had passed and it became clear the company could not continue, Rayburn, the Hostess's board, and senior managers made the decision to wind down. <http://dealbook.nytimes.com/2012/11/16/hostess-brands-says-it-will-liquidate/>. (Last visited March 17, 2013).

despite the threat. As a result, Hostess's management determined that many of their bakeries had been rendered inoperable. Therefore, on November 16, 2012, management made good on their warning and filed a motion seeking authority to wind down their businesses.²⁰⁶ After hearings on November 19, 2012, November 21, 2012 and November 29, 2012, the Court entered a final order approving the wind down motion on November 30, 2012.²⁰⁷ Following the order, Hostess began pursuing the systematic wind down of their businesses and the sale of substantially all of their assets in Chapter 11.

²⁰⁶ Wind_Down_Motion.pdf.

²⁰⁷ *Id.*

Chapter 8: Liquidation

Once the unions struck, it became clear that the company was no longer a viable operating entity insofar as its employees had walked off the job. While both Chapter 7 and Chapter 11 *may* result in a debtor's assets being entirely liquidated, Chapter 11 can be a far better vehicle in certain situations because of the length of time that it may take to bring a Chapter 7 trustee up to speed on the business and the value of its assets and, in the normal course of events, most Chapter 7 trustees do not seek authority to continue operating the business, so all going concern value is generally lost.²⁰⁸ Thus, especially with a multifaceted conglomerate, a Chapter 11 with a 363 auction will likely produce substantially greater proceeds than a Chapter 7 trustee's auction.²⁰⁹

When the union strike began on November 9, 2012, BCT was seeking more compensation for workers than Hostess's negotiated proposal provided. The purpose of that proposal was to assist Hostess's operations during reorganization, which, in a best-case scenario, would eventually assist the company in its emergence from Chapter 11 and allow workers to remain working. However, because a court order was necessary to implement almost *any* change in pay-and-benefits disputes between unions and Hostess in the first place, any proposals this late in the timeline "to restart the company's network of 33 bakeries and 565 distribution centers" would be trivial because of the losses and impairment that the company suffered during the strike.²¹⁰

Furthermore, before approving the Reorganization Plan, which provided for the modifications to worker compensation eventually decided on in the negotiated proposal, Judge Drain had taken proper objections in accordance with the Federal Rules of Civil Procedure before entering that final order approving that plan. The significance of this fact for BCT was that, without a previous objection or appeal, BCT's late attempt to change the terms of a court ordered agreement through a strike was on shaky legal ground at best and opened the door for Hostess to file claims for damages for an unlawful strike (because the strike was in contravention of a court order). Other unions, however, arguably had better ground to stand on because they objected to the motion to approve the Reorganization Plan. In many ways, without previous objections or appeals, BCT was the least ideal protestor.

²⁰⁸ Going Concern Versus Liquidation Valuations.

²⁰⁹ George Kuney, Hijacking Chapter 11, 21 Emory Bankr. Dev. J. 1 (2005). George Kuney, Misinterpreting Bankruptcy Code § 363(f) and Undermining the Chapter 11 Process, 76 Am. Bankr. L.J. 235 (2002).

²¹⁰ <http://www.usatoday.com/story/money/2012/11/15/striking-workers-defy-hostess/1708127/>. (Last visited March 17, 2013); *see also*, Transcript Emergency Hearing Liquidation, Scan_Copy_Hearing_Liquidation_1_19_2012, page 4.

Practically speaking, the reality of the parties walking into the Emergency Liquidation Hearing was bleak. Months of negotiations and a formally proposed plan had failed. Distribution centers were standing unmanned. If the Reorganization Plan had been the train out of perdition then the strike caused that train to screech to a halt. In approving the liquidation plan, after an arguably valiant effort to get the parties to negotiate, Judge Drain aptly stated, “Sadly, the parties were not able to come to an agreement. It’s a free country. People are free not to agree.”²¹¹

Nonetheless, a story line of a still valuable corporation was being woven and marketed to the press and public. The constituent parts of the company were still profitable according to Joshua Scherer, of Perella Weinberg, a global, independent advisory and asset management firm, testified that this was “a once in a lifetime opportunity for [Hostess’s] competitors.”²¹² Thus, ultimately because a single union, BCT, had failed to object, appeal, or comply with a filed reorganization plan, and instead implemented a strike, Hostess would close its doors and competitors had the opportunity to bid on profitable pieces of a great company.

Because the constituent parts of the company were valuable enough to protect, salvage, and sell, Judge Drain’s ordering of a final mediation was arguably his last attempt to save Hostess’s current workers’ jobs. The mediation at least failed in the sense that no agreement was made between BCT and Hostess. Because the mediation was private, we do not know precisely who said what and what positions were taken. Had the parties reached an agreement, it seems likely that the Court would have provided approval for yet another roadmap for Hostess. However, the plan after this round of mediation was liquidation, an approval of the sale of assets on a going concern basis, protection of certain equipment, the sale of approximately \$21.6 million in ingredients, and preservation of the ability to conduct a series of 363 auctions in the future.

Pre-Liquidation Emergency Hearing and the Confectionary and Baker’s Union Continuing Strike.

Ms. Lennox, an attorney on behalf of the debtor, began the emergency liquidation hearing by stating that there was “no end in sight to the strike, we still have strikers outside our facilities

²¹¹ The tone of “it’s a free country” echoes a sentiment of a factual reality. The fact that the parties had already met many times with experts, including attorneys, and had a court-ordered plan to follow, yet, still could not operate, coupled with the fact that one of the parties went on strike, gave Judge Drain the factual and legal foundation to approve a plan to liquidate the company. This sad set of circumstances provided the momentum for the conclusion that liquidation was necessary. In essence, there had been enough talking, damage to the company, and posturing, and since saving Hostess entirely was no longer a real possibility, the company needed to be sold before its value diminished any further. <http://money.cnn.com/2012/11/21/news/companies/hostess-closing/index.html?iid=EL>. (Last visited March 12, 2013).

²¹² *Id.*

today.”²¹³ Judge Drain then asked whether some form of agreement between BCT and the debtor could be reached. Ms. Lennox stated that the idea of mediation would be on the table; however, the financial damage suffered by Hostess, according to customers and lenders, was such that it would be hard to recover from even if there were an agreement in the near term, and therefore, the best shot at recovery was to see what could be sold as a going concern.²¹⁴

In response to Ms. Lennox’s opening remarks at the Pre-Liquidation hearing, Judge Drain chimed in and stated that, he himself had offered to mediate between the union and the debtor on an expedited basis, and he was so willing to mediate that day. Drain stated that mediation was important because while the result of a strike was a significant economic hit, “moving to a liquidation [wa]s also a significant economic hit.”²¹⁵ Judge Drain emphasized that “mediation really only works if the parties are willing to do it” and he strongly suggested that the parties *should* be willing to mediate, because not going through mediation would leave a “huge question mark over this case.”²¹⁶

Moreover, Judge Drain stated that this strike took place after a two-fold opportunity for the BCT union to speak up, indeed, after the last round of 1113 litigation²¹⁷, which was on the merits, BCT did not object to the relief that was sought. Judge Drain seemed to emphasize this point when he stated, “I want to repeat that [BCT, the union on strike,] unlike other unions, BCT did not object to the debtor’s motion to reject the collective bargaining agreements, and to impose the last, best final terms on the union. There was no appeal from that order. It is a final order.”²¹⁸

The court did not have the power to enjoin a strike. As Judge Drain noted, however, nothing in the Norris-LaGuardia Act prohibited claims or monetary claims against a union for an

²¹³ Scan_Copy_Hearing_Liquidation_1_19_2012: “Good afternoon, Your Honor. Heather Lennox of Jones Day on behalf of the debtors. I’d like to thank you for hearing us so quickly on what are some very critical matters for the estates. As Your Honor knows, we didn’t want to be here today asking for the relief we’re going to address. Actually to the contrary. I think folks at the company, both union and non-union worked very hard to try to reorganize the company, ***but after the [BCT] went on strike on November 9 after about a week, the debtors decided that the losses were such, or anticipated to be such that we couldn’t continue to operate.***” (emphasis added).

²¹⁴ Transcript Emergency Hearing Liquidation, Scan_Copy_Hearing_Liquidation_1_19_2012, page 4.

²¹⁵ *Id.* at page 14.

²¹⁶ *Id.*

²¹⁷ Section 1113 of the Code provides the framework for debtors and unions to modify pre-petition CBAs. <http://www.abiworld.org/committees/newsletters/employeebenefits/vol5num2/section.pdf>.

²¹⁸ *Id.*

unlawful strike, “or a strike that is basically improper,” or “contravenes another law.”²¹⁹ Judge Drain noted that violating a court order is unlawful and by inference, BCT, by continuing to strike, was potentially racking up a set of monetary claims from multiple parties. As if creating bookends to his argument, Drain went on again, “I not only by final order approved the rejection of the collective bargaining agreements, I approved the impositions of their terms, and that’s a final order.”²²⁰

Effectively, BCT, by continuing to strike, forced a prisoner’s dilemma, where, by asking now for too much in contravention of a court-order that was never objected to, nor appealed, BCT forced Hostess’s hand and forced itself “to accept the termination of 6,000 jobs, and the ... inevitable reduction of recoveries ... when there was no attempt [previously] to contest the terms that were imposed.”²²¹

With the aforementioned noted, Judge Drain, urged Mr. Freund, counsel to the BCT, to enter into private mediation that day. Unfortunately, Mr. Freund was in court that day but his client was not. Beguilingly Judge Drain stated, “so perhaps you should call your client and ask him whether this time tomorrow afternoon he would be available for mediation on this issue.”²²² The court adjourned and mediation eventually followed the next day.

Emergency Liquidation Motion Approved

On November 16, 2012, Hostess filed an Emergency Motion to wind down its business and to liquidate its assets.²²³ After a five-hour hearing, and a subsequent failed mediation, the motion to wind down the business was granted on November 27, 2012. Pursuant to sections 105, 363, 365, and 503(c) of the Bankruptcy Code, Hostess’s motion was granted and relief came in an approval of the: plan to wind down Hostess’s business, sale of certain assets, and an order authorizing Hostess to take any and all actions necessary to implement the wind down (the “Wind Down Plan”).²²⁴

²¹⁹ Judge Drain mentioned his opinion in *Ace Elevators*, which is available here: http://www.nysb.uscourts.gov/opinions/rdd/115931_152_opinion.pdf. (Last visited March 17, 2103).

²²⁰ Transcript Emergency Hearing Liquidation, Scan_Copy_Hearing_Liquidation.

²²¹ *Id.* Quoting Judge Drain.

²²² *Id.*

²²³ Motion to Wind Down.

²²⁴ The Wind Down Plan was approved, pursuant to sections 105(a) and 363(b) of the Bankruptcy Code, filed November 27, 2012, and *nunc pro tunc* as of November 21, 2012.

Emergency Liquidation Plan and Motion: Substantive Requests and Provision

The beginning of the end for Hostess and the unions began with a recital of where things went wrong and why the relationship was failed at its inception.

As previously mentioned, on February 3, 2012, the Court entered an order authorizing the Debtor to obtain DIP financing in order to operate.²²⁵ Throughout the following months, Hostess focused on and pursued the reorganization of its businesses. As set forth in the reasoning in the 1113 and 1114 motions, Hostess required the court to impose new terms for the collective bargaining agreements because, “the biggest component of [Hostess’s] costs were the obligations under collective bargaining agreements that cover nearly 15,000 active union employees.... Hostess simply cannot emerge as a viable competitor unless [it is] relieved of significant financial commitments and arcane work rules imposed by their collective bargaining agreements.”²²⁶

On January 25, 102, Hostess filed a motion to reject certain CBAs pursuant to sections 1113(f) and 1114(g) of the Bankruptcy Code.²²⁷ After months of work by both the unions and Hostess, either consensual or court ordered CBAs were accepted and implemented covering each of the twelve unions. Then, strikes began and continued and because of the “material impairment of [Hostess’s] business operations, [Hostess would soon lose] access to the funding necessary to operate [its] businesses, and ... [the strikes had] triggered certain remedial provisions of the Final DIP Order. As a result, [Hostess was] beginning to take steps to wind down the business operations.”²²⁸

Wind Down Plan

The Wind Down Plan provided a clear roadmap to closing down operations and eventually to 363 sales. Hostess sought to preserve itself through its Wind Down Plan in order to gain the most value for the company as a going concern. Interestingly, the price tag for winding down its businesses for the first 13 weeks as set forth in the Motion would cost Hostess around \$41 million in operating expenses alone. The \$41 million did not include legal fees, bankruptcy-management related costs, and did not include the unfunded liabilities that are off the books, i.e., pension plans. Thus, a purchaser of one of the constituent brands arguably would want a strong indemnification and exculpation clause, and a high hold-back amount, because of the potential litigation as a predecessor in interest for Hostess, as well as the fact that the Liquidation Motion requested that buyers would take on as many of the “related administrative expenses and other

²²⁵ DIP Financing Motion.

²²⁶ Hostess Motion to Wind Down.

²²⁷ Docket No. 174.

²²⁸ Motion to Wind Down at page 9.

claims as possible.” The purchasers of Hostess would buy valuable brands, but damaged goods, in the sense that there was a cloud of uncertain litigation surrounding each constituent brand. Tied to this potential litigation with the unions and other creditors was also the questions of whether the purchasers of Hostess’s brands would also hire on Hostess’s workers, and if so, on what terms.

Generally, a wind down plan is designed to maximize the value of the Debtor’s now-liquidating Chapter 11 estates while protecting the safety of consumers and the Debtor’s employees through the completion of procedures to maintain and protect the Debtor’s assets pending the ultimate liquidation and the return or sale of perishable items.²²⁹ For example, Hostess began to “dry pack” boilers²³⁰ to preserve the equipment for sale and secure the fleet, i.e., the delivery trucks.²³¹

Hostess’s hopes for the wind down was two-fold, first, the sale of assets on a going concern basis and second, buyers assuming as many of the “related administrative expenses and other claims as possible.”²³² Hostess developed the Wind Down Plan with consultation of advisors focusing on: (i) bakeries, (ii) retail stores, (iii) bakery outlets like the Merita Breads outlets, sometimes referred to as thrift stores, and (iv) corporate functions.²³³

As a part of the Wind Down Plan, a group of workers would “prepare, preserve, secure, and clean” each of the 37 bakeries. According to the Motion, each plant would require 28 employees to effectuate the activities necessary to preserve the bakeries. At the time the Wind Down Plan motion was filed, Hostess estimated that it had approximately \$29.3 million in excess ingredients and around \$1 million in non-branded-packaging. Hostess would attempt to sell or return as many of the ingredients as possible, however, some vendors would possibly refuse returns, and some ingredients could perish. According to the plan, the costs associated with winding down all of the bakeries and plants would be approximately \$17.58 million over the first thirteen weeks of the wind down.²³⁴

²²⁹ *Id.*

²³⁰ Dry packing is a process where steam boilers are placed in large protective cargo boxes that allow the boilers to be shipped without being damaged. Here is an example of dray packing <http://www.oilseedspress.com/News/Steam-boiler-packing-pictures/>.

²³¹ *See* Wind Down Motion. Here in Knoxville, there are delivery trucks parked in parking lots and guards on duty watching to make sure that equipment is not damaged available at <http://northknox.wbir.com/news/news/45991-knoxville-merita-workers-hope-rise-again-better-owners>. (Last visited March 17, 2013).

²³² Wind Down Motion.

²³³ *Id.*

²³⁴ Wind Down Motion.

Additionally, as a part of the Wind Down Plan, 165 depots and another 388 depot-and-retail facilities would need to be cleaned and prepared for sale. Twinkies and cupcakes would be sold or donated or destroyed. Costs associated with the winding down of the depot facilities were estimated at \$6.85 million over the first thirteen weeks of the wind down.²³⁵

The retail stores would need a similar cleansing and disassembling to preserve and protect the facilities for sale. Retail stores that were owned by Hostess would be marketed and sold. The remaining leases for the remaining retail stores would be rejected. Additionally, during the wind down, perishable inventory would be sold in going-out-of-business sales (“GOB sales”), donated or destroyed. All of the GOB sales would take place in the same ordinary course of business and the price of the products would not be sold at a discounted rate unless a store manager so decided. Costs associated with the disposition of the retail stores are approximately 8.76 million over the first thirteen weeks of the wind down.²³⁶

Costs associated with the corporate wind down over 13 weeks, including keeping accountants, internal legal department and executive management was approximately \$8.10 million.²³⁷ To clean, repair, pack, preserve, and quite literally protect equipment with security guards, certain third party contractors would be needed to perform functions in the Wind Down Plan. Those costs were included in a separate schedule.

Financing and Implementing the Wind Down Plan

Hostess was working with DIP lenders to gain consensual agreement about the use and amount of cash that would be lent to Hostess during the wind down period. Pursuant to the Emergency Liquidation Motion, Hostess was requesting that the Court allow the company to use cash in the event that DIP lenders did not agree to certain terms, because, the company needed the cash to operate. Hostess reasoned that the DIP lenders had adequate protection in its security interest in assets. Nonetheless, Hostess assured the Court in its motion that it was still seeking an additional revolving facility as an assurance to the DIP lenders. Notwithstanding that effort, Hostess requested that the court grant the motion allowing Hostess to use cash to operate during wind down, regardless of previous DIP lender agreements.²³⁸

The original liquidation budget, before the strike, that was approved by the court and consensually agreed to by both parties, was a thirteen-week plan. That plan covered the (1) pay

²³⁵ Wind Down Motion.

²³⁶ *Id.*

²³⁷ *Id.*

²³⁸ *Id.*

down of the \$45 million to asset based lenders (“ABLs”) for their pre-petition indebtedness;²³⁹ and (2) the payment of certain Wind Down Plan expenses. Hostess stated that it needed further DIP financing, because, while there should be cash flow from liquidation, it may take time to liquidate assets, and cash may not be available to pay claims as they come due. To assure the ABLs that provided Wind Down Plan financing before the strike that they would be protected during wind down and ultimately paid for their pre-petition debts, the ABLs requested a pre-petition revolving agent as a further guarantee of payment. If no such agreement was made, then, Hostess would likely request the court to approve the non-consensual use of DIP financing to wind down its business.²⁴⁰ Hostess argued that the assets and collateral that secured the ABLs’ financing in the first place was sufficient security to assure the ABLs that they would be paid. However, the ABLs had concerns that the assets would be destroyed during the strike or liquidation and wanted further security.²⁴¹

Another issue presented in the Wind Down Plan was the payment that would need to be provided to wind down employees. Employee retention plans for non-senior management to stay on during the wind down included a one-time retention payment of 25% of their respective salaries totaling \$4.36 million.²⁴² This retention payment would hopefully keep essential workers in the boat rowing to the shore of liquidation as opposed to jumping ship and leaving Hostess sitting adrift with the shore only in sight in the distance.

An incentive plan *ranging from \$0– \$1.75 million* was also proposed for senior management. The significance of a plan that starts at \$0 is that the executives are only paid an additional incentive on top of their wind down salary if certain metrics or goals are reached. Thus, an incentive plan is different than a one-time retention payment because it is not guaranteed. The significance of retention bonuses versus incentive plans are discussed in further detail below in response to certain objections to the Wind Down Plan.

All remaining employees and executives would be required to sign a general release of all claims against Hostess and certain parties as a condition to participating in the retention plans or incentive plans. Thus, employees that choose to stay on as a part of the Wind Down Plan, generally could not cause further expense to the company and its predecessors through the instigation of law suits or legal proceedings, and in return those wind down employees received compensation. Notably, Hostess would need to provide some protection to the employees that

²³⁹ ABL means Asset Based Lenders, i.e., Lenders that have a Security interest in collateral. If Hostess did not pay an ABL, then the ABL may take the collateral. An issue arises when the collateral is gone or damaged for an ABL. Thus, an ABL may want further protection beyond the collateral.

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² *Id.*

chose to stay on board during the wind down process because they were likely targets of litigation during a tumultuous time of winding down. This is further discussed in the next section.

Exculpation and Indemnification for Protected Persons

Hostess's Liquidation Motion also sought court approval to enforce the Wind Down Plan's exculpation provisions through the issuance of court protection. Specifically, the motion requested that the Court provide necessary injunctions against those taking actions against those employees that were personally sued because of their involvement in the wind down and that such employees could only be sued under the alter ego of their position at Hostess.²⁴³ The reasoning behind this section of the motion was that a board of directors and key officers were necessary to implement the wind down and it would be unreasonable to expect those individuals to participate in the Wind Down Plan if doing so would subject them to potential personal liability. Further, the Liquidation Motion provided for the execution of a trust to pay for suits arising out of wind down employees' actions in their corporate roles.

Objections to Motion to Wind Down

There were numerous objections to the Wind Down Plan.²⁴⁴ The numerous acronyms of various unions' objections look like alphabet soup in a docket-bowl. All of the objections to the Wind Down Plan had a similar theme: reducing the Wind Down Plan budget.

²⁴³ Indemnification for "Protected Persons" as that term is defined in the Motion for "any and all actions they have taken (or will take) in good faith, and any and all actions that they have refrained, or will refrain, from taking in good faith, to develop, approve, implement and/or oversee the Winddown Plan (the "Exculpation"). Motion, p. 30 at ¶ 63. Also, "...the Exculpation should be enforced by the court through the issuance of an injunction against the taking of such actions against the Protected Persons, and claims or causes of action challenging the foregoing should be enjoined (the "Injunction")." Motion p. 31 at ¶ 63.

²⁴⁴ Order Granted, Recognizing Objections. Motion by Oleysa Gats, the IUOE Stationary Engineers' Local 39, Stationary Engineers Local 39 Pension Trust Fund, and Stationary Engineers Local 39 Annuity Trust Fund, the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America and its Local 2828, Blommer Chocolate Company, the Bakery and Sales Drivers Local Union No. 33 Pension Fund and Mid-Atlantic Regional Counsel of Carpenters' Annuity Fund, the International Association of Machinists and Aerospace Workers, AFL-CIO, National Grid Companies, the United States Trustee, General Electric Capital Corporation, the Bakery and Confectionary Union and Industry International Pension Fund, the Bakery, Confectionary, Tobacco Workers and Grain Millers International Union, the Interstate Brands Corporation – International Brotherhood of Teamsters National Negotiating Committee, certain utility companies, Trustees of the RWDSU and Industry Pension Fund, and the United Food and Commercial Workers Unions and Employers Midwest Pension Fund.

IUOE Objection to the Wind Down Plan

As an illustrative example, the International Union of Stationary Engineers (IUOE) Stationary Engineers Pension and Trust Fund's objection to the wind down sheds light on the key concerns in much of the opposition to the Wind Down Plan. According to its motion, The Wind Down Motion exculpation provisions created an absolute immunity for actions taken by protected persons over an "indeterminate period of time with no justification for the breadth or scope."²⁴⁵ Moreover, the motion argued that the court did not have the authority to enforce the exculpation provision as written.²⁴⁶

The IUOE objection stated that a trust to indemnify officers and directors was unnecessary: "Incredibly, [Hostess's management] further seek to create a trust fund to indemnify the Protected Persons from any potential liability."²⁴⁷ In context, a trust fund sounds like a good common sense belt and suspenders solution to assure wind down employees that they would not lose their homes defending themselves from suits. On the one hand, if Hostess was still operating, then such a trust would be unnecessary because the corporation would pay for multimillion dollar legal-defense-fees for directors, officers, and employees acting within the scope of their employment. On the other hand, if the exculpation provision provides for defense funds for wind down employees and executives in the event that they are sued, where else would the money come from? Surely the multiple purchasers of the constituent brands would not sit down over tea and offer up a portion of their hard-fought purchased corporation to send cash over to defend executives of a predecessor corporation in a multi-million dollar lawsuit. In its objection, the IUOE reasoned that such a trust is unnecessary because corporate officers are already protected for certain activities by the business judgment rule. While this is an accurate statement of the law, the fact that the predecessor corporation will cease to exist means that there has to be money to defend corporate officers when they are acting within their respective duties, even under the business judgment rule. Here, the objections to the trust were likely fueled by the hope that more money would be in the pool for payments to unsecured creditors.

The Trust provides money to so ensure that wind down employees are able to pay legal fees if they are sued and the Wind Down Motion requests that the employees not be sued personally. This approach allows Hostess to ensure wind down employees, that if they are sued for their activities in winding up the corporation, they will be provided with remuneration for their legal fees.

²⁴⁵ Objection to Motion.

²⁴⁶ Objection to Motion.

²⁴⁷ Objection to Motion.

Moreover the IUOE objected to the executive and wind down employee incentive plan as unjustified and overly generous. The objection misconstrues 11 U.S.C. § 503²⁴⁸ as well as case law, specifically, *Dana II* 358 B.R. 567 (Bankr. S.D.N.Y. 2006).

Under 11 U.S.C. § 503(c)(3), a company is prohibited from making “other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.”²⁴⁹ Section 503(c) was added as a part of the Bankruptcy Abuse Prevention and Consumer Protection Act in 2005.²⁵⁰ The purpose of Section 503(c) was to “expand the authority of the bankruptcy courts to limit retention bonuses and severance pay to corporate insiders.”²⁵¹

Under New York federal case law, in order for such a plan to be approved, pay needed to be based on officer performance. In *Dana I*, the bankruptcy court in New York rejected an executive compensation plan that was not based on performance. In *Dana II*, the corporation modified the *Dana I* wind down plan and the court held that “unlike the previous iteration, has no guaranteed payments to the CEO or Senior Executives other than base salary and is a substantial retreat from the original proposals.”²⁵² Because the plan in *Dana II* was based on performance goals and served to incentivize the executives, the plan could be approved under section 503(c).²⁵³

Here, Hostess executives’ potential incentive pay during the wind down in total, ranged from \$0- \$1.75 million. The number, “0” is significant because it illustrates that the executives are not guaranteed any set amount. Moreover, the wind down employees were offered 25% of their previous annual salary as a one-time retention bonus, which is within the statutory requirements provided in section 503.²⁵⁴

²⁴⁸ <http://www.law.cornell.edu/uscode/text/11/503>. (Last visited March 17, 2013).

²⁴⁹ 11 U.S.C. § 503(c)(3).

²⁵⁰ S. 256, 109th Cong. (2005); H.R. 685, 109th Cong. (2005) (enacted); <http://www.wmitchell.edu/lawreview/documents/12.suhreptz1.pdf>.

²⁵¹ S. 256, 109th Cong. (2005); H.R. 685, 109th Cong. (2005) (enacted). *See also* Bethany C. Suhreptz, Key Employee Retention Plans, Executive Compensation, and BAPCPA: No Rest for Congress, No More for Execs., William Mitchell L. Rev., page 1208, available at <http://www.wmitchell.edu/lawreview/documents/12.suhreptz1.pdf>.

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ In fact, Hostess’s incentive plan complies with the following sections of 503(c): “Notwithstanding subsection (b), there shall neither be allowed, nor paid—(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the

Mark Popovich Objection to the Wind Down Plan

An objection, filed by Mark Popovich,²⁵⁵ an employee of IBC, noted that exculpation and injunctive relief would be unnecessary “given that the [Wind Down Plan] calls for certain sums to be set aside in “Trust” to fund any litigation arising as a result of actions taken during the wind down.” This objection postulated that because the parties were protected from individual liability by Hostess’s Directors’ and Officers’ insurance policies (D and O insurance), as well as a trust, there was no need for further protection from individual liability of wind down employees.²⁵⁶

This line of reasoning seems, on the whole, more reasonable than the line of reasoning in the IOUE’s objection. However, the issue might be, how long the D and O insurance would last after the wind down and more specifically, what the Statute of Limitations for claims arising out of actions of employees during the wind down was, and whether or not a tail could be purchased for the D and O Insurance. In essence, the critical question for wind down employees, might be: How would Hostess pay for the D and O insurance and how *long* after the company ceased to exist would the company indemnify officers? Moreover, did the D and O Insurance protect more employees that worked during the wind down that might be sued? The answers to these questions might provide answers as to why the Wind Down Motion included an implementation of a trust.

Motion Granted to Wind Down Business. Interim Order Pursuant to Sections 105, 363, 365

The court granted the Wind Down Motion²⁵⁷ and entered an order in favor of Hostess. The court held that the business justifications provided by the company were sound. The court noted that the following justifications were particularly reliable:

debtor’s business, ***absent a finding by the court based on evidence in the record that—... (B) the services provided by the person are essential to the survival of the business; and (C) either... (ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such non-management employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred....***” (emphasis added).

²⁵⁵ Objection by Mark Popovich.

²⁵⁶ The Objection provides: “See *Solow v. Kalikow* (In re *Kalikow*), 602 F.3d 82, 96 (2d Cir. N.Y.2010) (“Section 105 does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity.”) (internal citations and quotation marks omitted). Further the Debtors’ attempt to justify such an injunction under the Court’s powers under Section 363(b) of the Code is equally unavailing. Nothing in Section 363(b) authorizes an injunction or exculpation similar to the one requested herein.”

²⁵⁷ Interim Order.pdf.

- i. the proper administration of Hostess's Chapter 11 estates requires, and will continue to require, intensive planning, staffing and funding to ensure a proper, safe and orderly wind down of Hostess's estates and the prevention of immediate and irreparable loss of value,
- ii. a free-fall shutdown and liquidation would, among other things, irreparably damage production equipment, result in the failure to dispose, or improper disposal, of waste materials, materially adversely affect Hostess's ability to maximize the sale value of their assets, and could force the Hostess to incur significant administrative expenses, and
- iii. these consequences would dissipate the value of Hostess's assets and harm creditor recoveries in these Chapter 11 cases.²⁵⁸

The Court considered all of the motions filed, and on an interim basis held that Hostess was authorized pursuant to sections 105(a) and 363(b) of the Bankruptcy Code to take any and all actions that were necessary or appropriate in the exercise of their business judgment to implement the Wind Down Plan pending the Final Hearing.²⁵⁹

The Court attached the Liquidation Budget to the order to reflect the terms of the Interim Order. While there were various changes from the previous DIP budget, a critical change in the DIP budget was the access that Hostess had to additional cash for "Other Pre-Liquidation Expenses." The Court provided that "[Hostess] shall be authorized to pay a claim within this category only after obtaining the consent of the DIP agent and the pre-petition revolving agent, which consents shall not be unreasonably withheld."²⁶⁰

Rejection of Chapter 7 Filings

On November 19, 2012, the United States Trustee filed an objection to Hostess's request to take any and all actions necessary to implement the Wind Down Plan. Specifically, the objection argued that the Hostess bankruptcy should be converted to a Chapter 7 bankruptcy. "[Judge] Drain rejected a request by U.S. Trustee Tracy Hope Davis to convert the Hostess case to a Chapter 7 liquidation from Chapter 11, which would have handed control over the asset sales to a conservator. Conversion 'would be a disaster,' [Judge] Drain said."²⁶¹

²⁵⁸ Interim_Order_Winddown.pdf.

²⁵⁹ Interim_Order_Winddown.pdf page 3,4.

²⁶⁰ *Id.* Para. 5, page 4.

²⁶¹ <http://www.bloomberg.com/news/2012-11-27/bakers-union-asks-hostess-judge-to-appoint-trustee.html> (Last visited April 24, 2013).

The objection stated that “[Hostess is] administratively insolvent and [has] determined to liquidate [its] businesses.”²⁶² In support of the objection, the United States Trustee cited 11 U.S.C. § 1112. Section 1112(b) of the Bankruptcy Code provides that on request of a party in interest, and after notice and a hearing, “the Court shall convert a case to a case under Chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.” The Bankruptcy Code specifies instances under which cause may be found. That list, however, is not exhaustive.²⁶³

The cause set forth in the objection was that Hostess had “abandoned any meaningful reorganization activity, causing a substantial loss or diminution to the estate through the incurring of administrative expenses fees without any ‘reasonable likelihood of rehabilitation of the estate.’”²⁶⁴

The United States Trustee’s objection reasoned that the bifurcated treatment of administrative claims in the Wind Down Plan “[was] an implicit admission of the administrative insolvency of [Hostess].”²⁶⁵ In support of this reasoning, the objection provided “[t]hat administrative insolvency would preclude [Hostess] from confirming any plan of reorganization absent the ‘consent of the administrative creditors that would not be paid in full,’” citing *McMillan v. Ltv. Steel, Inc.*, 555 F.3d 218, 222 (6th Cir. 2009).²⁶⁶

The timing and facts of *McMillan*, however, were not analogous to the case at bar. In that case, a corporation sold all of its assets according to an “Asset Protection Plan,” and those assets satisfied the debts owed to secured creditors. However, after executing that plan, the debtor was unable to pay administrative expenses and other unsecured claims. For that reason, the corporation declared itself administratively insolvent and therefore unable to confirm a plan of reorganization.²⁶⁷

Here, Chapter 11 was filed, a reorganization plan was attempted, a strike occurred, and a Wind Down Plan was proposed to protect the estate and prepare it for liquidation and 363 sales in order to pay administrative expenses. In order to have money to pay administrative expenses incurred during the bankruptcy, Hostess needed to implement a Wind Down Plan because the reorganization plan was no longer viable. The lack of viability of reorganization plan based on

²⁶² See UST_Objection_To_WDP_Convert_7_pdf.

²⁶³ <http://www.law.cornell.edu/uscode/text/11/1112> (Last visited April 24, 2013.)

²⁶⁴ 11 U.S.C. § 1112(b)(4)(A). See UST_Objection_To_WDP_Convert_7_pdf.

²⁶⁵ See UST_Objection_To_WDP_Convert_7_pdf.

²⁶⁶ *Id.*

²⁶⁷ *McMillan v. Ltv. Steel, Inc.*, 555 F.3d 218, 221 (6th Cir. 2009).

circumstances is not the same as a reorganization that does not bear enough fruit to feed hungry administrators like the plan in *McMillan*. The plan in *McMillan* was completed and the debtor could not pay administrative expenses. Here, creating a Wind Down Plan does not necessarily lead to the conclusion that administrative expenses will not be paid.²⁶⁸

On the one hand, in this case, the reorganization plan was halted by a strike, and liquidation would likely pay administrative expenses. A conservator would likely take time to get up to speed and further, likely cause further substantial loss or diminution to the estate. On the other hand, a conservator may not request to be paid incentive bonuses or other executive expenses. Arguably, a conservator would be more neutral to the interests of the parties involved.

There is a little bit of chicken or egg circuitry to both sides of the argument. If a conservator was appointed, then, there would likely be revenue loss for every minute that the workers do not work and the company would be unable to sell products while the conservator established a plan. Presumably, if the case had gone to a Chapter 7, then the Chapter 7 administrative expenses would have priority over the outstanding Chapter 11 expenses. For example, the trustee and its attorneys would have been paid in full, for sure, and the Chapter 11 debtor's counsel and Official Creditor's Committee and respective counsel and advisers would have not necessarily been paid their fees if the judge converted the Chapter 11 to a Chapter 7 bankruptcy and had found that Hostess was indeed administratively insolvent.

Alternatively, the money, experts, consultants, and industry executives in place, might be charging fees, on fees, on fees, to implement an efficient wind down. Neither argument is perfect, but, on balance, Judge Drain found that the Wind Down Plan was well articulated and should be implemented to preserve the estate without a Chapter 7 conversion or a conservator.

Indeed, the Bankruptcy Code assigns priority to certain administrative expenses, including “the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.” 11 U.S.C. § 503(b)(1)(A). Under the Bankruptcy Code, administrative expenses are “entitled to priority over prepetition unsecured claims.”²⁶⁹ Here, the Wind Down Plan provides an avenue to pay administrative costs, which are costs that Hostess incurred *after* bankruptcy was filed. What is unclear, is, which expenses from the first bankruptcy in 2004 were a part of this bankruptcy.

Despite its distinguishable facts, the United States Trustee's objection cited the *McMillan* case (*supra*.) to support its reasoning. In that case the court applied a two-part test to determine whether a claim is entitled to administrative expense priority. A debt constitutes an actual,

²⁶⁸ *McMillan v. Ltv. Steel, Inc.*, 555 F.3d 218, 221 (6th Cir. 2009).

²⁶⁹ *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 5, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000) (citing 11 U.S.C. §§ 507(a)(1), 726(a)(1), 1129(a)(9)(A)) *McMillan v. LTV Steel, Inc.*, 555 F.3d 218, 225 (6th Cir. 2009).

necessary administrative expense “only if (1) it arose from a transaction with the bankruptcy estate and (2)[it] directly and substantially benefitted the estate. Thus, a debt must arise after the debtor files for bankruptcy-post-petition in order to be accorded administrative expense priority.”²⁷⁰ Furthermore, any liability that a corporation might have incurred pre-petition does not constitute an administrative expense under the Bankruptcy Code. The concern emphasized by the United States Trustee was that administrative creditors would not be paid or were unfairly discriminated against in the Wind Down Plan because executives and other expenses were paid as a part of the plan.

To support that contention, the motion reasoned that the incentive bonus plans are not retention payments in violation of section 503(c)(1) of the Bankruptcy Code. However, as previously mentioned, Hostess executives’ incentive pay provided the Wind Down in total, ranges from \$0- \$1.75 million. Because the executives are not guaranteed any set amount of pay under the plan, if executives did not meet certain benchmarks they would not be paid bonuses during the Wind Down. Indeed, the executives would be paid a salary during the Wind Down, to which the Trustee did not object, however, the bonuses that were objected to by the Trustee, meet the statutory requirements and case law because executives are not guaranteed the full amount of the incentive bonus. (see also Chapter 9, Dana I analysis).

Because Judge Drain rejected the United States Trustee’s motion to convert the proceeding to Chapter 7, Hostess began to make plans to argue its motions and to implement the Wind Down Plan and liquidation.

²⁷⁰ *McMillan v. LTV Steel, Inc.*, 555 F.3d 218, 225-26 (6th Cir. 2009) (internal citations omitted).

Chapter 9: Section 363 Sales

After a business, such as Hostess, files for bankruptcy, two major items on its agenda are: (1) a court approved confirmation of a reorganization plan; and (2) the sale of major assets on a going concern basis.²⁷¹ If a company, however, is unable to operate successfully after implementing a reorganization plan and is burdened by unyielding internal disputes, the company may file a Bankruptcy Code Section 363 motion to sell their assets at auction.

Section 363 provides, generally, authorization for the sale of assets in bankruptcy.²⁷² However, it is not a roadmap to the procedure to be used to do so—“there is nothing in the Bankruptcy Code requiring bidding (there is no mention of higher and better offers), stalking horses, or sale procedures orders; ...[or specific provisions on] issues [such] as environmental liabilities, toxic torts or successor liability in a sale context.”²⁷³ In some cases, Section 363 can be used to implement a confirmed plan.²⁷⁴ In other cases, as is the case here, a debtor in possession files a motion to sell and Section 363 can “be used on a free-standing basis to authorize a preplan sale free and clear through a trustee’s or debtor in possession’s motion to sell.”²⁷⁵

In a 363 Sale, there is a bargain that is being struck in the Bankruptcy Code between: (1) creditors and their right to seize collateral and; (2) the debtor that would like to sell or use assets to operate. Moreover, when a bankrupt corporation gives notice to the public and actively seeks bids, the value of the company becomes greater (hopefully) than the sum of its parts.²⁷⁶

Specifically, from the creditor’s perspective, a company that is being sold might be worth more than foreclosing on the collateral. For example, an oven, bags of flour, and other items that are used in the ordinary course of business are typically sold pursuant to Section 363 because those assets lose value when they simply sit on shelves. Generally, in a 363 sale, the company is out shopping for the highest bidder for the larger part of the company, the brand, the factory, the

²⁷¹ When a 363 Sale is the best Route, Robert Sable: available at: http://www.mcguirewoods.com/newsresources/publications/financial_services/jblp.15.02.pdf (last checked February 5, 2013).

²⁷² “The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate...” 11 U.S.C. § 363 (b)(1).

²⁷³ When a 363 Sale is the best Route, Robert Sable: available at: http://www.mcguirewoods.com/newsresources/publications/financial_services/jblp.15.02.pdf (last checked February 5, 2013).

²⁷⁴ George Kuney, *Misinterpreting Bankruptcy Code § 363(f) and Undermining the Chapter 11 Process*, 76 Am. Bankr. L.J. 235 (2002).

²⁷⁵ *Id.*

²⁷⁶ *Id.*

distribution channels, trucks, and operations. From a secured creditor's perspective, the benefit of a company carrying out a 363 sale is the difference between the value of a set of depreciated ovens for sale at a large second-hand baking equipment warehouse, versus the factory before the ovens are ripped from the walls. It benefits the secured creditor when a successful 363 auction takes place because the company is being marketed as a whole. The buyers are seeking to purchase the revenue-maker, the whole company.

Because a bidder for a company will provide more money into the estate to pay the creditor than the creditor would get for its security interest in the oven, a creditor thinks about the value of a used oven being pulled out of a wall versus the value of that oven taken together as a part of a functioning bakery. The business is worth more as a going concern than the sum of its parts sold at a foreclosure sale.²⁷⁷

What is a Stalking Horse?

The initial bidder with whom the debtor negotiates a purchase agreement is called the “stalking horse” bidder. The term is an old hunting term referring to either a real horse or an image of a horse (typically some type of screen) behind which a hunter would hide to conceal himself and enable him to get closer to his prey.²⁷⁸

The Debtor, i.e., Hostess, will engage an investment banker(s) and law firm(s), here, Perella Weinberg Partners and Jones Day, to approach strategic purchasers that are willing to purchase the Chapter 11 company. The first “auction”²⁷⁹ ends with the “selection of a stalking horse purchaser and the negotiation of an asset purchase agreement executed contemporaneously with the filing of a motion or petition. In agreeing to the asset purchase agreement (“APA”), this stalking horse purchaser agrees to purchase the assets subject to higher and better bids and subject to the approval by the bankruptcy court.”²⁸⁰

The benefit of selecting a stalking horse for a Debtor is that there is at least one potential buyer before the “live auction” and that potential buyer provides insight into what the ultimate price paid for the target corporation at auction might be. Hopefully, with an initial stalking horse, other bidders will come to the auction and drive the price up.

²⁷⁷ When a 363 Sale is the best Route, Robert Sable: available at: http://www.mcguirewoods.com/news-resources/publications/financial_services/jblp.15.02.pdf (last checked February 5, 2013).

²⁷⁸ <http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=2177>. (Last visited March 17, 2013).

²⁷⁹ The first “auction” is not really an auction. It is more like a bidding period, where consultants, investment bankers, and the Debtor’s management actively seek an initial stalking horse.

²⁸⁰ <http://materials.abi.org/sites/default/files/2012/May/HowToConductBetterSaleProcess.pdf>

Topping Fees and Break Up Fees

Before signing an Asset Purchase Agreement that states that a stalking horse will indeed pay for the target company a certain price, in the Asset Purchase Agreement, stalking horse bidders may require compensation from the Debtor called a topping fee or break up fee.²⁸¹ The amount of topping fee compensation is typically equal to a percentage of the purchase price, as stated in the Asset Purchase Agreement, that covers the time and money that the initial stalking horse corporation spent conducting due diligence. The benefit of a topping fee to the Debtor is that the fee incentivizes an initial bidder to look closely at the company with relatively low risk because the initial bidder will be compensated in part by the topping fee.

The benefit to the overall sale-process, is that a third party that is hopefully objective, or at least provides a buyer's opinion, as opposed to the Seller's unilateral valuation of a company, has completed due diligence and therefore acts as a customer-reference (see *supra*. 363 is a marketing handbook), for other potential purchasers.²⁸²

If the initial stalking horse purchaser is not chosen as the ultimate purchaser because another purchaser outbids the stalking horse, a break- up fee is triggered. "A break-up fee is an

²⁸¹ "Bankrupt companies often find it difficult to acquire a stalking horse bidder because most bidders prefer to wait and simply bid over the stalking horse. Stalking horse bidders rightly worry that their due diligence, and the significant expense it entails, will simply be used by either the bankruptcy estate to solicit higher offers or by subsequent bidders to simply bid over a well-researched and now entrenched bidder. To encourage the stalking horse bidder to set a floor for the auction price and terms of the transaction, a break-up fee is normally bargained for in the purchase agreement." Andrew S. Brown, *Breaking Up and Making Out (Rich): Recommendations for Revision of Bankruptcy Code Provisions Governing Break-Up Fees Used by Stalking Horse Bidders in § 363 Bankruptcy Asset Sales*, 62 FLA. L. REV. 1463, 1465 (2010).

²⁸² "The stalking horse's bid helps to assure that the bankruptcy estate will be sold for the minimum acceptable bid. The company, creditors, and trustee accepted the minimum acceptable bid when they executed the initial purchase agreement, before proceeding with the auction. Many reasons exist for prospective purchasers to require break-up fees (essentially a windfall to the bidder) and for sellers to grant such fees (essentially a punitive cost to the bankruptcy estate). However, break-up fees generate controversy because many argue they detract from the value of the estate by forcing other bidders to keep bids low to compensate for break-up fees. Others argue break-up fees undercut the bankruptcy code's and the debtor's goals to preserve as much value for the estate and its creditors as possible. This heated debate leads courts to adopt widely different standards and rules in governing the allowance of break-up fees." Andrew S. Brown, *Breaking Up and Making Out (Rich): Recommendations for Revision of Bankruptcy Code Provisions Governing Break-Up Fees Used by Stalking Horse Bidders in § 363 Bankruptcy Asset Sales*, 62 Fla. L. Rev. 1463, 1465 (2010).

incentive payment to a prospective purchaser with which a company fails to consummate a transaction.”²⁸³

The 363 Process and Break Up Fees for Hostess

Lead Bidder/Stalking Horse	Target Brands	Bid (USD)
Flowers Foods Corp.	Wonder	\$360m
Grupo Bimbo	BeefSteak	\$31.9m
McKee Foods Corp.	Drake Foods (Cake Business)	\$27.5m
Apollo Global Management LLC and C. Dean Metropoulos & Co	Hostess Cakes (Cake Business)	\$410m
Pending* ²⁸⁴		
Total Bid for Hostess Portfolio		\$829.4m

All of the bidding and auctioning for Hostess is now complete. \$830 million for the sale of a company’s assets is nothing to laugh at, nor is such a bid for assets small; however, this is a small number compared to Hostess’ revenue. Last year Hostess brought in \$2 billion in gross revenue, though it suffered \$1.1 billion in net losses. Thus, Hostess has great potential for profit if its production operates under an efficient system, but the turmoil, off balance-sheet liabilities, and pension plans lower the brand’s overall going concern value (see chart in Chapter 5 *supra*). With an \$829.5 million final purchase price, even after paying attorneys, creditors, investment firms and court costs following the 363 sale, there is still likely going to be a break-even moment for Hostess.

Stalking Horses in Hostess Bankruptcy II

The stalking horse for the Wonder Bread Brand was Flowers Foods, the Stalking Horse Bidder for its Drake's cake business was McKee foods, and the Stalking Horse bidder for the

²⁸³ “In simpler terms, a break-up fee is a termination fee paid by the bankruptcy estate to the stalking horse bidder if the proposed sale [is] not consummated through no fault of the [bidder]. The break-up fee compensates the unsuccessful initial bidder through a fee greater than the initial bidder's actual due diligence expenses. Andrew S. Brown, *Breaking Up and Making Out (Rich): Recommendations for Revision of Bankruptcy Code Provisions Governing Break-Up Fees Used by Stalking Horse Bidders in § 363 Bankruptcy Asset Sales*, 62 FLA. L. REV. 1463, 1465 (2010).

²⁸⁴ As of April 17, 2013 it appears that the sale of certain bread brands to United States Bakery has been approved, but there is not a corresponding court-document in the docket. According to Bloomberg news, United States Bakery will “pay \$30.9 million for the Sweetheart, Eddy’s, Standish Farms and Grandma Emilie’s bread brands, four bakeries and 14 depots, plus certain equipment.” <http://www.bloomberg.com/news/2013-04-09/hostess-approved-to-sell-drake-s-to-little-debbie-maker.html> (Last visited April 24, 2013).

Hostess Cake brand are private equity firms Apollo and Metropoulos.²⁸⁵ Notably, Flowers Foods was the Stalking Horse for Beefsteak, but, after a reduction in the break up fee, Bimbo out-bid Flowers Foods and won the Beefsteak battle. Bimbo bid \$1 million more for the Beefsteak brand. The bid of \$31.9-million bid included a \$900,000 breakup fee. Initially, the break up fee was \$12.6 million for the bread brands and \$1.05 million for the Beefsteak brand, with Flowers Foods Inc. securing the stalking horse position for both respective brands. The unsecured creditors objected to both break up fees, stating that such high fees would hamper the bidding. In the objection, the committee requested that the break up fees be reduced from \$12.6 million to \$10 million for the breads, and from \$1.05 million to \$810,000 for the Beefsteak brand. Ultimately, Drain reduced the fee to \$900,000 for the Beefsteak brand. Thus, the approximately \$30 million bid by Flowers for Beefsteak, was surpassed when Bimbo bid \$1 million more and accordingly paid the \$900,000 break up fee.²⁸⁶

However, Flower Foods out maneuvered Bimbo and was the named stalking-horse bidder for the Wonder Bread Brand.²⁸⁷ Flowers Foods, a Thomasville, Georgia, company, acquired Hostess's Wonder, Butternut, Home Pride, Merita and Nature's Pride brands, 20 bread plants, 38 depots and other assets for \$360 million.

The Tennessee-based-company and maker of Little Debbie snack cakes also got a piece of the pie. "U.S. Bankruptcy Judge Robert Drain in White Plains, New York, [on April 9th, 2013], approved the [363] sale to McKee [Foods Corporation], which made the only qualified bid for the brands. McKee will pay \$27.5 million for Drake's products including Devil Dogs, Ring Dings, Yodels, Yankee Doodles, Sunny Doodles, Funny Bones and Drake's Coffee Cake."²⁸⁸

While the stalking horses are offered a due diligence fee or break-up fee if their bids are topped, to pay their lawyers and accountants, Hostess also had some bills to pay to professionals

²⁸⁵ "Hostess Brands Inc. said private equity firms Apollo Global Management LLC and C. Dean Metropoulos & Co. have set a baseline offer of \$410 million to buy the company's snack cake brands including Hostess Twinkies and Dolly Madison." <http://www.bloomberg.com/news/2013-04-09/hostessapproved-to-sell-drake-s-to-little-debbie-maker.html> (Last visited April 24, 2013).

²⁸⁶ <http://www.reuters.com/article/2013/01/23/hostess-flowers-idUSL4N0AS6AH20130123> (Last visited April 24, 2013).

²⁸⁷ As of February 2, 2013, "Hostess reached a stalking horse agreement with US baker Flowers Foods for its bread brands. Flowers offered \$390m for the products, including the Wonder, Butternut, Home Pride and Nature's Pride brands. The auction for these brands will be held February 28, 2013." http://www.just-food.com/news/hostess-names-pe-firms-stalking-horse-for-twinkies_id121984.aspx. (Last visited March 17, 2013).

²⁸⁸ Hostess Approved to Sell Drake's to Little Debbie Maker, Dawn McCarty, April 9, 2013, Bloomberg News, available at: <http://www.bloomberg.com/news/2013-04-09/hostess-approved-to-sell-drake-s-to-little-debbie-maker.html> (Last visited April 24, 2013).

for their time and assistance throughout both bankruptcies. Chapter 10 explores those fees and the conclusion of the Hostess case.

Chapter 10: Professional Fees

Compensation of Professionals

There was an approximately \$830 million price tag for the Hostess portfolio after the 363 sales.²⁸⁹ However, not all of the sales earnings would go into the coffers of Hostess shareholders and executives. In fact, not all of that money would go to creditors. Generally, after secured creditors are paid with the proceeds of their collateral, attorneys and consultants get paid first, pursuant to the Bankruptcy Code § 503, which provides:

...

(4) reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant;

...

11 U.S.C. § 503(b)(4). On the one hand, in order to survive objection after objection and to move the bankruptcy process forward, hired guns and the best of the best lawyers in America are needed. On the other hand, with each penny paid to lawyers and consultants, the coffer lightens, and money that could perhaps be paid towards retired worker's pensions, or to secured and unsecured creditors is reduced.

There is a common saying that bankruptcy is a “feast for lawyers.”²⁹⁰ Indeed, depending on one's perspective, Hostess's bankruptcy may serve to reinforce the sentiment behind that phrase. The Hostess bankruptcy involved and continues to involve many lawyers and other professionals. The actual number of professionals and the dollar amounts spent cannot yet be tabulated, as the bankruptcy is still ongoing. Therefore, this section presents billing through February 2013 for some of the major players including Jones Day, debtor's counsel for Hostess; FTI Consulting, Inc. as Interim Treasurer; Stinson Morrison Hecker, LP, corporate counsel for Hostess; Venable, LLP, employee benefits counsel to Hostess; Perella Weinberg Partners, investment bankers for Hostess; and KPMG, auditors and tax advisors to Hostess.

As of February 2013, billing for these companies stands as follows:

²⁸⁹ Hostess Brands Inc. won permission to sell off the last of its major cake and bread assets, raising total sale proceeds from the baking company's liquidation to about \$860 million. http://online.wsj.com/article/SB10001424127887323550604578412571184918186.html?mod=googlenews_wsjs (Last visited April 24, 2013).

²⁹⁰ SOL STEIN, BANKRUPTCY A FEAST FOR LAWYERS (1992).

Companies' Billing Through February 2013	Total
Jones Day	\$25,270,676.66
FTI Consulting, Inc. ²⁹¹	\$12,063,012
Stinson Morrison Heckler	\$770,545.03
Venable LLP	\$320,057.15
Perella Weinberg Partners LP	\$2,109,868.83
KPMG LLP	\$4,363,973.42
Total	\$44,898,133.09

Interim Monthly Compensation of Professionals

In order to receive payment in a bankruptcy, lawyers and professionals cannot simply send off invoices and get paid. The judicial system acts like a watchdog during the bankruptcy, where, professionals must submit their fees to the court, and the court approves the payments of certain fees. For example, in Hostess, a motion for an order establishing the procedures for interim monthly compensation of professionals was entered on January 11, 2012.²⁹² This motion provided for the specific steps that had to be completed before a firm could be paid.

The Interim²⁹³ Compensation Order was approved by the court²⁹⁴ on January 27, 2012 and some key provisions are summarized as follows:

- By the 20th of each month following the month in which services were rendered, each retained professional is required to serve a Monthly Fee Statement on the following parties: Hostess; Jones Day; the attorneys for the committees;²⁹⁵ Kramer

²⁹¹ This total is missing fees and expenses from May, June, and July 2012. Files were not located. Estimating leads to a conservative estimate of \$45,000,000.00 (one month fee for attorneys and consultants) to \$120,000,000.00.

²⁹² Motion of Debtors and Debtors in Possession, Pursuant to Sections 105(a) and 331 of the Bankruptcy Code, Bankruptcy Rule 2016(a) and Local Bankruptcy Rule 2016-1, for an Order Establishing Procedures for Interim Monthly Compensation of Professionals.

²⁹³ Interim compensation is contemplated by section 331.

²⁹⁴ See Order granting Interim Compensation Order. The approved order also provided for details such as including amounts in US dollars.

²⁹⁵ Creditor's committees support the interests of the creditors in the case and attempt to control unnecessary spending to ensure that the creditors receive as much of their entitled claims as possible. The creditor's committees are entitled to appoint counsel as needed. Attorneys for committees are not subject to the disinterestedness requirements; therefore, attorneys who have represented one or more individual creditors previously will serve on the committees to provide valuable insight. See Jonathan P. Friedland et. al, Chapter 11 – "101" The Nuts and Bolts of Chapter 11 Practice (2005).

Levin Naftalis & Frankel LLP; Paul, Weiss, Rifkind, Wharton & Garrison LLP; and the Office of the Trustee. Each of these groups has a need to know and understand how funds are being spent as part of the bankruptcy; each group has a right to object to the fees and expenses being paid by Hostess.

- By the 20th of each month, a Monthly Fee Statement will be filed with the Court;
- The requirements for the Monthly Fee Statements include: a list of persons who provided services along with their titles and their billing rates; a detailed breakdown of the services provided; and time entries in 1/10 of an hour;
- Any objections to the compensation or reimbursements will be filed within 35 days of the submission of the Monthly Fee Statement;
 - Any party in interest can object to a fee application. Trustees often question fee applications “perhaps believing that other lawyers in the case may not be sufficiently vigilant in policing each other’s fees.”²⁹⁶ Judges can also object and review fees and expenses
- On the Review Deadline, Hostess will pay 80% of the fees²⁹⁷ requested and 100% of the expenses²⁹⁸ submitted for payment by the individual firms;
- Any expenses or compensation that has been objected to will be withheld until the dispute is resolved; and
- Every 150 days, each retained professional will serve and file with the Court an application for interim or final approval and allowance of the compensation and reimbursement of expenses; failure to file the renewed application will result in an ineligibility to be paid and may result in a disgorgement of fees paid since retention or the last fee application.

Here, the monthly fee statements filed by various law firms were similar in content. Each statement included the following sections in some form: compliance with guidelines, allowance of compensation, statement regarding fees, description of services rendered, basis for relief, relief requested, retention, background, and a statement of the court’s jurisdiction and venue relevant to the proceedings and the motions. Section 330(a)(3) contains a non-exclusive list of factors that a court may consider in setting fees, and each fee statement also recounts these

²⁹⁶ See Jonathan P. Friedland et. al, Chapter 11 – “101” The Nuts and Bolts of Chapter 11 Practice (2007).

²⁹⁷ Fees are limited to professional fees (hourly rates of attorneys, for example).

²⁹⁸ Expenses include items such as copy charges.

factors and provides a full description of why and how the work performed was of a benefit to the estate.²⁹⁹

Each firm provided a statement, as required, and served the statement on the appropriate parties. Each firm also submitted an affidavit of service for each statement. As an illustrative example of the process, Stinson filed its monthly fee statement for January 11 – 31, 2012 on February 2012.³⁰⁰ On February 21, Stinson filed a Certificate of Service related to the monthly fee statement.³⁰¹ The trustee then receives a copy of the statement to ensure that no one is taking advantage of the system or in some way not meeting the policy requirements of bankruptcy. The creditors' committees review all the fees so that they can object to potentially unreasonable fees and expenses that will, in the end, take money away from the creditors. There were no objections, the statement, along with the other statements submitted around the same time that had received no objection, was approved and subsequently paid by Hostess. For each set of applications, an Order Granting Applications for Interim Allowance of Compensation and Reimbursement of Expenses was issued by the court. Each order summarized the amounts payable to the firms for the appropriate period.³⁰² Interim quarterly statements, with accompanying affidavits, were also submitted to the court as part of the docket.

The rest of this chapter provides examples of fees, fee filings, objections, and court procedures relating to fees.

Jones Day

Jones Day was selected as the debtors' counsel for Hostess as part of an initial application to employ counsel.³⁰³ The application describes Jones Day's qualifications and the services the law firm was to provide during the proceedings. Additionally, the application details that Jones' Day charged for its legal services "on an hourly basis in accordance with the ordinary and customary hourly rates in effect on the date services are rendered; and seek reimbursement

²⁹⁹ See Jonathan P. Friedland et. al, Chapter 11 – "101" The Nuts and Bolts of Chapter 11 Practice (2007).

³⁰⁰ See Monthly Fee Statement.

³⁰¹ See Certificate of Service.

³⁰² See Order Granting Applications for Interim Allowance of Compensation and Reimbursement of Expenses filed on June 25, 2012 for the first interim applications and the Order Granting Second Applications for Interim Allowance of Compensation and Reimbursement of Expenses filed on November 7, 2012 for the second interim applications as examples.

³⁰³ Application of Debtors and Debtors in Possession Pursuant to Sections 327(a) of the Bankruptcy Code, Bankruptcy Rules 2014(a) and 2016(b) and Local Bankruptcy Rules 2014-1 and 2016-1, For An Order Authorizing Them to Retain and Employ Jones Day as Counsel, Nunc Pro Tunc as of the Petition Date.

of actual and necessary out-of-pocket expenses;” a schedule of fees as well as a list of “parties in interest” was included.³⁰⁴ In its language, Jones Day was basically parroting the requirements of the Bankruptcy Code to ensure the court that its rates are reasonable and that only necessary expenses, related specifically to this case, were billed.

Jones Day was paid an advanced payment of \$250,000 for restructuring on March 31, 2011. This initial payment was replenished on the following schedule:

Date of Replenishing Deposit(s)	Amount of Replenishing Deposit(s)
May 25, 2011	\$100,000
June 7, 2011	\$200,000
July 21, 2011	\$200,000
August 4, 2011	\$375,000
August 11, 2011	\$400,000
August 19, 2011	\$400,000
August 31, 2011	\$300,000
September 8, 2011	\$150,000
September 12, 2011	\$250,000
September 23, 2011	\$100,000
September 30, 2011	\$100,000
October 7, 2011	\$175,000
October 14, 2011	\$100,000
October 20, 2011	\$100,000
November 4, 2011	\$150,000
November 10, 2011	\$300,000
November 10, 2011	\$250,000
December 7, 2011	\$200,000
December 9, 2011	\$350,000
December 15, 2011	\$300,000
December 22, 2011	\$750,000
January 10, 2012	\$500,000
Total	\$5,750,000

There was a draw immediately prior to the bankruptcy petition date for \$625,471.22 for estimated fees and expenses. The prepetition draws totaled \$5,865,299.94. \$812,750.36 of the retainer that was previously not used and was then applied to pay for prepetition services. After the retainer was depleted, Jones Day began billing for the 2012 bankruptcy as follows:

Jones Day 2012 Fees³⁰⁵	Total Fees	Total Disbursements	Total
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³⁰⁴ *Id.* Fees for legal services range from Corinne Ball, a partner, who bills at \$975/hour to associates who bill at \$500/hour.

³⁰⁵ Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period January 11 through January 31, 2012; Monthly Statement of Services Rendered and

January 11 – 31, 2012	\$1,923,741.25	\$35,317.47	\$1,959,058.72
February 1 – 29, 2012	\$2,843,613.75	\$56,912.92	\$2,900,526.67
March 1 – 31, 2012	\$2,803,526.25	\$81,684.37	\$2,885,210.62
April 1 – 30, 2012	\$2,992,252.50	\$105,559.07	\$3,097,811.57
May 1 – 31, 2012	\$2,073,760.00	\$88,254.84	\$2,162,014.84
June 1 – 30, 2012	\$882,308.75	\$54,021.29	\$936,330.04
July 1 – 31, 2012	\$876,293.75	\$33,838.17	\$910,131.92
August 1 – 31, 2012	\$1,013,510.00	\$39,148.16	\$1,052,658.16
September 1 – 30, 2012	\$1,405,860.00	\$18,921.58	\$1,424,781.58
October 1 – 31, 2012	\$1,476,873.75	\$53,082.79	\$1,529,956.54
November 1 – 15, 2012	\$804,770.00	\$10,309.22	\$815,079.22
November 16 – 30, 2012	\$861,358.75	\$24,824.61	\$886,183.36
December 1 – 31, 2012	\$1,035,093.75	\$57,972.92	\$1,093,066.67
January 1 – 31, 2013	\$2,254,838.75	\$24,403.32	\$2,279,242.07
February 1 – 28, 2013	\$1,297,550.00	\$41,074.68	\$1,338,624.68
Total			\$25,270,676.66

FTI Consulting, Inc.

Hostess also employed FTI Consulting, Inc. (“FTI”) to provide an interim treasurer and additional personnel.³⁰⁶ According to its Terms of Engagement, FTI’s interim treasure management functions included “[p]rovid[ing] comprehensive treasure services and

Expenses Incurred by Jones Day, Counsel for Debtors, for the Period February 1 through February 29, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period March 1 through March 31, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period April 1 through April 30, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period May 1, 2012 through May 31, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period June 1, 2012 through June 30, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period July 1, 2012 through July 31, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period August 1, 2012 through August 31, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period October 1, 2012 through October 31, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period November 1, 2012 through November 30, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period December 1, 2012 through December 31, 2012; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period January 1, 2013 through January 31, 2013; Monthly Statement of Services Rendered and Expenses Incurred by Jones Day, Counsel for Debtors, for the Period February 1, 2013 through February 28, 2013.

³⁰⁶ Motion of the Debtors Pursuant to 11 U.S.C. §§ 105(A) and 363(B) to Employ and Retain FTI Consulting Inc. to Provide the Debtors an Interim Treasurer and Additional Personnel Nunc Pro Tunc to the Petition Date. Approved.

coordinat[ing] and direct[ing] company employees as necessary.”³⁰⁷ The significance of the interim nature of the position entailed that it could not follow out of bankruptcy and would, therefore, terminate upon the conclusion of the bankruptcy. During the bankruptcy, however, Hostess needed someone to fulfill those financial responsibilities and work with management to refine the company’s existing cash flow forecasts, related analyses, and reporting.

Mr. David Rush, Senior Managing Director, was appointed as Interim Treasurer on June 10, 2011. Mr. Rush was paid a monthly fee of \$65,000 while two additional employees, Larry Manning and Robert Molina, were paid \$55,000 per month. Further, FTI Consulting was allowed to bill for “reasonable and customary” out-of-pocket expenses. FTI was also promised a \$1,250,000 completion fee on the confirmation of a Chapter 11 plan of reorganization or liquidation; or sale of substantially all of the Hostess’s assets. Fees billed as part of the Chapter 11 bankruptcy were to be credited against the \$350,000 retainer paid prior to the petition date.³⁰⁸ FTI’s fees are detailed in the table on the following page:

FTI Consulting Fees ³⁰⁹	Total Fees	Total Disbursements	Total
January 11 – 31, 2012	\$696,546	\$32,397.17	\$728,943.17
February 1 – 29, 2012	\$1,034,305.00	\$49,869.89	\$1,084,174.89
March 1 – 31, 2012	\$1,130,544.50	\$39,866.18	\$1,170,410.68
April 1 – 30, 2012	\$1,275,145.50	\$53,161.96	\$1,328,307.46
May 1 – 31, 2012	Unable to Retrieve Documents		
June 1 – 30, 2012	Unable to Retrieve Documents		
July 1 – 31, 2012	Unable to Retrieve Documents		
August 1 – 31, 2012	\$993,912.50	\$51,053.70	\$1,044,966.20
September 1 – 30, 2012	\$1,269,112.00	\$48,442.12	\$1,317,554.12
October 1 – 31, 2012	\$1,571,929.50	\$54,938.35	\$1,626,867.85
November 1 – 30, 2012	\$1,497,064.00	\$50,790.77	\$1,547,854.77
December 1 – 30, 2012	\$970,500.50	\$33,671.11	\$1,004,171.61
January 1- 31, 2013	\$1,181,949.50	\$27,811.97	\$1,209,761.47
February 1 – 28, 2013			
Total			\$12,063,012.22

³⁰⁷ Motion of the Debtors Pursuant to 11 U.S.C. §§ 105(A) and 363(B) to Employ and Retain FTI Consulting Inc. to Provide the Debtors an Interim Treasurer and Additional Personnel Nunc Pro Tunc to the Petition Date.

³⁰⁸ *Id.*

³⁰⁹ Monthly Fee Statement – January 11 – 31, 2012; Monthly Fee Statement – February 1 – 29, 2012; Staffing Report – March 1 – 31, 2012; Staffing Report – April 1 – 30, 2012; Staffing Report – May 1 – 31, 2012; Staffing Report – June 1 – 30, 2012; Staffing Report – July 1 – 30, 2012; Staffing Report – August 1 – 30, 2012; Staffing Report – September 1 – 30, 2012; Staffing Report – October 1 – 30, 2012; Staffing Report – November 1 – 30, 2012; Staffing Report – December 1 – 30, 2012; Staffing Report – January 1 – 31, 2013; Staffing Report – February 1 – 28, 2013; *See also* Summary of Compensation and Expenses for a breakdown of expenses January 11 – April 30, 2012; Summary of Compensation Earned and Expenses Incurred August 1 – October 31, 2012; Summary for Expense Incurred November 1, 2012 – January 31, 2013.

Stinson Morrison Hecker LLP

Hostess also employed Stinson Morrison Hecker LLP (“Stinson”) as general corporate and conflicts counsel.³¹⁰ General corporate counsel handles corporate business matters. Conflicts counsel are attorneys from a different law firm (in this case, not Jones Day) who would handle matters that are in dispute—or matters with which debtors’ counsel has a conflict that can be separated off from the main issue (in this case, the bankruptcy). “Using conflicts counsel in certain situations mitigates the burden of disqualification while protecting the underlying reasons behind the disqualification.”³¹¹ The Stinson Morrison fees are detailed in the following table:

Stinson Morrison Fees	Total Fees	Total Disbursements	Total
January 11 – 31, 2012 ³¹²	\$57,927.50	\$124.20	\$58,051.70
February 1 – 29, 2012	\$60,966.50	\$1,021.17	\$61,987.67
March 1 – 31, 2012	\$73,417.50	\$474.21	\$73,891.71
April 1 – 30, 2012	\$86,835.00	\$1,424.94	\$88,259.94
May 1 – 31, 2012	\$94,750.50	\$1,069.93	\$95,820.43
June 1 – 30, 2012	\$56,925.00	\$1,181.47	\$58,106.47
July 1 – 31, 2012	\$50,700.50	\$939.25	\$51,639.75
August 1 – 30, 2012	\$73,286.50	\$510.81	\$73,897.31
September 1 – 30, 2012	\$39,489.00	\$513.71	\$40,002.71
October 1 – 31, 2012	\$29,609.00	\$540.94	\$30,149.94
November 1 – 30, 2012	\$46,219.50	\$259.82	\$46,479.32
December 1 – 30, 2012	\$21,573.50	\$286.91	\$21,860.41
January 1 – 31, 2013	\$33,077.00	\$483.28	\$33,560.28
February 1 – 28, 2013	\$35,361.50	\$1,475.89	\$36,837.39
Total			\$770,545.03

³¹⁰ Application to Employ Stinson Morrison Hecker LLP. Approval.

³¹¹ Ronald D. Rotunda, *Resolving Client Conflicts by Hiring ‘Conflicts Counsel’*, 62 HASTINGS L. J. 677 (2011).

³¹² Stinson Monthly Fee Statement – January 1 – 31, 2012; Stinson Monthly Fee Statement – February 1, 2012 – February 29, 2012; Stinson Monthly Fee Statement – March 1, 2012 – March 31, 2012; Stinson Monthly Fee Statement – April 1 – 30, 2012; Stinson Monthly Fee Statement – May 1 – 31, 2012; Stinson Monthly Fee Statement – June 1 – 30, 2012; Stinson Monthly Fee Statement – July 1 – 31, 2012; Stinson Monthly Fee Statement – August 1 – 31, 2012; Stinson Monthly Fee Statement – September 1 – 30, 2012; Stinson Monthly Fee Statement – October 1 – 31, 2012; Stinson Monthly Fee Statement – November 1 – 30, 2012; Stinson Monthly Fee Statement – December 1 – 30, 2012; Stinson Monthly Fee Statement – January 1 – 30, 2013; Stinson Monthly Fee Statement – February 1 – 28, 2013.

Venable LLP

Hostess also employed Venable LLP (“Venable”) as special employee benefits counsel.³¹³ Venable had been employed by Hostess prior to the bankruptcy on matters relating to employee benefits (these matters included representing Hostess regarding pension plans and related litigation). This prior experience and in-depth company knowledge made Venable a good choice of firm for employee benefits particularly given the issues related to pension plans in the current bankruptcy.³¹⁴ Venable’s fees are detailed in the following table:

Venable LLP Fees³¹⁵	Total Fees	Total Disbursements	Total
January 11 – 31, 2012	\$36,679.50	\$70.54	\$36,750.04
February 1 – 28, 2012	\$42,519.00	\$241.13	\$42,760.13
March 1 – 31, 2012	\$9,996.00	0	\$9,996.00
April 1 – 30, 2012	\$25,686.00	\$14.00	\$25,700.00
May 1 – 31, 2012	\$53,458.00	\$22.19	\$53,480.19
June 1 – 30, 2012	\$30,283.50	\$1430.66	\$31,714.16
July 1 – 31, 2012	\$18,484.50	\$36.80	\$18,521.30
August 1 – 31, 2012	\$22,332.00	\$81.40	\$22,413.40
September 1 – 30, 2012	\$19,786.50	0	\$19,786.50
October 1 – 30, 2012	\$27,481.00	\$39.03	\$27,520.03
November 1 – 30, 2012	\$16,954.00	\$37.00	\$16,991.00
December 1 – 31, 2012	\$4,028.50	0	\$4,028.50
January 1 – 31, 2013	\$2,896.00	\$32.90	\$2,928.90
February 1 – 28, 2013	\$7,467.00	0	\$7,467.00
Total			\$320,057.15

³¹³ Application to Employ Venable LLP as Special Employee Benefits Counsel. Approval.

³¹⁴ Application to Employ Venable LLP as Special Employee Benefits Counsel.

³¹⁵ Venable Monthly Fee Statement – January 2012; Venable Monthly Fee Statement – February 2012; Venable Monthly Fee Statement – March 2012; Venable Monthly Fee Statement – April 2012. (See also Quarterly Statement); Venable Monthly Fee Statement – May 2012; Venable Monthly Fee Statement – June 2012; Venable Monthly Fee Statement – July 2012; Venable Monthly Fee Statement – August 2012; Venable Amended Monthly Fee Statement – September 2012. (See also Original Statement); Venable Monthly Fee Statement – October 2012; Venable Monthly Fee Statement – November 2012; Venable Monthly Fee Statement – December 2012; Venable Monthly Fee Statement – January 2013; Venable Monthly Fee Statement – February 2013.

Perella Weinberg Partners LP

Perella Weinberg Partners LP³¹⁶ (“Perella”) was employed to provide investment banking services to Hostess. In critical part, Perella provided services to get Hostess to the 363-auction block. Generally, in Chapter 11 proceedings, investment banking companies assist the debtor in marketing the corporation, providing due diligence services, and ultimately, and hopefully, driving the sales price for the corporation. Perella’s fees are detailed in the following table:

Perella Weinberg Fees³¹⁷	Total Fees	Total Disbursements	Total
January 11 – 31, 2012	\$118,548.39	\$3659.98	\$122,208.37
February 1 – 29, 2012	\$175,000.00	\$76,355.88	\$251,355.88
March 1 – 31, 2012	\$175,000.00	\$22,875.83	\$197,875.83
April 1 – 30, 2012	\$175,000.00	\$22,710.48	\$197,710.48
May 1 – 31, 2012	\$140,000.00	\$3,486.92	\$143,486.92
June 1 – 30, 2012	\$140,000.00	\$533.09	\$140,533.09
July 1 – 31, 2012	\$140,000.00	\$1,700.98	\$141,700.98
August 1 – 31, 2012	\$140,000	\$1,281.57	\$141,281.57
September 1 – 30, 2012	\$140,000	\$463.24	\$140,463.24
October 1 – 31, 2012	\$140,000	\$78.72	\$140,078.72
November 1 – 30, 2012	\$70,000	\$139.64	\$70,139.64
December 1 – 31, 2012	\$140,000	\$1,359.45	\$141,359.45
January 1 – 31, 2013	\$140,000	\$1,268.18	\$141,268.18
February 1 – 28, 2013	\$140,000	\$406.48	\$140,406.48
Total			\$2,109,868.83

KPMG LLP

KPMG LLP³¹⁸ is an accounting firm that Hostess employed as an auditor to provide tax compliance, tax consulting, and tax provision services for Hostess.³¹⁹ KPMG’s fees are detailed in the following table:

³¹⁶ Pursuant to the Retention Order. Approved Order to Employ Perella Weinberg Partners.

³¹⁷ Monthly Fee Statement of Perella Weinberg Partners LP – May 2012; Monthly Fee Statement of Perella Weinberg Partners LP – June 2012; Monthly Fee Statement of Perella Weinberg Partners LP – July 2012; Monthly Fee Statement of Perella Weinberg Partners LP – August 2012; Monthly Fee Statement of Perella Weinberg Partners LP – September 2012; Monthly Fee Statement of Perella Weinberg Partners LP – October 2012; Monthly Fee Statement of Perella Weinberg Partners LP – November 2012; Monthly Fee Statement of Perella Weinberg Partners LP – December 2012; Monthly Fee Statement of Perella Weinberg Partners LP – January 2013; Monthly Fee Statement of Perella Weinberg Partners LP – February 2013.

³¹⁸ KPMG is one of the largest auditing firms in the world. It is currently one of the “Big Four” accounting firms along with the firms Price Waterhouse Cooper, Ernst & Young, and Deloitte & Touche.

³¹⁹ Application to Employ KPMG. Approval of Application to Employ KPMG.

KPMG Fees³²⁰	Total Fees	Total Disbursements	Total
January 1 – 31, 2012	\$428,278.45	0	\$428,278.45
March 1 – 31, 2012	\$226,656.75	\$6296.00	\$232,952.75
April 1 – 30, 2012	\$202,808.35	\$196.00	\$203,004.35
May 1 – 30, 2012	\$440,634.05	\$7,381.17	\$448,015.22
June 1 – 30, 2012	\$440,816.81	\$4,748.59	\$445,565.40
July 1 – 31, 2012	\$557,634.25	\$5,854.00	\$563,488.25
August 1 – 31, 2012	\$678,711.70	\$4,940.00	\$683,651.70
September 1 – 30, 2012	\$640,834.95	\$3,573.00	\$644,407.95
October 1 – 31, 2012	\$281,462.85	\$3,867.00	\$285,329.85
November 1 – 30, 2012 ³²¹	\$115,744.50	\$18,584.60	\$134,329.10
December 1 – 31, 2012	\$31,671.70	0	\$31,671.70
January 1- 31, 2013	\$148,092.20 ³²²	0	\$148,092.20
February 1 – 28, 2013	\$115,186.50	0	\$115,186.50
Total			\$4,363,973.42

These charts and summaries are by no means a complete presentation of all of the fees expended or the expenses accrued in conjunction with professional fees during Hostess's bankruptcy. It would be impractical and tedious, to count as well as to read, to provide a complete accounting of all the fees from the bankruptcy case in this work. Other law firms and professional services firms billed (and continue to bill) for professional services throughout the course of the bankruptcy that are not listed in this section. Some of these firms include Curtis, Mallet-Prevost, Colt & Mosle LLP who served as Conflicts Counsel to the Creditors' Committee; Blackstone Advisory Partners LP who served as financial advisors to the Official Committee of Unsecured Creditors; and Kramer, Levin, Naftalis & Frankel LLP who served as counsel to the Official Committee of Unsecured Creditors. As evidence by these tables, however, the major players listed as well as the other professionals who worked on the case received substantial compensation for their efforts during the course of Hostess's bankruptcy proceedings.

³²⁰ First Monthly Fee Statement for KPMG LLP; Second Monthly Fee Statement for KPMG LLP; Third Monthly Fee Statement for KPMG LLP; Fourth Monthly Fee Statement for KPMG; Fifth Monthly Fee Statement for KPMG LLP; Sixth Monthly Fee Statement for KPMG LLP; Seventh Monthly Fee Statement for KPMG LLP; Eighth Monthly Fee Statement for KPMG LLP; Ninth Monthly Fee Statement for KPMG LLP; Eleventh Monthly Fee Statement for KPMG LLP; Twelfth Monthly Fee Statement for KPMG LLP; Thirteenth Monthly Fee Statement for KPMG LLP.

³²¹ Amended Tenth Monthly Fee Statement for KPMG LLP. Original was for \$134,329.10 compensation and \$2,780.00 fees. The difference was related to a cap as provided for the in the engagement letter – "Tax compliance services are billed at the lesser of standard hourly rates or an annual cap of \$183,000, as provided in the engagement letter dated January 12, 2012." "Provision services are billed at the lesser of standard hourly rates or an annual cap of \$90,000, as provided in the engagement letter dated January 12, 2012."

³²² Amended Statement.

Objections by the U.S. Trustee

The Bankruptcy Code provides that the United States Trustee has the responsibility to determine if fees are “reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, ... or attorney and by any paraprofessional person employed by any such person; and ... reimbursement for actual, necessary expenses.”³²³ Section 330(a)(3) then describes what the court should consider in determining reasonableness of expenses. These factors, are

- a. The time spent on such services;
- b. The rates charged for such services;
- c. Whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
- d. Whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
- e. With respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and
- f. Whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

11 U.S.C. § 330(a)(3).

Each firm that submits an application for compensation bears the burden of proof for any claims for compensation.³²⁴ The Code requires that all expenses be actual and necessary and documented.³²⁵

Finally, the Bankruptcy Court has the power to reduce fees or expenses in absence of sufficient documentation or for just cause, even if the court approved the employment and retention of the firm.³²⁶

Objection to the First Interim Application

The United States Trustee (the “Trustee”) objected to the first interim application for fees for every professional firm.³²⁷ As an overall objection (to effect each firm), the Trustee

³²³ 11 U.S.C. § 330(a)(1)(A) and (B).

³²⁴ See Docket # 1092.

³²⁵ 11 U.S.C. § 330(a)(1)(B).

³²⁶ See Docket # 1092.

³²⁷ See Docket # 1092.

requested a 10% fee reduction, or holdback, because “the ultimate benefit to the estates for the services rendered by the professionals simply cannot be assessed at this time.”³²⁸

The Trustee then went on to express specific objections for each of the firms and their interim application for compensation. The objections for each firm were similar to those for Jones Day which included “vague services” which resulted in a request for specific time entries and clearly identified discrete tasks; issues with multiple attorneys attending meetings and billing for each, which was considered “excessive and not reasonable under section 330 of the Bankruptcy Code;” the fact that the firm billed for review and editing of monthly invoices, “which as opposed to fee application preparation, is not compensable;” and charging 20 cents instead of 10 cents per page for copying (which resulted in copying fees of \$78,175.81).³²⁹ The objection was granted and the copying fees were adjusted.

One unique objection was the Trustee’s objection to \$28,847.59 of Stinson’s, general corporate and conflicts counsel’s, fees being incurred as part of the 2004 bankruptcy because “[i]t [wa]s unclear what, if any, benefit the services in the prior case have for [Hostess’s] pending case in this Court.”³³⁰ Stinson responded and said, “[Hostess was] required to resolve the pending claims in the prior Missouri cases pursuant to the terms of the confirmed plan and documents related to the Creditors Trust in that plan.”³³¹ As an alternative, Stinson conceded that the amount of the objection roughly would equal the 10% holdback that the court could impose for professional fees and expenses and that this would be an appropriate way to address the amount in question.³³²

Each firm responded to the objections and adjusted their fee statements accordingly by the full 10%. Future statements listed the full amount and additionally indicated the 10% holdback amount. It appears the Trustee was trying to set the tone at the beginning that fees should be closely monitored before those fees are submitted to the court. Few objections were made to later statements.

³²⁸ *Id.*

³²⁹ *Id.*

³³⁰ See Reply by Stinson Morrison Hecker, LLP to Objection of the United States Trustee to First Interim Application for Compensation and Reimbursement of Expenses.

³³¹ See Reply by Stinson Morrison Hecker, LLP to Objection of the United States Trustee to First Interim Application for Compensation and Reimbursement of Expenses.

³³² See Reply by Stinson Morrison Hecker, LLP to Objection of the United States Trustee to First Interim Application for Compensation and Reimbursement of Expenses.

Chapter 11: Conclusion

The dust has not yet settled completely in the Hostess case. Lawyers, accountants, and other specialists are waiting to get paid for their work that was completed and there is still ongoing work and due diligence to finish the bankruptcy process. Perhaps claimants will submit pre-petition issues to the new owners of the Hostess brands. One thing is for sure, that after over 12,735 filings, millions of dollars in fees and expenses, as well as two bankruptcy filings, multiple attempts at reorganization, and ultimately liquidation, there must be something inside the Hostess corporate shell worth fighting for. Be it money, the iconic American brand, or perhaps something sweeter, Hostess has sold its constituent parts, and the legacy of the Twinkie and other baked goods will soon return to store shelves.

Appendix A



The Decline and Fall of the Hostess Empire

By: Kitty Ganier, Trip Conrad, and Wendy Patrick

Overview



- IBC, founded in Kansas City, MO in 1930, expanded rapidly, largely through a series of mergers and acquisitions with its competitors
- This growth strategy created an incredibly complicated operating procedure due to the differences in styles of the various companies and the multitude of different unions, pensions, and CBAs
- These inefficiencies, a shift in American dietary habits away from sugary snack foods, and a series of management issues forced IBC into bankruptcy in 2004
- Left bankruptcy and renamed Hostess Brands, Inc. after an infusion of cash from investors, but the underlying problems were unresolved and then compounded by a poor economic climate, which ultimately led back to bankruptcy 3 years later
- Hostess still possessed valuable assets and profitable products, but its inefficient processes and overleveraged capital structure made a purchase by a company without these problems the ultimate outcome



Eat Cake!



- James Dewar Came Up with Twinkies
- What a Wonder is Bread that can last for a long time
 - Nutrients and World War II, WIC programs
 - Sliced bread
- Snoballs in the 1940s
- Howdy Doody Show and Twinkies 1950s
- Acquisitions and late 1960s Ding Dongs and Ho Hos
- Inclusions/removal from millennial time capsule



Building an Empire



- IBC easy as ABC, acquires American Baking Companies
 - 1937 - IBC merges with Schulze Baking Company
 - 1943 - IBC purchases Supreme Baking Company of Los Angeles
 - 1960 - IBC acquires Supreme Baking Corporations and Kingston Bakery
- 1987 - IBC buys Merita Bakeries, a division of the American Bakeries Company
- 1995 - Big Belt: IBC becomes nations largest baking company after acquiring the Continental Baking Company
- 1998 - IBC purchases Nissen Baking; company sales surpass \$3 billion

Health Kick?

- 2004 carb-conscious consumers, rising cost of ingredients



Bankruptcy I

- September 22, 2004 IBC and subsidiaries filed Chapter 11 in the Western District of Missouri
- 25,000 employees
- 45 bakeries
- 800 distribution centers



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Why File Chapter 11?

Liquidity issues

Buy back of IBC own stock = debt

Shut down of facilities

Decline in Sales

High fixed-cost structure

Rising employee healthcare and pension costs

Increased ingredient and fuel costs

SEC issues

Move the Thrift shop Down the Road to Mexico? Getting Tricked by Business?

- During 2004 Bankruptcy, offers from Grupo Bimbo and Yucaipa and the IBT
- Purchases of other companies and failure to reorganize, restructure, and renegotiate employee contracts



What is the value in that?

- Exited Bankruptcy with Cash Infusions from Equity Investors
 - Ripplewood Holdings largest equity interest
 - Going to take a bath in the future?
 - SilverPoint and Monarch own senior debt
 - How much did they pay for debt? Will they break even?
- New name out of BR: **Hostess Brands, Inc.**
- Labor contracts and costs major issues in 2004 -
 - 2004 ends in 2009 BR



Bankruptcy II

- Throwing the Good after the Bad?
- Less than three years after exiting its 2004 bankruptcy, Hostess files again on January 11, 2012; this time in the Southern District of New York



Some Key Players



- Tim Collins
 - CEO of Ripplewood
 - Biggest loser in bankruptcy (over \$150 Million)

- Brian Driscoll
 - CEO of Hostess
 - Left in March 2012 after receiving a raise



- Frank Hurt
 - International President of BCTGM
 - Union that struck

- Corinne Ball
 - Partner at Jones Day
 - Lead attorney for Hostess





The Unions and Hedge Funds



- 12 different unions
 - 15,000 members
 - 40 separate pension plans
 - \$2 billion in unfunded pension liabilities
 - Most of the employees belong to the International Brotherhood of Teamsters or the Bakery, Confectionery Tobacco Workers and Grain Millers International Union
- Silver Point and Monarch Alternative Capital



- Consolidation
- Payment to Essential Suppliers
- Payment of Prepetition Wages
- Injunction Against Utility Companies
- Participation in Customer Programs
- Continue Cash-Management Systems
- Payment of Prepetition Taxes
- Payment to Prepetition Lienholders

First Day Motions



- Withdrawal from the Multi-Employer Pension Plans
- Modify the CBAs
 - Relax work rules
 - Lower wages and benefits
- Secure new capital
- Modernize production
- Capital restructuring/Debt reduction



Reorganization Plan



Strike!



- Summer/fall of 2012 - Negotiations between the hedge funds, SilverPoint, Monarch, and the unions, IBT and BCT with an ultimatum offer in September
 - Concessions: 8% cut in wages and 17% in cuts to Hostess's health care contributions
 - Exchange: a 25% share of the company's stock and a \$100 million junior claim in the bankruptcy
- Union votes
 - IBT: 53% for concessions; 47% against
 - BCT: 8% for; 92% against
- On October 21, Hostess began implementing cuts
- On November 9, BCT called a general strike, which halted work at 24 of Hostess's 36 bakeries
- On November 15, after workers failed to return to work despite repeated pleas from management, Hostess filed a motion to wind down the business



Liquidation Bankruptcy II

		Player A	
		Cooperate	Defect
Player B	Cooperate	3 / 3	1 / 4
	Defect	4 / 1	2 / 2

- When the union strike began on November 9, 2012, BCT was seeking more compensation for workers than Hostess's negotiated proposal provided. Is this a different union from BCT?
- An attorney on behalf of the debtor, began the emergency liquidation hearing by stating that there was "no end in sight to the strike"
- BCT, by continuing to strike, never objected to, nor appealed, forced Hostess's hand

A Glimpse of the Fees

As of February 2013, billing for these companies stands as follows:

Firm	Total
Jones Day	\$25,270,676.66
FTI Consulting, Inc.	\$12,063,012
Stinson Morrison Heckler	\$770,545.03
Venable LLP	\$320,057.15
Perella Weinberg Partners LP	\$2,109,868.83
KPMG LLP	\$4,363,973.42
Total	\$44,898,133.09

Target	Acquiror	Bid	Approval
Beefsteak Bread Brand	Grupo Bimbo, S.A.B. de C.V.	\$31.9 million	Yes, 363 Sale
Bread Brands	Flowers Foods	\$360 million	Yes, 363 Sale
Snack Cake brands	Apollo Global Manage ment LLC	\$410 million	Yes, 363 Sale
Drake's brand	McKee Foods Corporati on	\$27.5 Million	Yes, 363 Sale
Total		\$829.5 Million	



Any Questions?