

# CRS Report for Congress

## Rejection of Collective Bargaining Agreements in Chapter 11 Bankruptcies: Legal Analysis of Changes to 11 U.S.C. Section 1113 Proposed in H.R. 3652 — The Protecting Employees and Retirees in Business Bankruptcies Act of 2007

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# Rejection of Collective Bargaining Agreements in Chapter 11 Bankruptcies: Legal Analysis of H.R. 3652

## Summary

Introduced in the 110<sup>th</sup> Congress, the Protecting Employees and Retirees in Business Bankruptcies Act of 2007 (H.R. 3652) proposes a number of changes to the U.S. Bankruptcy Code. According to the sponsors, the changes are needed to remedy inequities in the bankruptcy process and to recognize that employees and retirees have a unique investment in their companies through their labor.

The bill contains many proposals for changing the Bankruptcy Code. This report focuses on the amendments and additions to 11 U.S.C. § 1113, which provides the procedures that are to be followed if a debtor in possession wants to reject a collective bargaining agreement (CBA).

The changes proposed for § 1113 may be intended to promote negotiation between the debtor and the authorized representatives of labor groups that have existing CBAs with the debtor company. They also appear to constrain court involvement in the process. This could lead to more agreed-upon modifications and fewer rejections of CBAs. Alternatively, it could prolong the negotiation process and put burdens on the debtor that would make liquidation more feasible than reorganization.

The bill prescribes the parameters of offers that may be made by the debtor in negotiations as well as the requirements that must be met before a court can approve rejection. It attempts to curtail what the sponsors have referred to as “excesses of executive pay” by making rejection of a CBA difficult if executives are to receive incentive pay and by requiring consideration of past concessions by the labor group in determining whether the labor group is being disproportionately burdened by proposed modifications to a CBA.

H.R. 3652 appears to propose changes to § 1113 that would resolve some differences between courts in interpreting the requirements for modification or rejection of a CBA. It also clearly states that rejection of a CBA is a breach of contract, even when approved by the court, and clarifies the damages that are available.

The bill provides an absolute right of all employees to strike if their CBA is modified or rejected. This contrasts with recent court decisions involving unions representing employees of financially distressed airlines in which the employees were enjoined from striking.

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# Rejection of Collective Bargaining Agreements in Chapter 11 Bankruptcies: Legal Analysis of H.R. 3652

## Introduction

Chapter 11 of the U.S. Bankruptcy Code<sup>1</sup> is used by financially troubled business debtors that want to reorganize their financial affairs so that they may remain in business rather than liquidate. Although a trustee is appointed in chapter 7 liquidations, in a business reorganization under chapter 11, the debtor generally remains in possession and no trustee is appointed,<sup>2</sup> thus allowing those most familiar with the business to continue managing it.

The Bankruptcy Code generally provides debtors the opportunity to either assume or reject executory contracts in existence at the time the bankruptcy petition is filed.<sup>3</sup> One sort of executory contract, collective bargaining agreements (CBAs), is treated somewhat differently. Although rejection of any executory contract is subject to the approval of the court, for most contracts, the business judgment rule applies and courts generally approve rejections that the debtor deems to be in its business interest. Rejection of CBAs must meet a higher standard.

Section 1113 of the Bankruptcy Code provides the procedures that must be followed to reject a CBA. Recently introduced legislation would modify several sections of the Bankruptcy Code, including § 1113.

H.R. 3652 and its companion bill, S. 2092, were introduced by Representative Conyers and Senator Kennedy and are entitled the “Protecting Employees and Retirees in Business Bankruptcies Act of 2007.” In this report, the two bills will be referred to as either H.R. 3652 or “the bill.” This report’s analysis of the bill will be limited to the modifications it proposes for § 1113 of the Bankruptcy Code. These modifications are found in § 8 of the bill.

In its findings section, the bill asserts that despite recently enacted provisions to limit executive compensation, executive pay enhancements flourish in business bankruptcies at the expense of workers and retirees. According to the bill, workers and retirees are being disproportionately burdened in business bankruptcies. These

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<sup>1</sup> 11 U.S.C. § 1101 *et seq.*

<sup>2</sup> A trustee may be appointed if the court determines there is cause to do so. 11 U.S.C. § 1104(a)(1) (including fraud, dishonesty, incompetence, and gross mismanagement as causes for replacing the debtor’s management with a trustee).

<sup>3</sup> 11 U.S.C. § 365.

workers and retirees have no way to diversify the risk of an employer's bankruptcy and are least able to absorb the losses imposed. H.R. 3652 urges "[c]omprehensive reform ... to remedy these fundamental inequities in the bankruptcy process and to recognize the unique firm-specific investment by employees and retirees in their employers' business through their labor."<sup>4</sup>

## Background

In 1984, the Bankruptcy Code was amended to add 11 U.S.C. § 1113,<sup>5</sup> which outlines the requirements that must be met before a court can approve rejection of a collective bargaining agreement (CBA) by a debtor company using chapter 11 to reorganize. The section applies only to chapter 11 bankruptcies. Although there are no committee reports to explain the reason for adding 11 U.S.C. § 1113, its addition followed the U.S. Supreme Court's holding in *National Labor Relations Board v. Bildisco and Bildisco*.<sup>6</sup> It is generally believed that Congress added the section in response to *Bildisco*.<sup>7</sup>

*Bildisco* was decided in February 1984, resolving a split between the circuits regarding the standard for rejection of a CBA. The Court held that rejection required that the agreement be burdensome to the debtor company and that rejection was favored after balancing the equities of the specific case. The Court also held that the debtor in possession did not automatically assume the CBA post-petition and would not violate § 8(a)(5) of the National Labor Relations Act (NLRA)<sup>8</sup> if it unilaterally changed the terms of a CBA prior to the bankruptcy court's approval of rejection of that agreement.<sup>9</sup>

By adding § 1113, Congress provided both a procedure and a standard for rejection of CBAs and clarified that they could not be rejected under 11 U.S.C. § 365 as are other executory contracts. Furthermore, unilateral changes to the CBA were addressed and generally prohibited.<sup>10</sup>

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<sup>4</sup> H.R. 3652 § 2.

<sup>5</sup> Bankruptcy Amendments and Federal Judgeship Act of 1984, P.L. No. 98-353, 98 Stat. 333, 390-91.

<sup>6</sup> 465 U.S. 513 (1984).

<sup>7</sup> Mitchell Rait, *Rejection of Collective Bargaining Agreements under Section 1113 of the Bankruptcy Code: The Second Circuit Enters the Arena*, 63 AM. BANKR. L.J. 355, 356 (1989).

<sup>8</sup> 29 U.S.C. § 158(a)(5).

<sup>9</sup> *Bildisco*, 465 U.S. at 528-29.

<sup>10</sup> "No provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of this section." 11 U.S.C. § 1113(f).

## Overview of Proposed Changes to 11 U.S.C. § 1113

H.R. 3652 proposes a number of changes to existing subsections of 11 U.S.C. § 1113 as well as adding six new subsections. As written, the bill would entirely replace the text of the first three subsections; however, the actual change to the text of the first subsection is minimal.

At first glance, the bill appears to make dramatic changes in the Bankruptcy Code, but in some cases, the bill's language may be clarifying the Code rather than substantively changing it. In other cases, the language in the bill may be intended to either legislate resolution of some point of law that has been disputed in the courts or legislatively overrule existing case law.<sup>11</sup> However, since there are no committee reports as yet, CRS cannot discern with certainty the sponsors' intent in proposing the changes. The proposed changes will be discussed in order, subsection by subsection, with accompanying discussion about the current state of the law, including ambiguities in the current code, various courts' interpretations, and scholarly writings about 11 U.S.C. § 1113. All headings referencing a subsection of 11 U.S.C. § 1113 refer to the subsections as proposed by this bill.

**11 U.S.C. § 1113(a).** Although the language of H.R. 3652 indicates that subsection (a) is deleted entirely, there is only one difference between the current text and the proposed text — that is the removal of the words “assume or.” As currently written, 11 U.S.C. § 1113(a) states that a debtor “may assume or reject a collective bargaining agreement only in accordance with the provisions of this section.” However, that is the only time that assumption of CBAs is referred to in the entire section.

Courts generally have found that 11 U.S.C. § 365 governs the assumption of CBAs,<sup>12</sup> but removing “assume” from the language of 11 U.S.C. § 1113(a), would seem to make it clear from the statute that nothing in 11 U.S.C. § 1113 applies to assumptions of CBAs. Note, however, although it would remove “assume” from this subsection, the bill would add a later subsection<sup>13</sup> stating that assumptions of CBAs are in accordance with 11 U.S.C. § 365, which addresses executory contracts generally.

**11 U.S.C. § 1113(b).** H.R. 3652 would limit the modifications to the existing CBA that can be proposed by the debtor. The current law provides general guidance about the type of proposal that should be made: a proposal should provide the modifications in benefits and protections that are necessary for reorganization and assure fair treatment to “all creditors, the debtor, and all of the affected parties.”<sup>14</sup>

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<sup>11</sup> See 153 CONG. REC. E1976 (daily ed. Sept. 25, 2007) (statement of Rep. Conyers).

<sup>12</sup> See *United Food & Commercial Workers Union v. Family Snacks, Inc.*, 257 B.R. 884, 899-901 (B.A.P. 8<sup>th</sup> Cir. 2001); *In re The Typocraft Co.*, 229 B.R. 685, 688 (Bankr. E.D. Mich. 1999).

<sup>13</sup> H.R. 3652 § 8 (adding 11 U.S.C. § 1113(l)).

<sup>14</sup> 11 U.S.C. § 1113(b)(1)(A).

In contrast, the bill would limit proposals to those that would (1) limit the effect of the labor group's financial concessions to no more than two years after the effective date of the plan;<sup>15</sup> (2) be the minimum savings the debtor needs to successfully reorganize;<sup>16</sup> and (3) not put too great a burden on the labor group, either in amount or nature of the concession, in comparison to burdens placed on other groups, "including management personnel."<sup>17</sup>

Current law puts no time limit on the duration of the effects a debtor's proposed modifications to a CBA may have on the relevant affected labor group. Although an authorized representative<sup>18</sup> always has the option of rejecting a debtor's proposal, a court will not necessarily find that the debtor's proposal was not fair and equitable to all affected parties even if its effects on the labor group are long-lasting. If the court finds the proposal fair and equitable, it may grant rejection of the CBA.<sup>19</sup>

H.R. 3652 would prohibit court approval of rejection unless the debtor's proposals for modification were in compliance with the proposed limitations.<sup>20</sup> Therefore, limiting the debtor to proposals affecting the labor group for no more than two years would assure labor groups that they would not be confronted with situations in which a CBA's rejection was approved by the court after the labor group had rejected a debtor's proposal for lengthy concessions. If such lengthy concessions were proposed, the court would not be allowed to approve rejection because the

<sup>15</sup> H.R. 3652 § 8 (amending 11 U.S.C. § 1113(b)(1)(A)).

<sup>16</sup> H.R. 3652 § 8 (amending 11 U.S.C. § 1113(b)(1)(B)).

<sup>17</sup> H.R. 3652 § 8 (amending 11 U.S.C. § 1113(b)(1)(C)).

<sup>18</sup> Neither the current nor proposed versions of section 1113 provides a definition for the term "authorized representative." Section 1114, which was adopted three years after section 1113, provides a definition for that section only. It states, "A labor organization shall be ... the authorized representative of those persons receiving any retiree benefits covered by a collective bargaining agreement to which that labor organization is signatory," unless the organization declines or the court finds other representation appropriate. 11 U.S.C. § 1114(c)(1). For section 1113 an authorized representative is the labor union that is signatory to the collective bargaining agreement for which the debtor is proposing modifications. In this memorandum, "representative" will be used interchangeably with "authorized representative" when discussing proposals, counterproposals, etc., that are addressed by section 1113.

<sup>19</sup> *See, e.g.*, *In re Bowen Enterprises Inc.*, 196 B.R. 734 (Bankr. W.D. Pa. 1996) (finding that a debtor's proposal for a wage cut for a period of five years was within the bounds of "necessary" even though there was no "snap-back" provision, particularly since the union had never requested such a provision); *but see* *Wheeling-Pittsburgh Steel Corp. v. United Steel Workers of America*, 791 F.2d 1074, 1090-93 (3d Cir. 1986) (finding that the absence of a "snap-back" provision must be considered by the bankruptcy court in determining whether the proposed modification was necessary and failing to affirm the lower court's approval of rejection of a CBA because the lack of a "snap-back" provision in a debtor's proposal that included wage cuts that would persist for five years flawed the bankruptcy court's finding that the proposal was fair and equitable). A "snap-back" provision is one that would later restore employees' wages or benefits that were reduced as a concession to the financial difficulties of the company.

<sup>20</sup> H.R. 3652 § 8(1) (amending 11 U.S.C. § 1113(c)(1)(A)).

debtor's proposal would not be in compliance with the requirements of (proposed) 11 U.S.C. § 1113(b)(1)(A). However, limiting the duration of modifications to a CBA may limit the debtor's ability to successfully reorganize. Modifications that can, in just two years, provide sufficient economic relief for the company's survival may necessarily require economic concessions from employees that are too burdensome to be acceptable because the effect on paychecks is too great. Conversely, modifications that last no more than two years but also have a smaller effect on paychecks may not provide sufficient economic relief to allow the debtor company to survive, effectively forcing the company into liquidation.

The bill's second requirement for debtors' proposals is that they must "be no more than the minimal savings necessary to permit the debtor to exit bankruptcy such that confirmation of such plan is not likely to be followed by the liquidation of the debtor."<sup>21</sup> It is questionable whether this will do anything to clarify existing law, under which there have been conflicts<sup>22</sup> over the meaning of "necessary" in the current requirement that the debtor make a proposal that "provides for those necessary modifications in the employees benefits and protections that are necessary to permit . . . reorganization."<sup>23</sup> Some courts have held that necessary means the minimum needed to avoid immediate liquidation;<sup>24</sup> other courts have found that "necessary" is a more lenient standard than "essential," and have looked at whether the modifications will ensure the debtor's ability to survive reorganization.<sup>25</sup>

By including the phrase "such that confirmation of the plan is not likely to be followed by the liquidation of the debtor," it seems that the bill is intended to use the more lenient standard. However, the use of "no more than the minimal savings" could cause a court to use a stricter standard. If the bill's language were strictly interpreted to mean that the debtor may propose no more than the absolute minimum savings, the debtor might be in a virtually untenable position. One court, in construing the current law's requirement that modifications be "necessary" to allow reorganization, noted that

in the context of this statute "necessary" must be read as a term of lesser degree than "essential." To find otherwise, would be to render the subsequent requirement of good faith negotiation, which the statute requires must take place after the making of the original proposal and prior to the date of the hearing, meaningless, since the debtor would thereby be subject to a finding that any

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<sup>21</sup> H.R. 3652 § 8(1) (amending 11 U.S.C. § 1113(b)(1)(B)).

<sup>22</sup> See, e.g., Daniel Keating, *The Continuing Puzzle of Collective Bargaining Agreements in Bankruptcy*, 35 WM. & MARY L. REV. 503, 526 (1994) ("Without question the single most controversial question under section 1113 has been how to define what modifications are necessary to permit the debtor's reorganization.") (citing Anne J. McClain, Note, *Bankruptcy Code Section 1113 and the Simple Rejection of Collective Bargaining Agreements: Labor Loses Again*, 80 GEO. L.J. 191, 208-09 (1990)).

<sup>23</sup> 11 U.S.C. § 1113(b)(1)(A).

<sup>24</sup> *Bowen Enterprises*, 196 B.R. at 741-42 (citing *Wheeling-Pittsburgh*, 791 F.2d at 1089).

<sup>25</sup> See, *In re Carey Transportation, Inc.*, 50 B.R. 203, 209 (Bankr. S.D.N.Y. 1985), *aff'd sub nom.* *Truck Drivers Local 807 v. Carey Transportation, Inc.*, 816 F.2d 82, (2d Cir. 1987) (citing *In re Allied Delivery System Co.*, 49 B.R. 700, 702 (Bankr. N.D. Ohio 1985)).



substantial lessening of the demands made in the original proposal proves that the original proposal's modifications were not "necessary."<sup>26</sup>

If the proposed requirement that proposed modifications would produce no more than the minimal savings required were taken literally, debtors would be similarly constrained.

The third limitation on proposals looks only at the burdens that are placed on the groups with whom the debtor is expected to have continuing relationships, rather than looking at whether all are being treated "fairly and equitably" as required by current law.<sup>27</sup> The proposed change would also specify management personnel as one of the groups to be considered in determining whether the labor group is being overly burdened.

Throughout the history of 11 U.S.C. § 1113, courts have considered management personnel when considering whether a debtor's proposal treated all parties fairly and equitably.<sup>28</sup> However, they have looked at the whole picture rather than simply comparing burdens. For example, a proposal to reduce wages for union employees was considered fair and equitable even though some management employees received an increase in pay. The court's rationale was that it was fair to increase the pay of supervisors who had been earning less than those they were supervising.<sup>29</sup> The language for proposed 11 U.S.C. § 1113(b)(1)(C) could be construed to require those cuts in wages and benefits for employees must be matched by similar cuts for management employees.<sup>30</sup> Whether that similarity would be construed to require dollar-for-dollar parity or percentage-based parity is unknown.

**11 U.S.C. 1113(c).** Current law requires three conditions be met before a court can grant a motion to reject a CBA: (1) The debtor must meet the requirements of 11 U.S.C. § 1113(b)(1) by (a) presenting a proposal that both treats all parties equitably and proposes changes necessary for reorganization,<sup>31</sup> and (b) providing the

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<sup>26</sup> In re Allied Delivery System Co., 49 B.R. 700, 702 (Bankr. N.D. Ohio 1985).

<sup>27</sup> 11 U.S.C. § 1113(b)(1)(A).

<sup>28</sup> See, e.g., In re Jefley, Inc., 219 B.R. 88 (Bankr. E.D. Pa. 1998); *Bowen Enterprises*, 196 B.R. 734; In re Pierce Terminal Warehouse, Inc., 133 B.R. 639 (Bankr. N.D. Iowa 1991); In re Indiana Grocery Co., Inc., 136 B.R. 182 (Bankr. S.D. Ind. 1990); In re Big Sky Transp. Co., 104 B.R. 333 (Bankr. D. Mont. 1989); In re Texas Sheet Metals, Inc., 90 B.R. 260 (Bankr. S.D. Tex. 1988).

<sup>29</sup> *Bowen Enterprises*, 196 B.R. at 743 ("it would not be unfair and inequitable for debtor to raise the wages of some of its non-unionized managerial employees whose wages now are lower than the wages of some of the highest-paid employees belonging to the bargaining group").

<sup>30</sup> H.R. 3652 § 8(1) (amending § 1113(b)(1)(C)) ("[Proposals] shall not overly burden the affected labor group ... in the amount of the savings sought from such group ... when compared to ... management personnel.").

<sup>31</sup> 11 U.S.C. § 1113(b)(1)(a).

representative with information needed to evaluate the proposal;<sup>32</sup> (2) The representative must have refused to accept the debtor’s proposal without good cause;<sup>33</sup> and (3) “[T]he balance of equities [must] clearly favor[] rejection.”<sup>34</sup>

H.R. 3652’s proposed subsection (c) would have three main prongs as does the current subsection, but most of its similarity ends there. Current law has three fairly simple subparagraphs, each of which involves some discretionary judgment regarding facts and circumstances. The subparagraphs in proposed subsection (c) are complex and one provides a presumption that would bar rejection of a CBA if not effectively rebutted. Current practices among companies in bankruptcy may have triggered a perceived need for this provision. It appears that other provisions of this subsection may be in part a response to recent court decisions, but may be responding to *Bildisco* as well.

### **11 U.S.C. § 1113(c)(1).**

*Impasse.* One of the changes in the process required for a court to approve rejection of a CBA is a new requirement that the parties have reached an impasse. The *Bildisco* Court specifically stated that approving a debtor’s request for rejection should not require the courts to determine that negotiations had reached an impasse.<sup>35</sup> Although 11 U.S.C. § 1113 was introduced in response to concern over the *Bildisco* decision, neither the word “impasse” nor the concept appears in the current section 1113. In proposed 11 U.S.C. § 1113(c)(1) the word appears twice<sup>36</sup> and it appears a third time as a concept.<sup>37</sup> CRS is uncertain if including “impasse” in H.R. 3652 is an attempt to resolve a long-standing issue or a response to current court decisions involving the airline industry. As noted below, courts have recently enjoined strikes that were threatened in response to rejection of CBAs.<sup>38</sup> The Railroad Labor Act (RLA), unlike the National Labor Relations Act (NLRA), requires parties to “exert every reasonable effort to make ... [an] agreement.”<sup>39</sup> According to recent court decisions, labor groups governed by the RLA continue to be bound by this obligation even after a court has approved rejection of a CBA under 11 U.S.C. § 1113.<sup>40</sup> These

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<sup>32</sup> 11 U.S.C. § 1113(b)(1)(b).

<sup>33</sup> 11 U.S.C. § 1113(c)(2).

<sup>34</sup> 11 U.S.C. § 1113 (c)(3).

<sup>35</sup> *Bildisco*, 465 U.S. at 526-27.

<sup>36</sup> H.R. 3652 § 8(1) (amending 11 U.S.C. § 1113(c)(1)) (“If ...the parties are at an impasse”); *id.* (adding 11 U.S.C. § 1113(c)(1)(A)) (“and the parties were at an impasse”).

<sup>37</sup> H.R. 3652 § 8(1) (adding 11 U.S.C. § 1113(c)(1)(C)) (“further negotiations are not likely to produce a mutually satisfactory agreement”).

<sup>38</sup> *See infra* “11 U.S.C. § 1113(g).”

<sup>39</sup> *Northwest Airlines Corp. v. Association of Flight Attendants (In re Northwest Airlines)*, 483 F.3d 160, 170 (2d Cir. 2007) (quoting 45 U.S.C. § 152(First)).

<sup>40</sup> *Northwest Airlines Corp. v. Association of Flight Attendants (In re Northwest Airlines Corp.)*, 349 B.R. 338 (S.D.N.Y. 2006), *aff’d*, 483 F.3d 160 (2d Cir. 2007); *Comair v. Air* (continued...)

courts interpreted the RLA as requiring labor groups to continue collective bargaining until there is no possibility that the parties can agree. At that point, most would agree that the parties have reached an impasse. If the changes to § 1113(c)(1) are adopted, courts may need to determine if impasse is reached at some earlier point.

CRS is uncertain how courts would construe the requirement that the parties be at “impasse.” Since the proposed bill includes the phrase “further negotiations are not likely to produce a mutually satisfactory agreement,”<sup>41</sup> courts may use a “more likely than not” standard. If, however, the courts construed “impasse” as equivalent to the recent court interpretations of the RLA standard, requiring an impasse as a prerequisite to rejection could effectively eliminate most rejections — possibly through attrition since bargaining may well continue for a considerable period of time before a court would consider the parties at an impasse. If the company were to delay filing for bankruptcy and try to negotiate modifications to the CBA, parties who had not been able to reach a mutually satisfactory agreement might be considered to be at impasse when the bankruptcy case commences. However, whether the bargaining takes place before or after the bankruptcy filing, if it takes place over an extended period of time, a company might be forced to liquidate rather than reorganize. Those opposing this provision are likely to argue this would defeat the purpose of chapter 11<sup>42</sup> and, by not preserving jobs, would not protect workers. Those in favor of this provision are likely to argue that it encourages the parties to negotiate modifications each can accept, allowing the company to then continue with its workforce in place under a revised CBA.

*11 U.S.C. § 1113(c)(1)(A).* In addition to finding that the parties are at an impasse, this subparagraph requires that, before approving a request for rejection, the court find that the debtor has fulfilled the requirements regarding proposing modifications. This is similar to current law, which also requires the debtor to have fulfilled the requirements of current subsection (b)(1), except that the requirements that must be met are different. The proposed change mirrors current law in requiring that the debtor provide appropriate information to the representative and bargain in good faith.

*11 U.S.C. § 1113(c)(1)(B).* Under the bill, before approving rejection, the court must also “consider[] alternative proposals by the authorized representative and determine[] that such proposals do not meet the requirements of subparagraphs (A)

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<sup>40</sup> (...continued)

Line Pilots Association International (In re Delta Airlines Inc.), 359 B.R. 491 (Bankr. S.D.N.Y. 2007); In re Mesaba Aviation Inc., 350 B.R. 112 (Bankr. D. Minn. 2006).

<sup>41</sup> H.R. 3652 § 8(1) (adding 11 U.S.C. § 1113(c)(1)(C)).

<sup>42</sup> Currently there is no explicit statement in the Bankruptcy Code regarding the purpose of chapter 11. However, the committee report describes it as being “to restructure a business’s finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.” H.Rept. 95-595, 95<sup>th</sup> Cong., 1st Sess. 220 (1977). H.R. 3652 proposes an explicit statement of purpose: “A debtor commencing a case under [chapter 11] shall have as its purpose the reorganization of its business and, to the greatest extent possible, maintaining or enhancing the productive use of its assets, so as to preserve jobs. H.R. 3652 § 14(1) (adding 11 U.S.C. § 1100).

and (B) of subsection (b)(1).” There is some ambiguity in this wording. Is the court to evaluate the representative’s proposals as possible alternatives to the current CBA that the court might be able to impose on both the debtor and the labor group in lieu of outright rejection? On the other hand, could it mean that the court is simply to look at the representatives’ proposals to determine whether they all meet the requirements of the subparagraphs? If they do, is the court then powerless to change the status quo of the CBA?

There is nothing in the bill that explicitly gives the court the discretion to evaluate the representative’s counterproposals and substitute one for the existing CBA. However, nothing in the current 11 U.S.C. § 1113(c) gives courts the power to impose the debtor’s last proposal on both the debtor and the labor group after the court has approved rejection, yet courts have exercised that power.<sup>43</sup> Inconsistencies between courts in applying the current law appear to be part of the impetus behind H.R. 3652.<sup>44</sup> Allowing the courts more discretion might increase those inconsistencies and lead to more “forum shopping” in bankruptcy filings.

Courts might construe proposed subsection (c)(1) as simply providing prerequisites that must be met before a CBA can be rejected. In this case, proposed subparagraphs (A) and (B) might act as a constraint on negotiations by the representative. Since liquidation of the company normally would involve loss of jobs, it may be in the labor group’s interest to make concessions if the debtor cannot reorganize without those concessions. However, as noted earlier, at times the burden on employees would be too great if the required economic relief provided to the employer were concentrated in a period of two years. To lessen the immediate impact on employees’ paychecks, a representative might want to spread the effect of the financial concessions over three years rather than two. However, a representative might be reluctant to offer such a proposal if making it would open the door for court-approval of rejection. This might create a built-in conflict between the labor group’s interest in avoiding rejection of the CBA and its interest in preserving jobs by making sufficient concessions to the debtor to assure successful reorganization.

Current law does not require the court to look at the representative’s counterproposals, but only at whether the representative had good cause for rejecting the debtor’s proposals.<sup>45</sup> Under current law, rejection has generally been the “stick” that was applied when representatives could not come to an agreement with debtors and did not have good cause for refusing to agree. The effect was to encourage negotiations, which is what section 1113 was intended to do.<sup>46</sup> It is unclear whether

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<sup>43</sup> *Northwest Airlines*, 483 F.3d at 171, 171 n.5 (citing *In re Northwest Airlines Corp.*, 346 B.R. 307, 331 (Bankr. S.D.N.Y. 2006)).

<sup>44</sup> *See*, 153 CONG. REC. E1976 (daily ed. Sept. 25, 2007) (statement of Rep. Conyers) (“Businesses, as a result [of splits among the circuits due to ambiguities in the law] take advantage of these venue options and file their Chapter 11 cases in employer-friendly districts.”).

<sup>45</sup> 11 U.S.C. § 1113(c)(2).

<sup>46</sup> *In re Garofalo’s Finer Foods, Inc.*, 117 B.R. 363, 370 (Bankr. N.D. Ill. 1990) (citing *In re* (continued...))

the proposed provisions would encourage both parties to negotiate. It is possible that the provisions could create an imbalance in the two parties' motivation to negotiate, but at this point, we do not know which party might be more motivated by the proposed provisions.

**11 U.S.C. § 1113(c)(1)(C).** This simply reiterates the impasse requirement by specifying that the court may only approve rejection if it finds that "further negotiations are not likely to produce a mutually satisfactory agreement."<sup>47</sup> As noted earlier, courts may construe this as requiring less certainty as to the futility of further negotiations than exists under the RLA's requirement for continued bargaining.<sup>48</sup> Under current law, the bankruptcy courts do not evaluate the prospects for an eventual agreement between the parties.

**11 U.S.C. § 1113(c)(1)(D).** This provision requires the court to consider how the labor group would be affected by the debtor's proposal, but it seems to presume that the labor group will strike if the CBA is rejected. It requires the court to consider the effect of such a strike, including the debtor company's ability to "retain an experienced and qualified workforce."<sup>49</sup> Reorganization in bankruptcy is based on the concept that it is better for all concerned if a company can continue in business rather than liquidate.<sup>50</sup> If the result of rejection of a CBA is a strike that would effectively put the company out of business, the court may decide not to allow a rejection. If, however, the debtor company is not in a position to remain in business under the terms of the existing CBA, the company may be forced to liquidate rather than reorganize.<sup>51</sup> This alternative might leave all creditors, including the labor group, in worse shape than they would have been had the company reorganized.

**11 U.S.C. § 1113(c)(2).** This subsection provides parameters for the court's consideration of whether the debtor's proposed modifications meet the requirements of subsection (b). The court must consider the impact on all subsidiaries and affiliates of the debtor company, including foreign subsidiaries and affiliates, but what this means in practice is unclear.

The court is also required to examine the history of financial concessions made by the labor group. If any have been made within twenty-four months prior to the filing of the bankruptcy petition, the court's evaluation of the debtor's proposed

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<sup>46</sup> (...continued)

Century Brass Products, Inc., 795 F. 2d 265, 273 (2d Cir. 1986).

<sup>47</sup> H.R. 3652 § 8(1) (adding 11 U.S.C. § 1113(c)(1)(C)).

<sup>48</sup> See, *supra* n. 36 and accompanying text.

<sup>49</sup> H.R. 3652 § 8(1) (adding 11 U.S.C. § 1113(c)(1)(D)(ii)).

<sup>50</sup> H.Rept. 95-595, 95<sup>th</sup> Cong., 1st Sess. 220 (1977) ("It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.").

<sup>51</sup> Under both current law and the bill, interim modifications could be made to a CBA if necessary for the company to remain in business, but the bill permits labor strikes in response to those modifications, so they may provide little effective relief. See discussion under 11 U.S.C. 1113(e) and 11 U.S.C. 1113(g).

modifications must aggregate the effect of the earlier concession with the effect of the currently proposed modifications. This aggregation is unlikely to affect whether the proposed modifications meet the requirements of proposed 11 U.S.C. 1113(b)(1)(A)-(B), but is likely to affect evaluation of the burden imposed on the labor group as compared to other groups.<sup>52</sup>

**11 U.S.C. § 1113(c)(3).** Under current law, in considering whether to approve rejection, the court has discretion in concluding that the required conditions have been met. While H.R. 3652 does not remove all of the court’s discretion, in one area the bill appears to significantly restrict the court’s discretion. H.R. 3652 would establish a presumption that the debtor has overly burdened the labor group in comparison to the burdens on other groups, including management,<sup>53</sup> if it “has implemented a program of incentive pay, bonuses, or other financial returns for insiders or senior management personnel during the bankruptcy, or . . . within 180 days” before the case began.<sup>54</sup> Unless that presumption can be effectively rebutted, the debtor will have failed to meet the requirements for rejection.<sup>55</sup>

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) restricted “key employee retention plans” (KERPS), which provided retention bonuses and severance pay to management employees who were retained to manage the business through its reorganization.<sup>56</sup> Since BAPCPA became effective, there has been a move toward paying managers incentive payments, which were not restricted.<sup>57</sup> Though some of these incentive pay schemes have been rejected by the courts as actually being retention bonuses that did not meet BAPCPA’s requirements,<sup>58</sup> others have been upheld as incentive bonuses and, therefore, not subject to the restrictions imposed by the post-BAPCPA Bankruptcy Code restrictions.<sup>59</sup> In 2006, both the Senate and the House introduced bills<sup>60</sup> that would have limited the use of incentive bonuses in the same way that BAPCPA had limited retention pay. Though the bills were not passed by the 109<sup>th</sup> Congress, their provisions are included in H.R. 3652. This bill would extend BAPCPA restrictions

<sup>52</sup> Proposed 11 U.S.C. § 1113(b)(1)(C).

<sup>53</sup> See H.R. 3652 § 8 (adding 11 U.S.C. § 1113(b)(1)(C)).

<sup>54</sup> H.R. 3652 § 8(1) (amending 11 U.S.C. § 1113(c)(3)).

<sup>55</sup> Under proposed 11 U.S.C. § 1113(c)(1)(A), the court could not approve rejection if the debtor was deemed to have failed to meet all the requirements of proposed 11 U.S.C. § 1113(b).

<sup>56</sup> 11 U.S.C. § 503(c).

<sup>57</sup> In the (Red)® The Business Bankruptcy Blog, [<http://bankruptcy.cooley.com/articles/business-bankruptcy-issues/>] (Oct. 16, 2007).

<sup>58</sup> *E.g.*, In *Re Dana Corporation*, 351 B.R. 96 (S.D.N.Y. 2006); *id.* at 102 (“this compensation scheme walks, talks, and is a retention bonus”).

<sup>59</sup> *E.g.*, In *re Global Home Products, LLC*, 2007 WL 689747 (Bankr. D. Del. Mar. 6, 2007); In *Re Dana Corporation*, 2006 WL 3479406 (S.D.N.Y. Nov. 30, 2006)(mem.) (finding Dana Corporation’s revised incentive plan sufficiently different than a retention bonus plan) .

<sup>60</sup> S. 2556 and H.R. 5113, 109th Congress (2006).

on retention pay<sup>61</sup> to incentive and performance bonuses as well as “bonus[es] of any kind, or other financial returns designed to replace or enhance incentive, stock, or other compensation in effect” before the bankruptcy petition was filed.<sup>62</sup> These restrictions are bolstered by the bill’s proposed amendment to 11 U.S.C. § 1113(c)(3).

This proposed amendment could make it difficult for the court to approve rejection of a CBA if there were any sort of incentive pay, even if the court had approved the incentive pay after finding that it was necessary to retain a person<sup>63</sup> whose services were essential for the business to continue,<sup>64</sup> and met the other restrictions of 11 U.S.C. § 503(c)(1). Arguably, this could put a court in the position of having little flexibility to make decisions that could result in the debtor company’s successful reorganization — if it allowed incentive pay to retain someone essential to the business, it could be unable to approve rejection of a CBA if the debtor could not rebut the presumption that the labor group was being burdened more than management. If it did not allow incentive payments, the company might lose an employee who was seen as necessary for survival. Either alternative might cause the debtor to liquidate rather than reorganize. However, it could also be argued that this provision would encourage debtors to carefully consider whether incentive pay was necessary and, if necessary, limit it so that an effective argument could be made that the incentive did not create a situation in which the labor group was disproportionately burdened by the modifications in a CBA.

**11 U.S.C. § 1113(d).** Under current law, the court is required to schedule a hearing within fourteen days after the debtor files an application for rejection.<sup>65</sup> All interested parties currently have the right to attend the hearing and be heard and must receive notice at least ten days before the hearing.<sup>66</sup> The court must rule on the application within thirty days unless otherwise agreed to by the debtor and representative.<sup>67</sup> If the court does not rule within the required time, the debtor may unilaterally modify or terminate the CBA pending the court’s ruling.<sup>68</sup>

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<sup>61</sup> 11 U.S.C. § 503(c)(1). Payments are not completely barred, but must meet certain standards and be approved by the court.

<sup>62</sup> H.R. 3652 § 7.

<sup>63</sup> 11 U.S.C. § 503(c)(1)(A) (extended to apply to incentive bonuses under H.R. 3652).

<sup>64</sup> 11 U.S.C. § 503(c)(1)(B) (extended to apply to incentive bonuses under H.R. 3652).

<sup>65</sup> 11 U.S.C. § 1113(d)(1). However, the date for the hearing can be extended by the court for seven days or by mutual agreement of the debtor and representative for longer periods. *Id.*

<sup>66</sup> 11 U.S.C. § 1113(d)(1).

<sup>67</sup> 11 U.S.C. § 1113(d)(2).

<sup>68</sup> 11 U.S.C. § 1113(d)(2).

H.R. 3652 would extend the period required for notice to at least twenty-one days.<sup>69</sup> The bill deletes, rather than modifies, the provision for holding the hearing within fourteen days of the filing date.<sup>70</sup> The deletion may have been unintentional — the intent may have been to set the same time frame for notice as for hearing. On the other hand, the deletion may have been intended to avoid requiring an early hearing on an application for rejection, permitting additional time for continuing negotiation between the debtor and the authorized representative.

The bill would restrict the parties who could appear and be heard, limiting them to only the debtor and the authorized representative.<sup>71</sup> This may have the effect of streamlining the hearing process by eliminating consideration of other parties' concerns. Under both current and proposed law, the creditors would have an opportunity to approve or reject the reorganization plan, which would incorporate the results of the rejection hearing.

Under the bill's proposals, there would be no time frame within which the court would be required to rule and no provision allowing the debtor to unilaterally modify a CBA while a ruling was pending.<sup>72</sup> This appears to encourage continuing negotiations between the debtor and the authorized representative without a statutory deadline.

**11 U.S.C. § 1113(e).** The bill proposes no changes to this section — while parties continue to negotiate changes to a CBA, courts would continue to be allowed to approve interim modifications to a CBA “if essential to the continuation of the debtor’s business, or in order to avoid irreparable damage to the estate.”<sup>73</sup> However, the addition of subsection (g) as proposed in the bill,<sup>74</sup> allowing labor groups to strike or engage in other methods of “self-help” in response to court-ordered modifications under this subsection, may tend to reduce either the extent to which courts are willing to approve interim modifications or the potential benefit to the debtor of an interim modification. If so, it could lead to liquidations rather than reorganizations when interim modifications are essential for the company to remain in business.

**11 U.S.C. § 1113(f).** H.R. 3652 would not change the current language, but would add a provision regarding allowed administrative claims.<sup>75</sup> Under the bill's proposal, all payments required under 11 U.S.C. § 1113 on or before the date of confirmation of the reorganization plan would be considered allowed administrative

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<sup>69</sup> H.R. 3652 § 8(2) (replacing 11 U.S.C. § 1113(d)(1)).

<sup>70</sup> H.R. 3652 § 8(2) (replacing 11 U.S.C. § 1113(d)(1)).

<sup>71</sup> H.R. 3652 § 8(2) (replacing 11 U.S.C. § 1113(d)(1)).

<sup>72</sup> H.R. 3652 § 8(2) (deleting 11 U.S.C. § 1113(d)(2)). Note that current law does not ordinarily allow unilateral modification of a CBA while the court's ruling on the proposed rejection is pending. Unilateral modification is allowed only when the court has not ruled within the time allotted by the statute. 11 U.S.C. § 1113(d).

<sup>73</sup> 11 U.S.C. § 1113(e).

<sup>74</sup> H.R. 3652 § 8(4).

<sup>75</sup> H.R. 3652 § 8(3) (amending 11 U.S.C. § 1113(f)).



claims. That would mean that the plan would be required to provide for full payment of the claims.

**11 U.S.C. § 1113(g).** Currently there is no statute addressing whether court-approved rejection of a CBA gives rise to a claim for damages and courts have been divided on the subject.<sup>76</sup> The bill would add a subsection that would define rejection of a CBA as a breach and would address the effect of rejection of a CBA, in terms of both money damages and “self-help” — the right of affected employees to strike.

**Rejection as Breach.** This is one of the subsections where the use of a particular word may have import that is not immediately obvious. In general, rejection of executory contracts has been treated as a breach.<sup>77</sup> However, recently, in *Northwest Airlines Corporation v. Association of Flight Attendants*,<sup>78</sup> rejection of a CBA was characterized not as a breach but as an abrogation.<sup>79</sup> As the court viewed it, an abrogation has a different legal effect than does a breach. While a breach would have a remedy, an abrogation under 11 U.S.C. § 1113 terminates the provisions of the CBA and allows substitution of court-approved provisions.<sup>80</sup>

It is possible that the word breach is used in this proposed subsection merely to identify the rationale for the prescribed remedy. On the other hand, it is possible that the word was used to legislate an effect of rejection that is different than that determined by the *Northwest Airlines* court. In evaluating which is more likely to be the case, one should consider that the court specifically contrasted the effect of rejection under 11 U.S.C. § 365 with that under 11 U.S.C. § 1113, stating, “Contract rejection under § 1113, unlike contract rejection under § 365, permits more than non-performance.”<sup>81</sup> According to the court, the purpose of 11 U.S.C. § 1113 is “to permit CBA rejection in favor of alternate terms without fear of liability after a final

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<sup>76</sup> The first court to directly consider the issue held that since 11 U.S.C. § 1113 made no provision for damages resulting from rejection of a CBA, Congress intended that there be no claim for damages. *In re Blue Diamond Coal Co.*, 147 B.R. 720, 729-32 (Bankr. E.D. Tenn. 1992). Other courts seem to have taken the position that union employees could make claim for damages if the CBA were rejected. These courts have considered the possibility of potential claims for damages as a factor when considering whether to allow rejection of a CBA. *See In re Maxwell Newspapers, Inc.*, 146 B.R. 920, 934 (Bankr. S.D.N.Y. 1992); *Carey Transportation*, 50 B.R. at 212; *In re Salt Creek Freightways*, 47 B.R. 835, 841 (Bankr. D. Wyo. 1985). At least one other court seems to have implied that there could be unsecured, nonpriority claims for breach after court-approved rejection of a CBA. *See In re World Sales, Inc.*, 183 B.R. 872, 878 (B.A.P. 9<sup>th</sup> Cir. 1995) (holding that since a CBA cannot be retroactively rejected, unilateral breaches that occur before “rejection cannot be relegated to unsecured status”). Recently, however, the second circuit court has implied that rejection of a CBA does not result in liability for damages. *Northwest Airlines*, 483 F.3d at 172.

<sup>77</sup> 11 U.S.C. § 365(g).

<sup>78</sup> 483 F.3d 160 (2d Cir. 2007).

<sup>79</sup> *Northwest Airlines*, 483 F.3d at 169.

<sup>80</sup> *Northwest Airlines*, 483 F.3d at 171.

<sup>81</sup> *Northwest Airlines*, 483 F.3d at 171.

negotiation before, and authorization from, a bankruptcy court.”<sup>82</sup> This seems to imply that the *Northwest Airlines* court’s position is not only that rejection is an abrogation rather than a breach, but also that there are no damages to be recovered from rejection of a CBA under 11 U.S.C. § 1113.

**Money Damages.** Under the bill, court-approved rejection would be a breach of contract with the same effect as rejection of any other executory contract under 11 U.S.C. § 365(g), but would exclude those damages from the limitations of 11 U.S.C. § 502(b)(7). Under 11 U.S.C. § 365(g), rejection of a contract is treated as a breach of contract immediately before the date the bankruptcy petition was filed.<sup>83</sup> Section 502(b)(7) limits damages for termination of an employment contract to one year’s compensation, without acceleration, plus any unpaid compensation. Although H.R. 3652 specifically excludes damages for rejected CBAs from the damage limitation of 11 U.S.C. § 501(b)(7), the explicit exclusion may not be necessary since courts have held that the subsection does not apply to CBAs.<sup>84</sup>

Section 365(g) of the Bankruptcy Code sets the date of the breach as just before the filing of the petition, which would make such claims pre-petition claims. Pre-petition claims are generally unsecured, nonpriority claims. However, this bill proposes to define administrative expenses, which are priority claims, as including all payments required under 11 U.S.C. § 1113 that must be paid on or before the date the reorganization plan is confirmed.<sup>85</sup> Proposed subsection (g) does not actually mandate payment of the breach damages before the confirmation date, so it is unclear whether those damages are intended to be treated as an administrative expense and, therefore, a priority claim rather than as a pre-petition, nonpriority claim. If given the status of an administrative claim, it is difficult to foresee a situation in which a company could benefit from rejection of a CBA since it would appear likely that any financial gain garnered by rejecting the CBA would be lost through the breach damages for rejections. If those damages are treated as are other breach damages for rejection of executory contracts, they would be unsecured, nonpriority, pre-petition claims, and the reorganization plan could provide for partial rather than full payment of them, thereby allowing some economic benefit to the company in bankruptcy.

**“Self-help.”** Self-help by a labor group may consist of a strike or a threat of strike even though a strike could be an economic blow that a distressed company might arguably be unable to recover from. When a CBA is rejected in chapter 11 reorganization under the current provisions of 11 U.S.C. § 1113(c), labor groups’ right to strike seems to depend upon whether the group is covered by the RLA or the

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<sup>82</sup> *Northwest Airlines*, 483 F.3d at 172.

<sup>83</sup> 11 U.S.C. § 365(g)(1). If the contract had been assumed either as part of a reorganization plan or under 11 U.S.C. § 365, the deemed date on which breach occurred would be different. 11 U.S.C. § 365(g)(2).

<sup>84</sup> See *United Steelworkers of America v. Cortland Container Corp.*, 105 B.R. 375, 378-79 (N.D. Ohio 1989); *In re Gee & Missler Services, Inc.* 62 B.R. 841, 844-45 (Bankr. E.D. Mich. 1986); but see 11 U.S.C. § 1114(j), which explicitly exempts claims for retirement benefits from the limitations of 11 U.S.C. § 502(b)(7).

<sup>85</sup> H.R. 3652 § 8(3) (amending 11 U.S.C. § 1113(f)).

NLRA. Groups covered by the NLRA may strike even if the rejected CBA contained a “no strike” clause. Since the CBA no longer exists after rejection, the “no strike” clause has no continuing effect. Airline transportation workers, however, are covered by the RLA, which requires that the parties exert every reasonable effort to negotiate agreements even after a court-approved rejection.<sup>86</sup> Therefore, several recent cases involving the airlines have resulted in injunctions prohibiting the unions from striking.<sup>87</sup>

Modifications to CBAs under current 11 U.S.C. § 1113(d)(2) or (e) do not make the CBA ineffective in its entirety. Therefore, although a “no strike” clause would become ineffective after rejection of a CBA, it would remain in effect under current law when there are interim modifications to a CBA.

H.R. 3652 would change the law so that all labor groups, even those controlled by the RLA would have the right to strike when a CBA was rejected. The right to strike would also exist if interim modifications were approved by a court — apparently without reference to whether the CBA included a “no strike” clause.

Since a strike might be a fatal economic blow to a distressed company and since interim modifications are approved by the court only when they are either “essential to the debtor’s business [or . . . to avoid irreparable harm to the estate,”<sup>88</sup> codifying the right to strike after court-approved interim modifications might jeopardize both the debtor company’s existence and its creditors’ claims. The proposed subsection would, by its language, also preempt all other federal and state laws regarding labor groups’ right to engage in self-help.<sup>89</sup>

**11 U.S.C. § 1113(h).** Under current law, there is no provision for future modifications of a CBA if the debtor’s financial condition improves. In negotiations over CBAs, representatives may ask for “snap-back” provisions that would provide for future modifications, but the absence of such a provision would not necessarily lead to a court’s determination that the representative had good cause for rejecting the debtor’s proposal. H.R. 3652 would add a subsection to assure that, based on changed circumstances, representatives could request modifications after CBAs were either rejected or modified. The bill would require the court to grant the request if the change would result in the new provisions being no more than the minimum savings needed for the debtor to reorganize successfully.<sup>90</sup>

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<sup>86</sup> *Northwest Airlines*, 483 F.3d at 174.

<sup>87</sup> *Northwest Airlines*, 349 B.R. 338, *aff’d*, 483 F.3d 160 (2d Cir. 2007); *Delta Airlines*, 359 B.R. 491 (Bankr. S.D.N.Y. 2007); *Mesaba Aviation*, 350 B.R. 112 (Bankr. D. Minn. 2006).

<sup>88</sup> 11 U.S.C. § 1113(e).

<sup>89</sup> H.R. 3652 § 8(4) proposes adding subsection (g) to 11 U.S.C. § 1113, which would say, in part, “Economic self-help by an authorized representative shall be permitted [upon rejection or interim modification] and no provision of this title or of any other Federal or State law shall be construed to the contrary.” This would mean that courts could not use the RLA as the basis for enjoining strikes by airlines employees.

<sup>90</sup> H.R. 3652 § 8(4) (adding 11 U.S.C. § 1113(h)).

Assurance of the possibility of future favorable modifications might make representatives more inclined to cooperate with debtors' proposals for modifications. However, under current law, while "snap-back" provisions have been available for modifications, they have not been required as part of either a negotiated modification or a court-approved rejection.

**11 U.S.C. § 1113(i).** Currently there is no provision for arbitration rather than a court hearing to rule on a motion for rejection of a CBA. H.R. 3652 would add a subsection to allow arbitration in lieu of a court hearing if requested by the authorized representative, so long as the court finds that arbitration would help the parties reach an agreement that was mutually satisfying. This could reduce the demand for courts' resources; however, only the authorized representative can make the request. The debtor cannot make the request, and the court cannot order arbitration without a request.

Using arbitration to resolve a debtor's request to reject a CBA may open greater possibilities for finding a middle ground between complete rejection of a CBA and assumption of the existing CBA. It may also, however, increase the time required to resolve the issue. Under current law, unless otherwise agreed to by the debtor and representative, the court is required to hold hearings on requests for approval of rejection within no more than twenty-one days<sup>91</sup> and to rule on the application no later than thirty days after the beginning of the hearing.<sup>92</sup> As noted earlier, the proposed changes to § 1113 eliminate both of these deadlines.

The bill does not directly address which party will pay for arbitration. It appears, however, that if all of the bill's provisions were to become law, the debtor would probably pay for the arbitration as an administrative expense since subsection (j) provides for reimbursing the representative for reasonable costs and fees incurred.

**11 U.S.C. § 1113(j).** Although current law includes provisions for allowing priority claims as administrative expenses for various expenses incurred in reorganization,<sup>93</sup> there is no provision for reimbursing the authorized representative for fees and costs incurred in complying with the requirements of 11 U.S.C. § 1113. The bill would add subsection (j) to make these costs reimbursable upon request and notice and hearing. Under the bill's proposed changes, they would be considered administrative expenses.<sup>94</sup> As administrative expenses, they would be priority claims whose payment in full must be provided for in the plan for reorganization. This provision could result in shorter negotiations or more flexible proposals by the debtor, who would need to balance the cost of continued negotiations with the economic benefit that might be gained through those negotiations. However, it could

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<sup>91</sup> 11 U.S.C. § 1113(d)(1).

<sup>92</sup> 11 U.S.C. § 1113(d)(2).

<sup>93</sup> Some of these are wages for post-petition services as well as professional fees. 11 U.S.C. § 503(b).

<sup>94</sup> The bill's proposed addition to 11 U.S.C. § 1113(f) would make all payments required under 11 U.S.C. § 1113 administrative expenses if payment was required before confirmation of the plan.

also lead to more liquidations if administrative expenses increased to the point that they could not be accommodated in a reorganization plan.

**11 U.S.C. § 1113(k).** When a debtor’s reorganization plan involves either selling all or part of the business or ceasing some or all of the business, the bill would require the debtor and authorized representative to meet to determine the effects on the labor group. Any accrued obligations that were not assumed as part of a sale transaction would be treated as administrative expenses.

Under current law, all post-petition obligations that are required by the CBA are considered administrative expenses. Additionally, where a CBA has been assumed, accrued pre-petition obligations under the CBA may also be administrative expenses.

**11 U.S.C. § 1113(l).** Although the bill would remove the word “assume” from 11 U.S.C. § 1113(a), it would add a subsection that would clearly state that assumption of CBAs are treated as are other executory contracts and assumed under 11 U.S.C. § 365.

## Conclusion

In its findings,<sup>95</sup> the bill states that Congress finds that chapter 11 was enacted “to protect jobs and enhance enterprise value for all stakeholders,”<sup>96</sup> but is, instead, being used to “caus[e] the burdens of bankruptcy to fall disproportionately and overwhelmingly on employees and retirees.”<sup>97</sup> Revising the process for rejection of CBAs is one of the ways this bill proposes to rectify the inequities it asserts.

For many companies in bankruptcy, expense for employees is the largest expense in the budget, and some modification of that expense may be essential to their successful reorganization. Section 1113, as it currently exists, has provided labor groups with protection from debtor companies’ unfettered rejections of CBAs, but has also provided a method for debtor companies to reject CBAs when they could not reach a compromise with the authorized representatives of the labor groups. The proposed revisions to section 1113 would constrain both debtor companies and the courts when debtors file under chapter 11.

The bill clearly contemplates allowing labor groups to have a greater, possibly definitive, role in determining the feasibility of reorganization. Labor groups, but not debtors, would be allowed to request arbitration rather than a court hearing to determine approval of a debtor’s request to reject a CBA. In certain circumstances, the bill would allow labor groups to obtain future relief due to changed circumstances without having to bargain with the company. The bill would also extend the right to strike to all labor groups whenever a CBA was modified or rejected without their consent. Finally, the bill provides labor groups with a defined remedy for rejection of a CBA, though courts might differ in their interpretation of that remedy.

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<sup>95</sup> H.R. 3652 § 2.

<sup>96</sup> H.R. 3652 § 2(2).

<sup>97</sup> H.R. 3652 §2(2).

Companies in financial distress may argue that the bill's proposed changes to chapter 11 are insufficiently flexible to allow successful reorganization. If that is their conclusion, they might try to resolve their financial difficulties outside of bankruptcy or choose to liquidate rather than reorganize.